Tax Cuts, the Certainty Factor, and Job Creation *(SB News-Press)*

(December 23, 2010) Now that the Bush tax cuts are officially extended for the next two years, a significant question remains: *Is the U.S. economy really in recovery mode without job growth?* The answer is "no" and here's why.

Robust job growth always defines true, sustainable economic recovery. When firms modernize their infrastructure, update their technology, and install new equipment, they do so as part of a plan to increase sales and profits. When companies put more money into R+D, improved manufacturing output, and new facilities, these capital expenditures all have a clearly identifiable return on investment (ROI). These actions require more employees to get all the additional work done, and the new jobs created become part of the regular business model and daily operations. More products and services are produced and expected to be sold in the target market. The wages and salaries for the additional new employees are paid from those stronger sales. These are tax-producing jobs that then pay into the tax system. More importantly, they're sustainable jobs because they are supported by increased demand from buyers.

However, the *business* decisions to modernize, update, install, and invest always start with what I call "The Certainty Factor." Before committing funds to new projects, every size company throughout the private sector will first assess the external economic landscape and determine what will impact projected sales, costs, and profits. There needs to be a reasonable, identifiable ROI. Why would businesses commit significant outlays to projects that will only result in higher taxes, more legislated costs, and greater regulatory compliance requirements of time and money? If a firm faces huge questions about personal and business income taxes, Obamacare costs and regulatory compliance, and a proposed national VAT, it makes sense to not commit funds until the impacts of these issues are in better focus.

When tax rates are low, stable, and predictable, that improves the level of certainty for companies to make plans for future sales, costs, and profitability. When government spending is under control, deficits are reduced, and regulations are cut back, these also increase certainty. Stronger certainty helps to foster positive expectations about future opportunities in the competitive market. More certainty provides businesses with the expected profit incentives that merit the investment of company funds into expansion and growth plans. The result? Companies hire more workers.

But when taxes are high, federal spending out of control, and regulatory requirements are overly burdensome, these decrease the level of certainty about future sales, costs, and profits. This greater *uncertainty* results in negative expectations about future results, and diminishes profit incentives. As such, businesses either postpone, cut back, or eliminate altogether investments of company funds. The result? Companies postpone, cut back, or eliminate jobs. That's why in this past September there were an estimated $2.1 trillion of private sector funds sitting on the sidelines not being invested in enterprise activities – and NOT creating new jobs!

By now, everyone has seen the ubiquitous (and nauseating) orange ARRA signs, with the stick figure pushing some kind of tool into some kind of pile, and the hopeless audacity to pronounce: "Putting America To Work." This is not job creation. The $800 billion stimulus was funded with high taxes, regulatory fees, and more debt issued by the Treasury. A more accurate tagline for those signs would be: "More People Added To The Taxpayer-Funded Payroll." As the stimulus funds were running out, those government-paid positions were nearing the end of their funding. They are not sustainable jobs, but temporary appointments. They are not tax-producing, but tax-consuming activities. No job was created. No value or wealth was created. No tax revenues were generated. And what did Obama and his advisors first propose as the stimulus funds ran out? A new secondary stimulus package of higher taxes and more borrowing . This clearly exposes their collective lack of even the most fundamental understanding of economics. Government cannot create a job.

So while the Bush tax cuts extension provides some initial improvement in near-term "certainty" for households and businesses, Obama is actually not (nor ever could be) the architect, initiator, or supporter of lower taxes, as he is now three years (as candidate and president) repeatedly on the record advocating tax hikes on "the rich – those individuals making more than $250,000 per year." But higher taxes on the most productive workers, entrepreneurs, business owners, and companies actually disregards and cripples *The Certainty Factor,* resulting in much less private sector funding of the enterprising activities that create lots of new jobs (and more overall tax revenues coming in).

Yet many economists, such as former Clinton advisor and UC-Berkeley professor Robert Reich, want much higher tax rates, arguing that because America's wealthiest top one percent of individuals account for over one-fifth of all income earned, they are not paying their "fair share" to support runaway government spending, while the relatively larger middle class gets stuck with a disproportionate amount of the federal bill. He has actually proposed a 50% top tax rate on that top one percent of Americans, AND an additional half percent annual tax on their wealth (asset values) – which he calls “fair”. Where is the logic in taxing wealth annually that is the result of income and investments that have already been previously taxed?

Obama and his advisors believe that raising taxes will automatically result in more tax revenues coming in. But two recent anecdotes demonstrate clearly this flawed thinking in light of elementary principles of supply, demand, and competitive pricing. First, officials of the Washington, DC Metro raised prices in 2009 believing it would bring in more revenue. But the result of the higher prices was that overall use (demand) of the system went down (as riders adjusted their transportation budgets and choices), and total revenue dropped. And second, Oregon raised its income tax on the richest 2% of its residents last year to fix its budget crisis. However, the state treasury collected almost 33% LESS revenue than forecasted.

The economy will never be in a true recovery until the private sector recognizes a level of regulatory and legislative certainty that encourages risk-taking and new enterprising activities. If such a free-market environment can be supported by less government intrusion, the economy will create millions of new jobs and the recovery will be true and sustainable for the long-term. But continued uncertainty about the future will keep GDP growth weak, and job creation on the sidelines indefinitely.