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Bad economics, bad politics

By Richard W. Rahn
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If you were an elected official and knew increasing tax rates would diminish job opportunities and that most people prefer lower rather than higher taxes, would you advocate lowering or raising taxes? That might seem a no-brainer, but many Democrats in Congress favor raising tax rates. So would most of their presidential candidates, who say they would repeal the Bush tax cuts.

Their argument is that the government needs more money, and the deficit is too high. Are these statements true? According to the Congressional Budget Office (now controlled by the Democrats), the deficit will continue to fall as a percentage of gross domestic product (GDP), even if the president's tax cuts remain in place. The deficit is below the average level for the last half-century, and the total national debt held by the public as a percentage of GDP will continue to fall (the debt is about 37 percent of GDP, down from about 48 percent 20 years ago).

It is claimed that future Social Security and Medicare expenditures will eat the entire federal budget if there are no changes made to these programs, but these are long-term problems needing a long-term solution. Increasing taxes in the short run will not fix a long-run structural problem.

The claim that the government needs more money is only true if one believes the present enormous level of waste and mismanagement is acceptable.

Fortunately, the government documents its own incompetence. Two highly regarded former U.S. Treasury officials, Ernest Christian and Gary Robbins, have reviewed Office of Management and Budget (OMB) studies and report "more than 200 expenditure programs have failing grades of D or F."

In addition, according to their calculations, an OMB study "reveals that on average more than half of all federal expenditure programs are falling about 50 percent short of their stated goals. This means that out of every dollar spent, 50 cents may possibly be accomplishing something worthwhile, but the remaining 50 cents might as well been poured down a rat hole. In these cases alone, the cost of government incompetence is over $250 billion per year." (Not including the military or entitlement programs, such as Social Security and Medicare.)

The simple fact is government does not need more money; it just needs to spend the money it now has with greater (not perfect) competence. Also, the forecasts by government agencies about future revenues and expenditures, let alone the deficit, should be taken with a great deal of caution. Given the margin of error in the projections, they should not be used as a basis for increasing taxes.

The attached table shows huge swings in the deficit projections made by CBO (the OMB projections were similar) in 1997, 2001, 2004, for the 2007 deficit, now estimated to be about 177 billion. The deficit estimates for 2011 went through a trillion-dollar swing in just a three-year period.

ESTIMATES OF THE U.S. FEDERAL GOVERNMENT DEFICIT BY CBO (in billions of dollars)		
Year of Estimate	**For Year 2007**	**For Year 2011**
1997	-278	NA
2001	+573	+889
2004	-267	-162
2007	-177	-35

In 1997, Congress passed and President Clinton signed a capital-gains tax cut. The experts failed to anticipate the increase in revenues in part coming from that tax reduction. In 2003, Congress passed the Bush tax rate reductions, and the experts again failed to anticipate the surge in revenues, though expenditures were higher than they had projected.

It is worth noting that the deficit this year will be less than projected a decade ago even though there was an unexpected major tax rate reduction and a huge increase in military and homeland security expenditures.

Sen. Carl Levin, Michigan Democrat, is a good example of what is wrong with the Democrats. He is smart (Harvard Law) and articulate, but wants government to meddle in almost everything and has an uncanny ability to come up with "solutions" that only make things worse.

For example, his home state of Michigan had been at the bottom in comparative economic performance among the states in recent years primarily because they adopted the Levin/liberal/labor agenda of too much taxation, spending and regulation. Mr. Levin ranks near the bottom of the rankings from almost all of the taxpayer and free-market economic organizations, showing he has little appreciation of the dead weight loss caused by the American tax system.

He sees companies moving to other countries. But rather than propose a reduced U.S. corporate taxes (the world's highest) so American firms can better compete in the global marketplace, he wants to increase taxes and regulations on them. He is one of the fathers of the Sarbanes-Oxley bill — a disaster for U.S. publicly owned companies that has seriously eroded U.S. competitiveness.

He now wants price controls on certain of the fees charged by credit card companies, ignoring the fact that price controls always result in shortages and poorer service. Such issues are best left to the competitive market place where merchants and card companies can struggle to see who can offer the best combination of price and service.

Through their own mistakes and incompetence, the Republicans have handed the Democrats a golden opportunity, but Democrats like Mr. Levin et al., seem unable to pry themselves away from economic meddling and pushing for tax increases even when there is no case for them. This is no way to win elections.

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