On Tax Policies

With tax cut legislation in the works, several leftists have regurgitated a 2014 *Huffington Post* article by Ben Walsh—who argues for a *90 percent* tax rate for the highest-paid Americans. It is one of the dumbest articles ever written (and I've read quite a few at HuffPo and Vox.com).

Walsh first (correctly) notes, "Currently, the top rate of 39.6 percent is paid on income above $406,750 for individuals and $457,600 for couples." He wants that rate to be 90 percent. An individual who earns, let's say, $500,000 per year is obviously better off than the average American, but $500,000 hardly places one in the "filthy rich" category. Nevertheless, Walsh thinks a *90 percent tax rate* would be perfectly appropriate for such an individual. ($10 says Walsh earns far less than $406,750 per year.)

Walsh complains about the "decades of a more or less strict adherence to the gospel that tax cuts for the highest income earners are good." Walsh is mistaken. The gospel is that tax cuts for *all* income earners are good. No one—wealthy or not—should pay any more than is necessary to fund the *essential* functions of government. Taxes are high because the government spends too much. It spends too much because it is involved in far more than the essential functions outlined in the U.S. Constitution. It is involved in far more because the politicians promise benefits and services in exchange for votes—and shamelessly ignore the U.S. Constitution.

Walsh forgives John F. Kennedy for his 1960s tax cuts, because he (was a Democrat and) only "cut rates to around 70 percent." But "The huge drops—from 70 percent to 50 percent to less than 30 percent—came with the Reagan presidency" in the 1980s. God forbid that the government should consider allowing anyone to keep 70 percent of what he earned! Walsh believes that being a slave to the government for 30 percent of the year is insufficient. He needs more cotton picked, and working in the fields only three days out of 10 is unacceptable. To Walsh, nine days out of 10 makes more sense. (Even God rested on the seventh day.)

Walsh called Kennedy's tax cuts "hardly radical. He lowered rates when the American economy was humming along, no longer paying for World War II and, relative to today, an egalitarian dreamland."

Walsh is again mistaken. The economy was sluggish. In fact, the nation suffered a recession from April 1960 through February 1961, during which the Gross Domestic Product fell 1.6 percent. Asked why he supported tax cuts, Kennedy told a reporter, "To stimulate the economy. Don't you remember your Economics 101?" (Why, Mr. Walsh, does one need to stimulate an economy that is "humming along"?)

Further, the nation *was* still paying for World War II, which left the nation's national debt in excess of $250 billion. The debt was more than $286 billion at the end of 1960, and more than $300 billion when Kennedy was assassinated. Since then, the national debt has skyrocketed. For many years now, the government has only been paying interest on the national debt; it has *not* paid down the principal—and it possibly never will.

There will probably be no "official," dramatic, instant default on the national debt. There will simply be a "gradual default" through the use of devalued dollars. When government bonds, stock, and notes are cashed in, the creditors are paid with money that is worth only a fraction of what it was when the loan originated—because of the Federal Reserve's expansion of the money supply. If you purchased a $100 savings bond years ago, is not the government partially defaulting on that loan when it eventually pays you back with dollars that are worth only half the value they had when you bought the bond?

Consider this scenario: You loan your neighbor $100 to buy groceries. He promises to pay you back next year. Twelve months later you receive your $100 back, but in that year the nation has experienced price inflation of five percent. If you take that $100 to the supermarket, you will *not* be able to buy the same groceries for the same price your neighbor paid. You will only be able to buy 95 percent of the products he bought last year—but it will still cost you $100 because of inflation. Did your neighbor honor his loan commitment, or did he cheat you out of $5.00? Although he paid back the $100 he borrowed, that $100 is by then worth only $95. *That* is how the federal government will gradually default on its $20 trillion debt. *That* is why the government tolerates—and even encourages—inflation of the money supply.

Getting back to Walsh, as far as the 1960s being an "egalitarian dreamland" relative to today, he is apparently unaware of the struggle for civil rights six decades ago. Does he think African-Americans were treated better in the 1960s than they are now? Does he not know that more women than men now attend college? Is he not aware that the CEO of General Motors is a woman? By "egalitarian dreamland" Walsh may mean that the "income gap" was smaller in the 1960s, when there were no multibillionaires like Bill Gates and Mark Zuckerberg. But taxing the heck out of Gates and Zuckerberg would do nothing but punish Gates and Zuckerberg. It would not make poor people any less poor, and it would not magically turn janitors into corporate CEOs. If Walsh wants income equality, that is easy to achieve: Impose Venezuelan-like socialism and almost every American will be equally poor (except for the elites running the regime, of course).

Walsh and other leftists make the argument that because the economy was going gangbusters when there was a 90 percent tax rate, we should now restore that 90 percent rate, sit back, and watch the jobs appear and the poor dine in five-star restaurants. But the economy was not going gangbusters under the 90 percent rate. As noted, there was a 1960-1961 recession, as well as a 1953-1954 recession. If the high taxes of that era were so wonderful and great for the economy, why did those taxes not prevent those recessions?

At the same time Walsh and others pine for a return to a 90 percent tax rate, they also argue that almost no one paid that rate anyway because of tax loopholes. Walsh: "A very high marginal tax rate isn't effective if it's riddled with loopholes, of course." We are to believe the claim that a 90 percent tax rate was responsible for a great economy (even though it was not so great an economy), and *also* believe that most wealthy people escaped that high rate. *How can rates that almost no one paid have created an economic boom?*

The economy is of course influenced by *thousands* of factors. It is ridiculous to claim that high tax rates can be good for any economy. (To argue that high taxes in the 1950s caused prosperity is like arguing gravity helps Olympic high-jumpers.) The U.S. economy grows *despite* high taxes and government interference, not because of them. Fortunately, the combination of capitalism and individual liberty is so powerful that it can withstand almost any assault. *But that does not justify intensifying the assault.*

Additionally, the leftists (who rarely complain about deficits when they are in power) argue that we cannot afford tax cuts because the government needs that revenue to pay its bills. Granted, the government spends more than it takes in each year and keeps borrowing money to cover its massive deficits. But it is *not* true that tax cuts cause a loss of tax revenue. In fact, the opposite is true. After the Kennedy, Reagan, and Bush income tax cuts, federal tax revenue *increased*. (Yes, tax revenue increased.) Since 1950, federal tax revenue has declined from year-to-year only a handful of times, and those declines were due to recessions or other factors, not tax cuts. (For example, federal tax revenue declined because of reduced economic output after the terrorist attacks of September 11, 2001.)

Tax cuts result in increased tax revenue because they encourage businesses and individuals to spend more, invest more, be more productive, and hire more workers. More people working and paying taxes means fewer people on welfare not paying taxes. A lower tax rate imposed on a larger population of workers generates more tax revenue than a higher tax rate imposed on fewer workers. (Ten percent of a bucket of water is greater than 20 percent of a cup of water.) But, if tax cuts result in increased tax revenue, why does the national debt keep growing? The debt continues to grow *not* because tax revenue goes down (it does not), but because Congress (Democrat and Republican members alike are at fault) spends the increased revenue generated by the tax cuts—*and then spends even more*.

Let's address the 1990s, a period in which Democrats also claim higher income taxes generated a good economy. Again, those income taxes did not *cause* an expanding economy. The growing economy of the late 1990s was partly the result of a cut in the capital gains tax (from 28 to 20 percent) and welfare reform—which Bill Clinton opposed but which were eventually shoved down his throat by a Republican Congress. Economic growth was also encouraged by the introduction of Roth IRAs, a significant decline in the price of oil, and the increased use of computers and the expanding Internet. Small and large businesses alike took advantage of the new technology, and that increased productivity, boosted wages, and prompted additional hiring. High income taxes did not cause the improved economy of the late 1990s. Nor did Bill Clinton. (He just happened to be in the White House when it occurred.)

As with income taxes, the reduction of capital gains taxes also results in increased tax revenue. To many people that does not makes sense. How can cutting capital gains taxes yield greater tax revenue? The answer is that lower capital gains taxes encourage investors to sell their assets and reinvest their profits elsewhere, while increasing the capital gains tax encourages investors to sit on those assets and *not* sell them. When assets are not sold, *there are no capital gains to tax*. Ten percent of something generates tax revenue, while 20 percent of nothing yields zero tax revenue.

All of this is common sense, which many leftists seem to lack. They ridicule the famous "Laffer curve," but Arthur Laffer is correct. Increasing a tax rate yields increased tax revenue—*but only to a point*. Zero tax produces no tax revenue; a five percent tax produces some tax revenue; a 10 percent tax produces more revenue. But a 100 percent tax would produce no tax revenue, because people would simply stop working (or deal in an off-the-books black market). A 90 percent tax would produce some limited tax revenue, but most people would still stop working. The goal of the money-hungry legislator is to find the "sweet spot"—the tax rate which produces the most tax revenue, while not prompting many people to stop investing, stop working, or flee to a black market.

The problem the legislators have is that the cumulative "sweet spot" is too low to fund a $4 trillion-per-year government. The politicians attempt to solve that problem by finding the sweet spot of each income level. They tax lower-income workers at lower levels, and tax higher-income workers at higher levels. A person who earns $25,000 per year can hardly afford a $5,000 tax bill, but a person who earns $100,000 per year can at least still feed, shelter, and clothe his family after paying a $20,000 tax bill. But even with "progressive" income tax rates, the government still comes up short. So it taxes capital gains as well.

What makes the capital gains tax particularly egregious is that (like the income tax) it is not indexed for inflation. Assume you earned $50,000 last year and were able to invest $5,000 of that income in the stock market. If you hold your stocks for several years and then sell them for $8,000, the capital gains tax is applied to your $3,000 gain ($8,000 minus $5,000). But the IRS ignores inflation in the equation. Your $8,000 may only be worth $7,000 because of the inflation that occurred while you held your stocks. (That is, what used to cost $7,000 now costs $8,000, because the Federal Reserve keeps inflating the money supply, making your money worth less each year.) Your gain therefore is not really $3,000. It is actually only $2,000 ($7,000 minus $5,000). Nevertheless, the government taxes the inflated value of the gain. You are being taxed for $3,000 that has only $2,000 in purchasing power.

If the government increases the capital gains tax rate, you are even worse off. You may decide not to sell your stocks for $8,000. If you do not sell the stocks, your gain is zero. The tax is therefore also zero. If you can afford to do so, you will hold on to your stocks and not sell them until the next time Congress lowers the capital gains tax rate to a less unreasonable level. Again, this is common sense. *People act in their own economic self-defense*.

Even some Marxists understand this. During a 2008 Obama-Clinton primary debate, journalist Charles Gibson pointed out to Obama that increasing the capital gains tax would result in *reduced* tax revenue. Obama accepted that argument, yet told Gibson he *still* endorsed a tax increase for purposes of "fairness." In other words, even though increasing the tax would *lower* federal tax revenue, Obama wanted to hike the rate anyway to "screw the wealthy." (Obama apparently did not care that many non-wealthy Americans also own stocks and pay capital gains taxes.)

But what most causes leftists to advocate counterproductive tax policies is their belief that income belongs not to the person who earned it but to the government, and that the job of Congress is to distribute it "fairly." To leftists, the economy is one large pie. If one person has a larger slice of pie, surely he must have come by that portion unfairly! They believe their job is to cut the economic pie into equal pieces so that everyone receives his "fair share." It does not occur to them that the pie can and does grow. The pie grows larger when businesses and individuals are more productive. (The nation's Gross Domestic Product goes up.) The pie shrinks when businesses and individuals are less productive. (The Gross Domestic Product falls; two such quarters in a row are classified as a recession.)

The leftists believe the pie belongs to and should be divided into slices by the government. As a result, they look at tax cuts as a "gift" from that government to the taxpayers. But a tax cut is *not* a gift from government; it is simply *a reduction in the amount of confiscated wealth*.

Consider this: You have $200 in your pocket and are approached by an armed mugger on the street. He demands all your money and you reluctantly but immediately hand over the $200. Then, because you are some distance from home, you plead for $20 for cab fare. If the mugger keeps $180 of your $200 and gives you back $20, you did *not* receive a $20 "gift" from a generous and kind-hearted mugger. No, you were robbed of $180! It is *your* money, not his. *You* earned it, not him. (Obama and Elizabeth "Wampum" Warren may argue, "You didn't build that" wealth; but *you did*.) As the mugger flees into the night, you do not head home with a smile on your face, happy to have had your income "redistributed" to the "less fortunate."

Walsh defends the mugger, essentially lecturing, "Calm down. After all, you get to keep 10 percent of your income!" (How generous of him!) He further defends that defense by pointing out that fewer than one percent of American taxpayers are in the current top income bracket that is nailed with the 39.6 percent tax rate. That so few Americans pay the top rate, of course, makes it easy to label them the enemy in his class war. "There are only 1.3 million or so Americans in that group, so let's further put the screws to them." (No, he didn't use those words. But he expressed those sentiments.)

Walsh tries to marginalize the impact of the 39.6 percent rate, writing, "A 90 percent top marginal tax rate doesn't mean that if you make $450,000, you are going to pay $405,000 in federal income taxes. …Right now, you pay the top marginal tax rate on every dollar you earn over $406,750. So if you make $450,000, you only pay the top rate on your final $43,250 in income."

Translation: "You would only be screwed out of 90 percent of all income above $406,750." To the average person (even those who earn nowhere near that amount), that sounds like a disincentive to work hard. Why bother being productive, creative, and more valuable than $406,750 per year if you can keep only 10 percent of your income for any additional effort? You may as well do the bare minimum and let some other sucker work hard for next to nothing. (How would those who support a $15 per hour minimum wage feel if Congress responded, "Okay, we'll approve a $15 minimum wage, but you will have to pay a 90 percent tax on all overtime"?)

Ah, but it gets worse. Writes Walsh: "If rates are high for the top earners and low for everyone else, there's a big chance you will pay a low rate and a small chance you will pay a high rate. Given these odds, it is rational to accept high income tax rates on top earners and low rates for the rest…" That's like writing, "There's a big chance you will not get murdered if you live in one of Chicago's better neighborhoods. Given these odds, it is rational for most north-siders to accept high murder rates on the city's south side."

If the government were to tax income over a certain level at 90 percent, *what is the point of working harder to achieve success?* It is accurate to state that few people probably ever paid the 90 percent rate when it was in effect. But why was that so? Because it was so draconian that people *found ways around it!* If you tax high incomes at 90 percent, businesses will simply find other ways to reward their high-paid executives. Instead of paying them $5 million per year, they might pay them $500,000 per year and give them incredible perks that are more valuable than the after-tax income they lose. If I earn $5 million but must pay a 90 percent tax on my final $4,500,000 in income, for example, I would get to keep only $450,000 of that $4.5 million. I would ask my employer to slash my pay and give me benefits and extras worth far more than $450,000! *I would get around the system*. That is, instead of being paid $5 million, I'd rather get paid $500,000, plus $4.5 million or so in perks and privileges that are not taxed.

Meanwhile, the federal government could actually *lose* tax revenue! Why? If my employer were to slash my salary from $5 million to $500,000, the government would *not* receive 90 percent of $4.5 million; it would receive *zero* percent of that amount because I will not have received that income in the first place! Duh! (Note to math-challenged "progressives": Zero percent of nothing is *not* better than 90 percent of something.)

Increasing taxes to sky high levels would encourage employers to reward executives with non-taxable benefits. I might even set up a tax-free organization called "The Don Fredrick Foundation," and ask my employer to contribute $4.5 million per year. I would distribute a minimal portion of that amount for well-publicized charitable causes, but would mostly use my "foundation" to rent a furnished mansion for me and cover my first-class travel expenses. (Do you wonder where I got that idea? Hint: It rhymes with "shill and pillory.")

Yes, Congress would then work overtime (for a change) to tax those non-taxable benefits. But that is how the IRS code got to be tens of thousands of pages in the first place!

Do the Democrats not understand why high-income earners move from states like California, New York, Illinois, and Connecticut to states with low or no state income tax, such as Nevada, Texas, and Florida? Highly-paid people are not stupid. They have enough sense to escape high taxes by moving to another state—or by moving overseas. Amazingly, Democrats see corporations moving overseas to avoid high corporate taxes, yet are not intelligent enough to comprehend that increased personal income taxes will also drive individuals overseas. (This is not the 19th century, when traveling to Europe took weeks on a ship. An American can work and live in Europe, fly back and forth in only hours when necessary, and communicate with friends, relatives, and business associates immediately via the Internet. Our ancestors endured incredible hardships crossing the continent in covered wagons in search of better lives. Seven hours on a flight is no big deal.) The greater the tax burden, the greater the incentive to flee the tax man. If the burden is too great in New York, businesses and people will move to Texas. If the burden is too great in the United States, businesses and people will move overseas.

Even many Democrat legislators understand that corporations (which cannot print money) do not pay taxes. They merely pass the corporate taxes on to consumers with higher prices on their goods and services. The corporate tax in the United States is 35 percent. You can be assured that when you buy a product Made in USA, its price covers that 35 percent. (Similarly, when a company advertises “free shipping,” the cost of shipping has already been included in the product’s price. Nothing is free.)

True conservatives seek a government that is no larger than it needs to be, and taxes as low as possible. Democrats push for increased spending, in an effort to force tax increases. Republicans push for tax cuts, in an effort to force spending cuts. What happens, of course, is that spending never gets cut, and taxes can never be increased enough to cover all the spending because such high tax rates would cause the economy to contract—if not collapse entirely.

Meanwhile, Democrats and Republicans alike try to force changes in human behavior with various tax code provisions. To promote home ownership, for example, they have long allowed taxpayers to deduct mortgage interest. Such tax deductions are unjustified. Why is where you live the business of the federal government? Why should homeowners get a tax break that renters cannot receive? As the population grows, the nation will certainly need more housing. But what difference does it make if those people live in houses or apartments? A carpenter paid to install doors should not care whether those doors are in single family homes or apartments. Yes, homeowners are likely to take care of their homes better than renters take care of their apartments. So what? People who own their cars probably take better care of them than people who rent or lease cars. So what? Should car owners pay lower taxes than car leasers?

The Reagan tax cuts reduced income tax rates, but many people forget (or are unaware) that the legislation also phased out the deduction of credit card interest. That was an effort to limit the loss of tax revenue. As usual, of course, Americans were inventive, and they quickly found a way around the tax code. What was their solution? Home equity loans. Taxpayers could deduct interest on home equity loans. But that did not eliminate credit card debt. It only saddled homeowners with home equity loans *and* credit card debt. Renters, however, lost the ability to deduct credit card interest, but had no homes against which they could borrow. As a result, many of the least wealthy Americans (renters) ended up worse off than homeowners because of the Reagan tax cuts. It would have made more sense to allow no credit card or home equity loan interest deductions, and set the tax rates even lower.

There is now an uproar over the proposed loss of deductibility of state and local income taxes from federal tax returns. But why should residents of states with no income tax have to pay higher federal income taxes to subsidize residents of states with income taxes? Allowing New Yorkers to deduct state income tax results in decreased federal income tax revenue. The rates for everyone must therefore be made higher to offset that lost income. Floridians and Texans are therefore paying higher than necessary federal income taxes so that the New York state legislature can keep spending like there is no tomorrow. Senators and Congressmen from states like New York, California, New Jersey, and Connecticut are whining that the loss of that tax deduction is unfair and that their constituents will now have to pay higher taxes to subsidize Floridians and Texans. In reality, Texans and Floridians have been subsidizing the residents of the high-tax states for decades.

The tax code should not pick winners and losers. Tax revenue should be used as intended. (The gasoline tax should be used for roads and bridges, not for bicycle paths and jogging trails.) The tax code should not favor one group of citizens over another. There should be as few deductions and loopholes as possible. The tax revenue gained from closing loopholes and eliminating deductions should be offset by reductions in the tax rates. We must stop pitting the poor against the middle-class, the middle-class against the wealthy, homeowners against renters, non-investors against investors, married against the unmarried, and the childless against parents.

Of course, if groups of Americans are not pitted against each other, the taxpayers will join together against the politicians. But that is the last thing the politicians want, and that is why the tax code will continue to be burdensome, complicated, and unfair.

That’s my two cents worth (1.208 cents after taxes).

Don Fredrick
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