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Are They Worth It?

By Richard W. Rahn
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Members of Congress each will receive a $4,700 pay raise this month, which will give them a salary of $174,000 per year. Do you think they are worth it?

Most of us would like to be in the position of voting for our own pay raises from an employer who has almost unlimited access to money, so when many others are taking pay cuts or losing jobs we would not have to worry. Given that members of Congress were in a large part responsible for the current economic mess, it is hard to see how they can justify a raise, which they claim is merely a cost-of-living increase.

Part of the problem is that they give themselves pay raises based on the rate of inflation. If these increases depended on the rate of change (increase or decrease) in real per capita disposable income (i.e., after taxes) of the average citizen, Members of Congress would have an incentive to maximize economic growth rather than encourage inflation.

In the next few weeks, members of Congress will have an opportunity to pass a "stimulus package" that enhances economic growth or one that makes things worse. There are some policy wonks and politicians who advocate a large increase in government spending and employment, and massive public works projects much like Presidents Herbert Hoover and Franklin Roosevelt pushed through in the 1930s. As can be seen by the numbers in the accompanying table, the results were disastrous.

GOVERNMENT SPENDING AND ECONOMIC PERFORMANCE

Year	Federal Government Spending as a Percent of GDP	Federal Government Civilian Employees as a Percent of Total Employment	Unemployment Rate	Disposable Personal Income per Capita in Constant (2000) Dollars
1929	2.6	1.3	3.2	5,846
1939	10.4	2.1	17.2	5,914
1959	19.2	3.8	5.4	8,066
1979	20.7	2.9	5.8	16,931
1999	18.6	2.1	4.0	24,564
2006	20.4	1.9	4.6	28,066

Federal government spending in real terms increased fourfold and the number of federal government employees nearly doubled in the decade from 1929-39. In addition, the top income tax rate increased more than threefold from 24 percent to 79 percent. The result was the only decade of no real per capita income growth in U.S. history, and a more than fivefold increase in the unemployment rate (which at one point hit 20 percent).

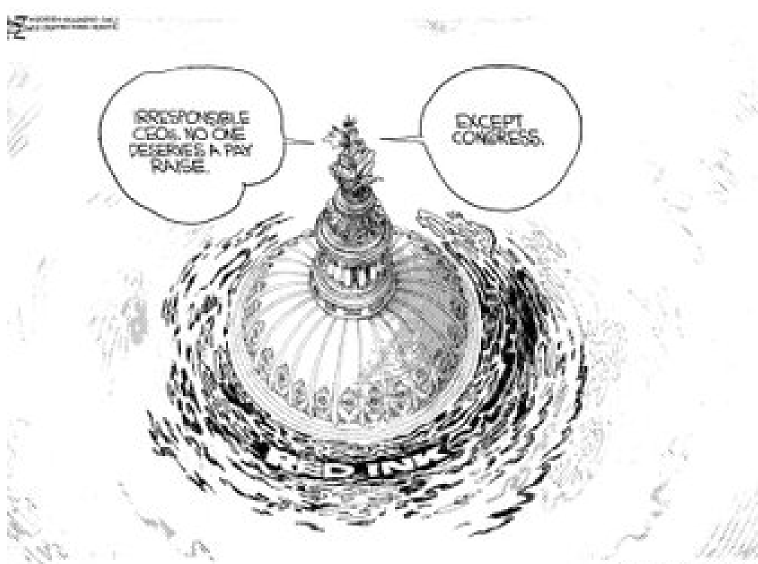
During the Eisenhower administration of the 1950s, the brakes were put on the growth in federal spending (as a percentage of gross domestic product). As a result, federal spending has not been higher than 23.5 percent or lower than 18.5 percent of GDP for the last half-century. And the number of federal government civilian employees has remained almost static, at a little less than 3 million during this same 50-year span. This has been primarily because the federal government has increasingly contracted out its work over the years - which, for the most part, made good economic sense. (Note: local government employment has quadrupled and state government employment has doubled over the last half-century.)

Once the growth in the federal government relative to size of the economy slowed, the growth in real per capita incomes greatly increased. (Relative spending stopped growing but costly regulatory growth has continued to rise at a rapid pace.)

There was a rapid growth in real disposable (after tax) incomes after the Kennedy income tax rate cuts in the early 1960s, after the Reagan tax rate cuts in the early 1980s, after the Clinton capital gains tax rate cut in 1996, and finally after the Bush tax rate cuts in 2003.

Given the last century of empirical evidence, the lessons should be clear. Cutting marginal tax rates on work, saving and investment and cutting excessive regulatory costs on the private sector would be productive "economic stimuli." Big increases in government spending and increasing tax rates on productive economic activity will prolong and deepen the economic downturn.

The direction in which the new Obama administration and the Congress head will tell the taxpayer whether they are worth their pay.



Finally, Chief Justice Roberts has again complained about the lack of adequate pay increases for federal judges. In this, the chief justice is on solid ground because the U.S. Constitution clearly states that the compensation of judges is not to be reduced during their term of service. If the pay increases the judges receive do not keep up with inflation, which they have not, then they are suffering a real pay cut, in violation of the Constitution. The judges would be worth a pay increase for themselves, not only by standing up for their own rights, but by also requiring the Internal Revenue Service to index the basis of capital gains for inflation. As it is now, taxpayers are required to pay a tax not only on real gains but also on gains due to inflation (which is caused by the government). This "inflation tax" is an unconstitutional wealth tax.

If the judges required the IRS to obey the Constitution, it would have the side benefit a giving a real boost to the economy - now needed more than ever.

Richard W. Rahn is a senior fellow at the Cato Institute and chairman of the Institute for Global Economic Growth.

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