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RAHN: The rise of the job and savings killers

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Responsible people are fearful. Those who save for the future increasingly understand that they are the targets of the predatory class. They see the United States and most other governments running record deficits, and most implicitly understand that this will not come to a good end. Greece and California are already serving as the canaries in the coal mine.

The Federal Reserve is holding short-term interest rates below the rate of inflation, so those who have interest-bearing savings accounts or certificates of deposit are seeing their savings erode, while at the same time, the Obama administration and Congress are increasing tax rates on interest, dividends and capital gains. Governments are expropriating (stealing) people's savings.

The U.S. and most other governments of the world are issuing debt at such a rapid rate and at such high levels, with no real plans to reverse such behavior, that it is almost a certainty they will not pay back what they owe. How will they avoid paying back the money? Well, there is always the old, tried-and-true way of inflation, whereby the central bank (the Federal Reserve in the United States) prints so much money as to erode the value of the money - so the government ends up paying (in real value) only cents on each dollar it borrowed. (I actually own a bank note for "one hundred trillion dollars" issued by the central bank of Zimbabwe in 2008. The note is next to worthless except as a collector's item. The issuance of so much currency is how the government of Zimbabwe managed to expropriate all of the savings of its citizens.)

Politicians in developed countries have found that their citizens often get upset when inflation reaches high levels and then tend to vote out the culprits. You may recall that the less-than-astute Jimmy Carter lost his re-election campaign, in part, because inflation at one point reached 14 percent and the prime interest rate hit 21 percent.

An insightful European banker suggested to me over breakfast a couple of weeks ago that the European political class would use selective expropriation, rather than inflation, to avoid paying back all of the debt. The way this would be done would be that the political leaders would announce they would only pay back those bonds with full interest that were held by labor unions and other "politically correct" interest groups but not the bonds held by "greedy bankers" and rich people. Maturities would be extended and promised interest rates lowered - effectively reducing the value of the bonds.

My initial reaction was that, yes, such a selective expropriation might work in Europe, but not in the United States. As I thought more about it, however, looked at what was happening and heard President Obama's rhetoric attacking "greedy" bankers and insurance companies, I began to think that not only was my European friend right about Europe, but his scenario was equally valid here.

Look at the evidence. Savings by individuals and businesses and their productive investment (what economists call capital formation) are necessary for an economy to grow because that is where the money comes from to build new factories, buy equipment, engage in research and development, and fund new jobs. Rapidly growing economies require high levels of investment. Stagnant and declining economies do not.

When governments run high deficits, they take away the capital that could be used to create economic growth and new jobs. In the United States, government has not taken more than 15 percent of gross savings in any of the recessions in the past 30 years - up to this one (and actually has contributed to gross savings in some years when the surpluses of state and local governments are included). However, now the government is taking almost 40 percent of the gross savings (see chart), and at the same time, the personal savings rate has been falling again for the past year.

The Obama administration's budget (as re-estimated by the Congressional Budget Office) shows budget deficits in the trillion-dollar range for each of the next 10 years, meaning that the government debt as a share of gross domestic product will continue to rise, leaving less saving for the productive private economy and job creation. The savings rate is likely to continue to fall because:

c The maximum federal tax on interest, annuities, royalties, etc. is slated to rise a whopping 24 percent.

c The maximum federal tax rate on dividends is slated to rise an obscene 189 percent (from 15 percent to 43.4 percent).

c The maximum tax rate on capital gains will rise by a destructive 59 percent. (These coming tax increases already are in law, courtesy of the just-passed health care bill, and the expiration of the George W. Bush tax-rate cuts at the end of this year).

These tax-rate increases understate the real tax increase under way because many state governments also are increasing tax rates on interest, dividends and capital gains. In addition, as inflation rises, the real tax on capital, and particularly capital gains, rises very rapidly because the Internal Revenue Service unconstitutionally taxes people on imaginary income (that is, inflation) in addition to real gains - causing an effective real tax rate, which often can exceed 100 percent. Most of the people targeted to pay these increased tax rates are not only upper income, but also astute. Common sense and the empirical and theoretical evidence show that people will not pay such tax rates. They can avoid the tax by consuming, rather than saving, by buying nonproductive assets - e.g. gold, rare automobiles, etc., or by moving to more tax-friendly environments.

The political class, particularly in Washington and Europe, is engaged in the most massive act of wealth destruction since World War II. As in World War II, there will be hundreds of millions of innocent victims who will suffer real misery. After the collapse, will there be an international tribunal to try those who destroyed the jobs, savings and hopes of millions of their fellow citizens? We can only hope.

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