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By Richard W. Rahn

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Washington's flight from reasoned and truthful discourse has never been more apparent. The advocates of the Clinton economic program have resorted to creating fantasy numbers to defend the indefensible. We are told that both a tax increase and a spending decrease—which according to their own numbers is really a spending increase—will reduce the deficit, reduce interest rates, create more new jobs, and increase economic growth. What economic theory provides such results? Certainly not the classical, Austrian, Keynesian, or supply-side. It's Alice in Big-governmentland!

The plain fact is, the Clinton economic program has no empirical or theoretical underpinnings, but to say so is to be labeled a tool of the special interests or even worse, unpatriotic. In addition to the economically illiterate—a large group due to the constant stream of misinformation from many in the press and the public education establishment—those who are supporting it are for the most part very special interests. These special interests are those that have a vested interest in bigger or more powerful government. Such special interests are not so easily classified because they include public employees, labor leaders, many employees and leaders of non-profit groups, and even many business men and women—anyone who is looking for special privileges from government or funding either directly or indirectly. Merely look at the business community, which is far from monolithic against big government. There are those who have a vested interest in protectionism to shield them from competition, those in "politically correct" industries (e.g. high tech electronics) who hope for special tax breaks for their industry, and of course all of those who seek government contracts which even includes some business trade associations.

One should not be surprised that the good folks at National Public Radio show a persistent bias toward more government spending and taxing, given their perceived self interest. It is taken as a matter of faith that new taxes are needed to reduce the deficit, despite overwhelming historical evidence that new taxes have served only to reduce economic growth and fuel additional spending, thus increasing the deficit. Those who argue for almost any tax increase to reduce the deficit are as about as sophisticated as those who argue that General Motors and IBM could eliminate their losses by increasing the price of their vehicles and computers.

Many in the media and the Washington political establishment accept language and actions from government officials that if used by a private businessperson would result in the harshest of criticism, if not indictment for fraud. Why is it acceptable for a tax increase, such as the one proposed on some Social Security recipients, to be labeled as a spending cut. If truth in labeling legislation applied to government, about half of the Clinton budget's "spending cuts" would be correctly called tax increases. (In fairness the practice of falsely labeling tax increases as "spending cuts" was also a practice of Dick Darman's, but in a less blatant manner).

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"Laffer Curve Effect." If the Clinton Administration was serious about encouraging greater economic growth rather than merely playing political games, they would not have proposed raising tax rates above the revenue maximizing rate for any given tax. (This is commonly known as the "Laffer curve effect," which is understood to be a truism by serious economists, but dismissed by left-wing ideologues who misstate it by claiming that it asserts that any tax cut will pay for itself, which of course it does not.) Recent work by a number of leading economists shows that the revenue maximizing rate for the income tax is probably no higher than 31 percent, so any proposal to raise it higher would need to be accompanied by very serious evidence that the higher rate will raise the revenue that is claimed. Until such evidence is presented, the proposal should be disregarded.

Second, any serious tax increase proposal should have a discussion of the extraction and compliance cost coupled with it. Every tax imposes a cost on whatever is being taxed and these costs normally reduce the level of the activity being taxed, whether it is labor, capital, or consumption, and these costs should be detailed and analyzed for their consequences. For instance, an excise tax on an item such as energy will reduce employment in the automobile related industries, reducing income and payroll taxes, and add to the "consumer price index" which in turn will increase federal government outlays for Social Security payments. In addition, there are costs incurred in collecting the tax by the government and there are the costs of private sector record keeping and compliance, which need to be detailed. Again, if any tax increase proposal does not contain a professional analysis of the above-mentioned costs, in order to obtain a real measure of the gain or loss from the proposed tax change, it ought to be disregarded.

Third any proposed tax increase, after taking into account the factors noted above, should be compared to the advantages of reducing spending versus the tax increase. The widespread belief that the deficit cannot be reduced without tax increases is nonsense. The federal tax system already provides tax revenue growth in excess of nominal GDP growth (i.e. inflation plus real GDP growth).

Given that federal spending is at a record high as a percent of GDP, it is foolish to argue that we cannot cut spending. Every major study of government spending has shown enormous amounts of waste in the way programs are managed. Very little analysis is done concerning the cost-effectiveness of most government programs. Many government transfer programs tax poorer citizens to provide subsidies to richer citizens. The privatization and asset sales options are routinely ignored for political reasons. The fact is, spending does not even have to be "cut" in the sense that businesses and households understand a spending "cut." If government growth is held to the increase in inflation the deficit would fall, because in most years the natural growth in government tax revenue greatly exceeds the increase rate of inflation. Thus, many government programs could be allowed to increase in real terms if others were in fact reduced or increased at a rate lower than the inflation rate (defense spending and agricultural subsidies could easily fall into this category).

In sum, the following questions need to be asked of, and satisfactorily answered by, the Administration and the Congress before any taxes are increased:

1. **Has all waste, fraud, and abuse been eliminated from current government spending programs?**
2. **Are all current and projected government spending programs cost-effective?**
3. **Have all income transfers from poorer to wealthier citizens been eliminated (such as the farm subsidies)?**

4. **Have all activities that could be better run by the private sector than the public sector been privatized?**
5. **Has the government sold all unnecessary assets than it owns (such as excess strategic metals stockpiles and land)?**
6. **Are all the proposed tax rate increases well below the revenue maximizing rate for the relevant tax?**
7. **If the proposed tax increase becomes law will all of the costs of collection, compliance, extraction, inflation, increased unemployment, and loss of income and international competitiveness, be significantly less than the revenue received?**

Members of Congress should insist that each and every one of the above questions be totally and honestly answered in the affirmative before considering any tax increase. To do less would be a dereliction of duty.

The President is right, we do have a deficit problem and it ought to be reduced. But the source of the problem is government spending, which has been growing much faster than national income. Tax increases will not and cannot cure a spending problem. Only when the President and the Congress face the reality of the spending problem will the resulting deficit problem be cured. The miracle of the spending cure is that if you take the medicine you will find you do not need to increase taxes, because our existing tax system already produces a yearly increase in tax revenue that exceeds the growth of national income.

Good economic policy depends on good theory and sound data, which are in turn dependent on honesty in the use of words. Let us urge those members of Congress and the press who argued that "lying to Congress" was an indictable offense during Iran-Contra to apply the same standard to economic policy misinformation as they do to foreign policy misinformation.

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