A Further Perspective

E.J.'s Broken Record

By Ross Kaminsky on 3.18.11 @ 6:09AM

E.J. Dionne's "What, me worry?" opinion of America's federal and state budget problems should frighten anyone who has had the misfortune to prosper through hard work or wise investment. Arguing that those who claim "we're broke" are crying wolf, Dionne uses economic idiocy and moral travesty to aid those whose goal is to keep as much taxpayer money as possible flowing through the grasping hands of government, the long-term consequences be damned.

Imagine a man, the breadwinner for his family, who loses his job. He has enough in savings to cover his mortgage, country club membership, utilities, food, and payments on four cars for three months. Is he broke *today*? No. Is he about to be broke if he doesn't dump the country club membership and two of his cars, and start eating at cheaper restaurants, at least until he gets a new, and hopefully stable, job? Absolutely.

Under Dionne's analysis, however, that man is fine because someone else hasn't lost his job. It's the same thinking a mugger might have.

According to his analysis, Wisconsin isn't broke because "employees and bills are being paid" and the U.S. isn't broke because it can still borrow money at low interest rates. Dionne is whistling past the graveyard of government budgets, bringing out the Keynesian and Progressive zombies there entombed.

The U.S. can borrow at low interest rates because the Federal Reserve is spending the better part of a trillion dollars in "QE II" to "flatten the yield curve" (causing long-term interest rates to drop so the spread between long and short rates narrows, thus forcing investors to take more risk rather than save money or buy bonds.) And that's on top of a couple trillion more the government has forced into the financial system in the past two years. Those actions are exacerbating the consistent weakening trend of the U.S. dollar over the past couple of years, risking inflation and lessening the wealth of all Americans in a way that most, who don't think about currency rates daily -- or even yearly -- don't recognize.

The federal government can get away with these damaging shenanigans because it can print money and cover up its mistakes by taking more of your (or your child's future) paycheck. In that sense, the federal government won't technically go broke -- but it can sure seem like it has when exploding entitlements and interest payments consume 100% of tax revenue -- projected to happen within 30-40 years if we don't reform Medicare, Medicaid, and Social Security. This will leave Big Brother to borrow all the money needed for national defense,

infrastructure, and politicians' undying love of bridges and highways with their names on them.

That borrowing means nothing more than taxes to be imposed on our children and grandchildren once the current scoundrels are safely in retirement after having hooked the nation on the narcotic of "free money" and scurrying away once their supply (of other people's money) dries up.

States are in a different situation. They can't print money and generally must balance their budgets. When Wisconsin expects a $3.6 billion budget deficit over two years, it must be closed by spending cuts, entitlement reforms, and revenue increases. Entitlement reforms are needed most, with one analysis suggesting that half of the state's budget deficit is due to the cost of Medicaid.

But, Dionne and his Progressive fellow travelers see tax hikes and "soaking the rich" as the only policy change needed to solve all our fiscal ills. Dionne approvingly quotes comedian-turned-political-joke Al Franken's description of the income growth of America's top earners as "unbelievable" and concludes that governments are not broke because "some people are definitely not broke." What's yours is mine, after all.

The left's inclination to make our income tax system even more "progressive," which is to say even more punitive of success, ignores several key facts:

First, the tax cuts passed under President George W. Bush gave our nation its most "progressive" tax system in modern American history, with the share of taxes paid by the top 1% going from under 34% in 2001 to over 40% in 2007, before dropping to 38% in 2008. (The economic turmoil of 2008 and 2009 hit the taxable incomes of upper earnings in the reverse of the prior years' growth of their incomes that Franken and Dionne bemoan. I wonder if they feel better now that the rich are less rich.) The top 5%, earning about $160,000 a year or more, pay about 59% of all federal income taxes, up from 53% in 2001. And the bottom 50%'s share of income tax payments has fallen from 4% to 2.7%.

Second, "Hauser's Law" suggests -- though not without skeptics -- that the share of GDP which the government can collect in tax revenue falls within a narrow band centered roughly around 19% for the past three decades. So, similar to the Laffer Curve's concept of a revenue-maximizing tax rate, Hauser's Law posits that raising tax rates won't substantially increase tax revenue.

Third, and related to Hauser's Law, is the fact that, as Alan Reynolds of the Cato Institute notes, "squeezing...a tiny sliver of taxpayers who already pay more than half of all individual taxes...won't work. It never works." Reynolds goes on to explain that "successful people are not docile sheep just waiting to be shorn" and how the non-sheep can and do change their investment and income structures to avoid punitively high tax rates.

Fourth, as President Obama's recent chief economic advisor, Christina Romer, showed in a paper she wrote with her husband, "tax increases have a large, rapid, and highly statistically significant negative effect on output." More specifically, "Our baseline specification suggests that an exogenous tax increase of one percent of GDP lowers real GDP by roughly three percent." To be fair, the Romers argue that tax hikes implemented to lower a deficit have less negative economic consequences. However, history shows that tax hikes implemented to cut deficits inevitably lead to higher spending and higher future deficits. Thus, financial markets and entrepreneurs' "animal spirits" will not react to any tax hike as if it will actually reduce the deficit.

Fifth, every bit of economic history, including our own nation's recent self-destructive spending binge, suggests that the "multiplier" on government spending is less than one. In other words, every dollar that the federal government spends raises GDP by less than $1 because that money was taken from the private sector where it would have been more productive. Many studies by "Chicago" or "Austrian"-school economists suggest the multiplier is a substantially negative number, with the most anti-Keynesian report claiming that $1 of government spending reduces GDP by $3.40.

By thinking that America's budget problems can be solved by taxing the rich, Dionne and Franken make both an economic and a moral error. Economically, they think in a "static" model, meaning they assume that people's behavior does not change when tax rates change.

While no rational person would make such an assumption, it happens to be the way that Congress also analyzes tax proposals, leading to a bias toward tax hikes. A more rational "dynamic" model, while certainly subject to bias from the modelers' political leanings or pressure from politicians for tweaks that benefit their desired results, would nevertheless be more realistic than viewing Americans as sheep. As Richard Rahn points out regarding static modeling and bogus multiplier assumptions, "bad numbers lead to bad policy."

Dionne's moral error is perhaps even greater than his economic naïveté. He sees governments which if not technically "broke" today are rapidly speeding toward that wall, either for actual bankruptcies of states or for federal actions to pay bills that devalue the dollar so dramatically that America's condition will be with compared Greece's without hyperbole. The dollar demolition risks rapid inflation and devastating effects on Americans' net worth. But instead of putting the brakes on the speeding car about to hit the wall, Dionne suggests taking the cars of the "rich" and smashing them first as if that actually accomplishes anything but to salve his disdain for those who have achieved the American Dream.

The fact that some Americans aren't broke does not mean that our governments are solvent. While "we" are not all broke, that says nothing about the financial state of governments. As George Mason University economist Don Boudreaux rightly argues, "Just because (government) is a creature of popular sovereignty

and has the muscle to confiscate assets doesn't mean that every cent of every citizen's property belongs to a collective pool of assets owned by 'us.'"

In other words, Dionne and his ilk's argument to tax "the rich" implies nothing less than socialism: from each according to his ability, to each according to his need, laziness, pre-existing condition, or excitement that she won't have to pay her own mortgage once Barack Obama takes office.

For liberals, the top 5% of earners and perhaps the top 25% of earners (the threshold for which is a hardly-rich $67,000 adjusted gross income) are little more than serfs, people who should be thankful that they're allowed to work in a nation properly owned by everyone but them. The "rich" should apparently pay more and shut up, allowing Dionne's beloved governments, engorged like leeches on the financial blood of its citizens, to keep on drinking.

Letter to the Editor

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