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# Obama's Hidden-Tax Heist

***by Richard W. Rahn***

## FED POLICY ERODES PRODUCTIVITY GAINS

How is it possible that the government can spend almost twice as much as it takes in without having high inflation? The fact is that over a long period of time, it can't. In the short run, which can be a few years, the government can paper over its fiscal irresponsibility by expropriating most of the productivity gains in the private sector through regulatory and central bank actions. This is precisely what has been happening in the United States.

The reason real, after-tax, per capita incomes have been able to increase year by year for most Americans for the past two centuries is that productivity has been growing -- that is, the amount of goods each worker produces per hour has risen steadily. The reason productivity rises is that workers tend to be better trained, the amount of productive capital per worker rises, and there is a steady flow of innovation, which reduces costs and improves goods and services.

To understand productivity growth, look at the advances of farm and construction machinery -- which enable one worker to do more, better and with greater safety. Wal-Mart, Amazon and FedEx have made amazing developments in reducing distribution costs by instituting better equipment and systems. Magnify these individual company and industry gains throughout the economy, and the result is a steady national gain in worker productivity.

Over the past few decades, worker productivity growth has averaged more than 2 percent. Most of this gain eventually ends up in worker paychecks, with some being siphoned off to support people who are not working and pay for various government schemes. Even so, for the quarter-century preceding 2007, after-tax, real (inflation-adjusted) per capita, disposable income grew at about 2 percent per year.

Since 2007, worker productivity growth has slowed, in part because of the lack of new investment. The big change has been that real, per capita, disposable income has slowed sharply since the end of the recession, being less than 1 percent per year, which has yet to make up for the 3.64 percent loss in 2009. By contrast, in the three years after the end of the Reagan recession in 1982, real, per capita, disposable income grew by almost 4 percent per year.

The recent gains in productivity growth have been taxed away by government. The increases in taxes are all non-legislated taxes, largely invisible to most people. First, there is the inflation tax imposed by the Federal Reserve, which currently taxes away about 2 percent of the purchasing power of the individual's money each year. There is nothing new in this tax; the Fed has been in the business of creating inflation since it was formed in 1914.

What is new is the big tax on savings, again imposed by the Fed. By artificially holding down interest rates to lower-than-expected real market rates, the Fed is, in effect, expropriating interest income (an implicit tax) that savers normally would be expected to enjoy. This interest manipulation enables the government to fund its debt at less than what would be real market rates at the expense of savers, making the deficit appear much smaller than it really is.

There also has been huge growth in the unseen "regulatory tax" over the past four years. A regulatory tax is the cost of regulation imposed on the productive sectors of the economy when the costs of the regulation exceed the benefits. The Obama administration continues to ignore legislative mandates, both on comment periods and cost-benefit analysis, for the tidal wave of new regulation that is hitting businesses -- and individuals.

The Fed also imposed the hidden tax of capital allocation as a result of its artificial low-interest-rate policies. Simply put, large institutions with strong balance sheets or companies that have been designated "too big to fail" (a few major financial institutions) can obtain all the loans they want at virtually zero interest. Smaller companies, particularly new ventures, are being restricted in their ability to get funds because of all the new regulations supposedly designed to reduce risk. Those regulations have the same effect as imposing a high tax on smaller firms and startups -- which also happen to be the big job creators and innovators. In effect, we have created a system in which small, innovative firms are being "taxed" to subsidize large or government-favored enterprises.

Despite the fact that the government (including the Fed) has managed to heist almost all of the private sector's productivity gains through hidden taxation, the amount of continued deficit spending is too great to avoid a future great inflation. The Obama administration has made it clear that it is not serious about reining in spending. Its tax-increase proposals would not fund the government for more than a few days at most and would do real damage to the economy. The Republicans, rather than being unified and insisting on ending this scam, which they could do by refusing to vote for all of the spending, seem to be content to slightly slow the rate of the nation's fall.

The bleak outlook is that most Americans can expect a continued decline in their real, after-tax incomes. History shows that at some time, the monetary bubble will burst. The longer the Fed continues to mask what it is really doing, the bigger the bust will be -- only the exact day of reckoning is uncertain.

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