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Uncle Sam won't stop overspending

Government should be provider of last resort, not first

By: Richard Rahn - January 7, 2013

Tax revenue in 2013 will be lower (despite the just passed tax increase), and government spending will be higher than forecast. It's an easy prediction — and this is why.

The capital gains tax rate and the tax on dividends is being raised to 23.5 percent from 15 percent for higher-income people. There are many studies, including those made by the U.S. Treasury, showing that the revenue-maximizing rate on capital gains is less than 15 percent. Taking a capital gain is often a discretionary event, and it is well documented that capital gains realizations fall as the rate is increased. Thus, this rate increase will be a net revenue loser for the government.

There are also many studies, including one from Christina Romer, President Obama's first economic adviser, indicating that tax rates above 33 percent and even as low as 20 percent do not produce any net, new revenue for government over the long run. The new tax bill raises the maximum federal rate to 39.6 percent and limits many deductions. Most states have a state income tax that adds several more points to the federal tax. Taxpayers in California and New York will be facing marginal tax rates of well more than 50 percent. People confronted with such rates are going to find legal or illegal means of reducing their tax liability. The empirical evidence is that in the United States and other countries, the way to get the "rich" people to pay more is to keep rates low enough for them to voluntarily work, save and invest rather than put their smarts and energy into avoiding confiscatory taxes. You can bet that increasingly, rich Californians and New Yorkers are going to move their legal residences to low-tax states such as Texas, and some even to foreign countries.

Expenditures will also be far higher than forecast. The simple fact is the Obama administration and Congress, particularly the Democrats, are unable to resist the urge to spend more. Look what happened to the financial aid bill for victims of Superstorm Sandy. The bill was packed with expenditures that had nothing to do with the storm, and the amount needed for reconstruction (above what is being handled by insurance) has not been carefully calculated. As a result, huge lump sums ($60 billion in total) were passed by the Senate with little idea of how the money will be spent and who will benefit.

We can say with almost certainty that there will be unforeseen emergencies in 2013 — hurricanes, earthquakes, tornadoes, floods, droughts and wars — for which Congress will feel the need to appropriate taxpayer money. Most often there have been major scandals involved with these types of appropriations — whether for Hurricane Katrina in New Orleans or billions in aid to "rebuild" Afghanistan.

Given that the financial cookie jar is not only empty but contains more than $16 trillion in IOUs, should we not be asking some fundamental questions about how government is spending our money? Many people, including me, like to live near the water, but if you live by the sea, there is always the danger of storms. If you live by a river or lake, there is always the danger of floods.

Millions of Americans live along the Atlantic and Gulf of Mexico coasts. If you do, you should know with almost a 100 percent certainty that you will get hit by a hurricane at some point. In some places, it may be more than once every 15 years and in other places as rare as every 90 years — but all will get hit. Every time a major hurricane hits, the people receive "federal disaster aid."

Think about this. Why should a couple living in the hills of northern Georgia, away from any body of water that can cause them flood damage, have to pay increased taxes to compensate for the damage to homes for those who choose to live by the sea? The probability of flood and wind damage is well known for almost every square mile of the United States. Private insurers charge different rates for the risks of various forms of natural disasters, depending on where you live.

The reason we have government flood insurance and disaster aid is because the people who choose to live in high-risk areas do not like to pay the insurance rates required to fully protect their property. They find it easier to lobby Congress to provide them with low-cost insurance and aid, rather than pay full freight for their choice.

Government emergency aid for medicine, food and water in a disaster is an appropriate function of government. Government subsidies for rebuilding structures for people who choose to live in riskier places, however, is not appropriate and penalizes the more prudent, such as the couple choosing to live in northern Georgia.

The point is that the U.S. government is heading rapidly toward insolvency because members of Congress are spending money on things that individuals should insure themselves for — whether it is normal health care or vagaries of nature. A government that is expected to do all things for all people will eventually not be able to afford to do anything for anyone.