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Congress in Fantasyland

By Richard W. Rahn

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In the real world, we need to check the math

If Congress suddenly required every car and truck in America (all 250 million of them) to be immediately destroyed and replaced with new cars and trucks that got better gas mileage, would the country be worse off or better off? Those members of Congress who voted for the "cash for clunkers" program would probably say "better off," even though a perfectly good auto and truck stock would be destroyed.

The congressional clunker caucus would say millions of workers would be employed to replace all of the existing cars and trucks. Yes, that would be true, but everyone else would be poorer. Those who had to buy a new car would have less money to spend on everything else, which would mean fewer jobs in the rest of the economy -- more autoworkers but fewer farmers, teachers and medical researchers -- not a good trade-off.

Congress would likely respond by proposing a tax credit for the purchase of the new car. The tax credit could only be paid for by higher taxes now or in the future, which means people would be worse off because of the dead weight loss of collecting taxes in addition to the amount actually collected.

Members of Congress would then say that we are saving gasoline by having a more efficient auto fleet -- which ignores the fact that building a new car takes far more resources, including petroleum, than could possibly be saved by the gain of additional miles per gallon.

Congressional "logic" could also be applied to housing.

Why not knock down all houses built in America before 2000 and replace them with new and more energy-efficient houses? Wait -- we already evidenced the results of that experiment -- it happened in New Orleans. Rather than the government directly knocking down the houses, Hurricane Katrina did it for us. Are the people of New Orleans better off or worse off because of Katrina? Are all of the American taxpayers who footed much of the rebuilding cost -- hundreds of billions of dollars -- better off or worse off because of Katrina?

Many in Congress argue that the reason New Orleans is still a mess is because of federal, state and local government mismanagement and corruption. Yes, but now don't they want the government to run the health care system? And these folks are telling us that their new medical system will cover more people, will cost less, give us better care and not add to the budget deficit -- hmmm. Fantasyland!

Members of Congress and the Obama administration keep telling us that the "new health care system," the "cap-and-trade" energy program, "clunkers for cash" and the "stimulus" program can all be paid for by taxing the rich, i.e., the top 1 percent of income earners. Let's check the math.

The Congressional Budget Office projects a total additional deficit of approximately \$4.9 trillion dollars during President Obama's first term (2009-2012). Currently, the top 1 percent of taxpayers pay 40 percent of the

tax, or \$450 billion a year, or approximately \$1.8 trillion dollars during the next four years, leaving a \$3.1 trillion hole. Increasing the tax rate on those high earners to 100 percent might yield an additional \$1.5 trillion the first year, but this will only work for the first year. Most people, after being taxed 100 percent on their income, will quit work and/or put their investments in nontaxable entities, such as tax-free local government bonds.

It is also not mathematically possible to take care of all the new spending by increasing taxes on the top 5 percent of taxpayers (those making \$160,000 or more annually) who already pay 61 percent of the federal tax (or \$676 billion per year). Most of these people are now paying close to the revenue maximizing rate, which means that any increase in their tax rate is unlikely over the long run to bring in much more tax revenue.

Quite simply, upper-income people have options. History shows that when tax rates are raised, many will choose to work less (leisure is nontaxable), retire earlier than they had planned and save and invest less in taxable, productive activities. Those making more than \$160,000 per year would need to have their taxes roughly tripled to take care of just this year's deficit. (One merely has to look at the tax evasion practiced by the chairman of the congressional tax writing committee, the secretary of the Treasury and the former majority leader, et al. at today's tax rates to know that they and their colleagues, as well as most everyone else, will find either legal or illegal ways to avoid paying the tax.)

Those who do not live in Fantasyland understand that the only options are:

- To greatly increase taxes on middle- and lower-income groups (a political nonstarter).
- To "fund" all of the new spending by selling bonds to the private market at much higher interest rates (thus sucking out private capital and increasing the cost of homeownership, which will lead to slower growth and higher unemployment).
- To have the central bank (the Fed) buy the new debt (leading to higher rates of inflation, making everyone poorer).
- Or for the government to act responsibly and reduce spending.

There are real costs to living in Fantasyland.

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

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