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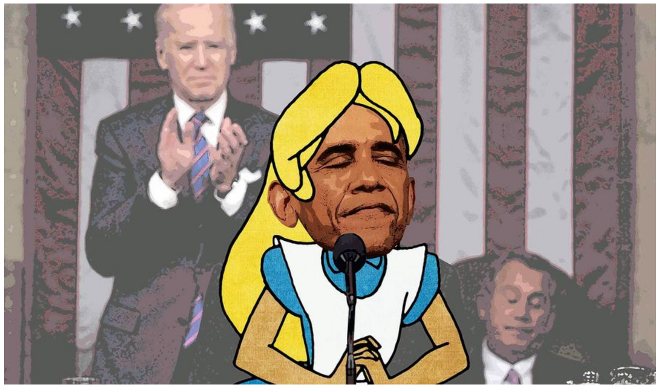

The President's Fictional Record

BY RICHARD W. RAHN

MANY OF OBAMA'S POLICIES ARE UNREALISTIC

If you were a librarian, would you put President Obama's recently delivered State of the Union address in the fiction or nonfiction section? All presidents puff their accomplishments and gloss over their failures, but no previous president has been so blatant in just making up "facts" and numbers that are so disconnected from reality.

The Islamic State (which is also called ISIS or ISIL) is gaining territory, yet the president said we are "stopping ISIL's advance." He said, "We're upholding the principle that bigger nations can't bully the small — by opposing Russian aggression." In the year since his last State of Union address, Russia has grabbed Crimea, taken control of part of Eastern Ukraine, and continues to take more territory in Ukraine. If this is success, what would failure look like?

The president's description of the economy was also a trip through Fantasy Land. Real family incomes are still far below where they were when he took office, and labor force participation rates have not been this low in more than three decades — but never mind. His failure to understand failure leads him to propose policies that will only make things worse.

He proposes certain tax credits for the middle class that he intends to "pay for" with an increase in the capital gains tax rate. Over the past 40 years, the capital gains tax rate has been lowered and raised many times, and there is extensive empirical evidence about both short-run and long-run revenue-maximizing rates. The president seems to forget that the capital gains tax is largely a discretionary tax because people can decide when to sell an asset to realize a capital gain, and higher rates greatly affect people's willingness to realize capital gains. Also, the Internal Revenue Service insists on taxing the inflationary component of a capital gain — that is, the rise in the value of an asset due solely to a change in the price level, which is not simply income. In effect, the IRS, on its own, has imposed a wealth tax without constitutional authority.

The president's proposed rate increase is most unlikely to provide any short-run revenue gain and will be a big revenue loser over the long run. The nonpartisan and highly competent Tax Foundation has calculated that the president's proposed increase in the capital gains tax rate will reduce the nation's capital stock (plants and equipment) by 2.29 percent, thus reducing wage rates by 0.69 percent, and equivalent full-time jobs by 135,000. It will reduce gross domestic product by $141.8 billion, or 0.8 percent, which will lead to a loss in tax revenue, not a gain. Studies by the U.S. Treasury concluded that the revenue-maximizing rate for the capital gains tax was less than 15 percent. For the president to claim that his proposed capital gains tax rate increase from 23.8 to 28 percent will be a revenue gainer rather than a revenue loser has no basis in reality — it is fiction.

Mr. Obama proposed to limit the amount individuals could have in their individual retirement accounts (IRA) to $3.4 million. He claimed that would provide a retiree with about $210,000 income per year, without an explanation of where that number comes from. Now, back to the real world. Assume that you have managed to accumulate $3.4 million in your IRA and wish to invest it without any risk of loss of principal. U.S. Treasury securities are considered the most risk-free assets. On Jan. 20, the day the president delivered his State of the Union address, the 10-year Treasury bond had an interest rate of 1.82 percent, which would give one an income of $61,880 per year, not $210,000.

In reality, though, there is likely to be inflation over the next 10, 20 and 30 years, so future dollars will not be worth anywhere near as much in the future as they are today. To protect yourself against the threat of future inflation, you may wish to purchase U.S. Treasury Inflation Protected Securities or TIPS. TIPS had an interest rate of 0.23 percent on Jan. 15, which would yield a real income of only $7,820 per year.

Assuming the president is sincere that it is fine for people to have a real and secure retirement income of about $210,000 per year, he should allow them to accumulate about $90 million in their IRAs — unless he knows for certain how long they are going to live.

The point is that many of the president's economic proposals are "make believe." My recommendation to the Republican-controlled Congress is to accept all of the president's tax cuts and "pay for them" with real cuts to the budget. A number of think tank scholars, including my Cato colleagues, have provided lists of programs that should be eliminated or radically cut because they are wasteful and counterproductive. Almost any tax cut and reduction of destructive spending would be a win-win for the economy.

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