PAYBACK

WHY THE TOP 1% MUST INVEST IN THE REST AND HOW IT CAN RENEW AMERICA

THOMAS ALLEN MOON

This book is the print version of an online version available at no charge to all who wish to learn about the U.S tax system, its flaws, and how to fix it.

Visit the website for hyperlinks to sources and information to advocate for tax justice.

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PROJECT

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For my children, Anna and Amy, their husbands, Mike and Jason, and their children, Jordan, Ryan, Lilia and Jasper – and all Americans with the courage to advocate for a brighter future for those they love

ACKNOWLEDGEMENTS

The Payback Project is a labor of love that began roughly ten years ago — or 40, if we count my decades of rumination over the problem of tax justice before retirement finally gave me the space to act on it. The inspiration came from my eldest daughter, Anna Clark. She had heard me speak of issues of fairness in our tax system for much of her life until 2013 when, as a master's student at Johns Hopkins University, she noticed her instructors using interactive media in novel ways to engage students in conversations about complex societal challenges. She suggested I follow their lead to create a platform to engage citizens in the issue of tax justice. What came from there has been a journey through the ecosystem of advocates, creators, journalists, and editors whose talents I have leaned on heavily to turn my research into a website, and now this book you are reading.

Chief among those I want to thank is Editor Tony Robinson of Beacon Editorial for his dedication to the years-long task of sculpting the content into chapters and the considerable skill he brought to the endeavor. His affinity for addressing economic inequality, stemming from his undergraduate years at UC Berkeley and continuing throughout his literary career, has been a boon to The Payback Project since 2014. I am also thankful for the early contributions of journalist Edward Iwata and civic engagement expert Marc Tognotti, PhD, whose editorial work was instrumental in shaping the core narrative and my writing in general. Others whose talents have been central to the creation of this platform include Lee Hunter, whose exceptional design brought the concept to life; Michael Drake for his quality videography; and Jay Staton, whose expert web development continues to bring citizens into this critical conversation.

I am incredibly grateful to my family for their support throughout this process, beginning with my daughter, Anna, whose talents in creative direction, storytelling, and media production have enabled me to project my voice on this issue more loudly than I ever could have accomplished on my own. Her sister, Amy, also supported the effort, reading chapters and offering valuable input. My brother, Bill, listened, read every word, and made insightful suggestions over the years. With help from our friend Hugh Ferguson, Bill enabled me to see the tax issue from multiple perspectives, and the book is better for it.

Finally, I am grateful to my wife and original thought partner, Jeanne, who passed away in 2020. After 54 years of marriage, her deep caring for those who suffer injustice continues to inspire me.

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AUTHOR'S NOTE

The facts are extracted from governmental and expert sources hyperlinked in the text where appropriate in the digital version. The data on which my conclusions are based was taken largely from sources that used data obtained from government sources, as follows:

Bureau of the Census (Census) – website: https://www.census.gov/

Bureau of Economic Analysis (BEA) – website: https://www.bea.gov/

Bureau of Labor Statistics (BLS) – website: https://www.bls.gov/

Congressional Budget Office (CBO) – website: https://www.cbo.gov/

Department of the Treasury (Treasury) – website: https://www.treasury.gov/

Federal Reserve System (FED) – website: https://www.federalreserve.gov/

General Accounting Office (GAO) – website: http://www.gao.gov/

Internal Revenue Service (IRS) – website: https://www.irs.gov/uac/tax-stats

Joint Committee on Taxation (JCT) – website: https://www.jct.gov/

Office of Chief Actuary of Social Security (Chief Actuary SS) – website: https://www.ssa.gov/oact/

Office of Management and Budget (OMB) – website: https://www.whitehouse.gov/omb

Organization for Economic Co-operation and Development (OECD) – website: https://www.oecd.org/

The following major sources of data are included in full length:

- Historical Statistics of the United States 1789-1945, Bureaus of the Census;

- Wealth Inequality in The United States Since 1913: Evidence from Capitalized Income Tax Data, Emmanuel Saez and Gabriel Zucman;

- Online Appendix of Wealth Inequality in the United States since 1913: Evidence from Capitalized Income Tax Data, Emmanuel Saez and Gabriel Zucman;

- The Fading American Dream: Trends in Absolute Income Mobility Since 1940, Raj Chetty, David Grusky, Maximillian Hell, Nathaniel Hendren, and Jimmy Narang;

- Fiscal Year 2016 Historical Tables Budget of The U.S. Government, Office of the Management of the Budget;

- The 2015 Annual Report of The Board of Trustees of The Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds, The Board of Trustees, Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds;

- 2015 Annual Report of The Boards of Trustees of The Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds, The Boards of Trustees, Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds;

- The Distribution of Household Income and Federal Taxes,2008 and 2009, Congressional Budget Office;

- The following tables supplement information provided in the Congressional Budget Office's July 2012 report The Distribution of Household Income and Average Federal Tax Rates, 2008 and 2009, Congressional Budget Office;

- Table 3. Number of Households, Average Income, and Shares of Income for All Households, by Before-Tax Income Group, 1979 to 2009, Congressional Budget Office;

- The Distribution of Major Tax Expenditures in the Individual Income Tax System, Congressional Budget Office;

- Corporate Tax Expenditures, Information on Estimated Revenue Losses and Related Federal Spending Programs, General Accounting Office;

- Taxes and the Economy: An Economic Analysis of the Top Tax Rates Since 1945, Congressional Research Service; and

- The Moment of Truth, The National Commission on Fiscal Responsibility and Reform (Simpson/Bowles).

These sources provide historical context, highlight demographic and income disparity issues, explain flaws in the existing use of tax preferences, and warn of future challenges for taxing and spending policies. Although some of these reports are several years old, for the most part, they are as relevant to tax policy today as when written.

Since this book has been written over an extended period of time, many changes that significantly affect tax policy have occurred. For the most part, this book was written after the Great Recession of 2008/2009 and before the pandemic of 2020. No post-pandemic data has been added, but it is important to note that most trends discussed in the book have been exacerbated in recent years.

For the past 40-plus years, America's economic, social, and political fabric has been torn by the trends I discuss in the book, including the intense concentration of income and wealth at the top, the number of families verging on poverty reaching dangerous levels, education and health care becoming less and less available to most Americans, a dignified and secure retirement becoming a mirage for many in upcoming generations, growing anxiety among more and more Americans arising from job insecurity, and an out-of-control national debt that threatens America's easy access to world credit markets and low-interest rates. These trends are not only continuing, but most are accelerating. At some point, still unknown but looming, the continuation of these trends will force a fundamental change in tax policy. I believe that America needs a tax policy that contributes to reversing these trends, not continuing them. To me, this is a matter of patriotism, not ideology.

My opinions are based on what I have inferred from the factual data included in this book. While I believe my opinions are reasonable, I am aware that what is reasonable is itself a subject of debate among reasonable people. Despite its many flaws and limitations as the forum for discovering the closest approximation of truth that can be reasonably found, I agree with J.S. Mill's views on the merits of a vigorous and honest debate within the marketplace of ideas. Fact and reason almost always win out over time, but that can be a very long time that rarely occurs within an election cycle.

In lieu of using traditional footnotes or endnotes, and in place of a bibliography, I used hyperlinks in the digital version because I wanted as much raw data to be available to readers as reasonably possible. In most instances, the hyperlinks should themselves show the data on which I have relied. Except for Chapter III, "What History Should Have Taught Us," I have not hyperlinked my interpretation of the Social War in ancient Athens to any authors. I relied primarily on Plutarch's *Lives* for the lives of Solon and Aristotle and on Aristotle's Politics, as published in the *Great Books*, as well as years of reading the ancient history of Greece and Rome.

As to how two of history's leading conservatives dealt with the need of their conservative societies to change to meet the threats at hand, I relied primarily on Plutarch for Lycurgus. As to Bismarck, I relied primarily on Emil Ludwig's biography, as well as other secondary references. While I could have used any number of historical examples to make my points, I chose these because I thought them especially pertinent to the time.

As to an overriding lesson from history, I am especially mindful of Will Durant's observation in several of his volumes in *The Story of Civilization* that the concentration of wealth and income in a few is natural and inevitable, but, if it gets out of hand, it can tear a society apart. So, history and my personal experience have taught me that some people are smarter, harder working, and luckier than others, and that it is natural and inevitable that they will have more, but if they take too much, it can lead to disastrous consequences.

With respect to Chapter IV, as it relates to the pre-20th Century American economy, government spending, and government taxing, I have based most of my comments on what I gleaned from two major sources: first, *Historical Statistics of the United States 1789-1945*, as published online by the Bureau of the Census at https://www2.census.gov/, and second, *The Tax History Project History of Taxation in the United States*, as published online by The Tax History Museum online at http://www.taxhistory.org/, both of which are included in Major Sources of Data. For the rest of the chapters, the hyperlinks should suffice to show what data I used.

With all that out of the way, I invite readers to have at it and make of it what they will. My best hope is that this book will spark a serious and honest debate about taxes. God knows the country needs it.

INTRODUCTION

Growing up in America in the 1950s and 1960s, I was blessed with all the opportunities that I could handle to lead the life of my choice. Looking back, I have worked hard, reaped the rewards of living in the U.S., and earned the life of my choosing. I want today's children and future generations to receive the same golden opportunities that helped me attain the knowledge and skills to succeed in college, in the military, in law school, and in a career that has lasted more than 50 years.

Capitalism has been good to me. I have enjoyed a successful legal career as an attorney with the Internal Revenue Service, then with the U.S. Securities and Exchange Commission, and then as a public finance attorney in private practice. However, my firsthand experience has also revealed how brutal and ruthless capitalism can be. To be ethical, it must be practiced with integrity, and without lying and manipulation.

I still believe that capitalism is the best hope for humanity, but it is high maintenance. Only pure, uncorrupted capitalism assures opportunity for those who work hard and play by the rules. Without persistent vigilance to protect against ever-present creeping corruption, like antitrust violations and markets perverted by fraud, capitalism degenerates into economic thuggery in which the honest and diligent are devoured by the dishonest and ruthless.

In the last forty years, the world has spun in a way that is incomprehensible to many. Rising education costs, slow growth in both the global and domestic economies, the public's loathing of taxes, and other factors make it far more difficult for young people to pay for the higher education they need in order to make it in a competitive world. Globalization and technology, two inexorable and irreversible forces, pose grave threats to the American Dream. Globalization represents free and full international commerce among the world's nations. Technological innovation represents the replacement of human effort and skill in the delivery of goods and services with intellect, in the form of software, computers, and robots. In this world, capital knows no national home, and only workers with scarce and superior skills will command premium wages.

In the world that is emerging, capital seeks its highest return wherever in the world it may be found. American workers must compete with workers internationally for opportunities, and everyone will also have to compete for whatever wages capital is willing to pay. For workers with competitive skills, the world will never have been better, but for those workers with less than superior skills, the future looks bleak.

Unless the U.S. economy grows and all Americans who are willing to work have hope, the American Dream will fade, and with it, so will its status as a superpower. If this country hopes to sustain its greatness, every hard-working person of merit must be able to access the education needed to be upwardly mobile. Our country cannot afford to waste talent. In the interest of keeping America's economy strong, all those with talent, especially those who also have ambition and drive, must be provided with the resources necessary to fully develop their potential. Lack of money should not stand in the way of any American of ability getting the education they need to become all they can become.

Opportunity does not imply equal opportunity for all, but it does mean adequate opportunity for all who are willing to work. Some will have higher hills to scale than others. There will always be those who struggle to work their way through local community colleges while others get into elite universities on legacy admissions without a financial care in the world. However, preparing as many young people as possible to enter the middle class will ensure that America's economic engine does not run out of gas, and everyone will be the better for it.

Two generations ago, I could make it mostly on my own, with only a bit of government help. In those days, hard work, ordinary skill, and a little luck were still a ticket to the American Dream. From the end of World War II into the 1980s, most Americans could support their families by working as a retail salesperson, a bank teller, a barber or hairdresser, a car salesman, a gas station attendant, a milkman, an auto mechanic, an assembly line worker, a carpenter, a plumber, an electrician, a policeman, a fireman, a bus driver, a grocery store checkout clerk, or a secretary.

Today, many of these jobs that used to sustain us are gone, and the jobs that are replacing them are very different. Most middle and low-income Americans will need a boost if they want to pursue the education necessary to compete in our 21st-century job market. And for America to compete in a global economy, where neither capital nor skilled labor respects national boundaries, the lack of highly skilled labor could doom us to second-rate status or worse. To achieve the goal of creating a workforce second to none, one that will help America stay competitive in the global economy, calls for plunging into the political world of taxing and spending, a world that few voters understand.

Embracing wide-ranging tax reform to help pay for the education necessary to revitalize the middle class—a cornerstone of social and political stability, a wellspring of innovation, and our engine for economic growth—is the task ahead. Where the middle class goes, so goes America.

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I wrote this book because we need a new narrative about taxes. The dialogue in the media is a confusing morass of sound bites and debate, but most citizens still lack a foundational understanding of our tax system. Before voters can make informed decisions regarding tax policy, they need to understand how the system works as well as the barriers to better tax policy. In this tax-policy primer, I also include some proposals that I believe will help Americans remain competitive.

My personal experience with taxes comes not from the top down as an academic, but from the inside out as a dealmaker. In more than 30 years of law practice, I did hundreds of tax-driven deals that exploited an endless number of tax loopholes. Sweet deals were made sweeter and marginal deals were made possible by tax preferences of all kinds. Experience has taught me that the deals I did benefited the consultants and the businesses that engineered them more than the taxpayers who paid for the benefits. None of the benefits that arose from these deals were worth the cost to the taxpayers. As my penance for 35 years of doing tax-driven deals, I have written this book to point out a better way.

No one enjoys being taxed. Few besides the billionaire investor Warren Buffett will admit to it. But as things stand, only the very few are winning in the tax game; the overwhelming majority of Americans are losing. I would like to see more of us do better, and this book explains how. I have done well in my life. I am retired and in my eighth decade and, depending on market fluctuations, I am in the top one, two, or three percent in terms of income and wealth. With the benefit of hindsight, I believe that the clear majority (as many as 98% of all Americans) would be better off if we ended the tax gamesmanship that goes on every year in our political system.

It may be hard to believe, especially to those who hate taxes like the plague, but over the decades, many conservative lawmakers and tax policy experts have proposed tax reform proposals similar to the ones outlined in this book. For the most part, these earlier reform proposals fell short because of political timidity, partisan bickering, and private greed. For most of my life, I have agreed and disagreed with Republican and Democratic lawmakers and presidents alike. So, I write this not as a partisan political advocate, but as a partisan American.

The "Ameri-Share Tax Plan" that I offer envisions an economy in which (1) those with superior skills can realize their full potential, (2) those with less-than-superior skills (but who are willing to work) will have a decent standard of living and their children will have a fair shot at getting the post-secondary education they need to realize their potential, (3) the American economy will grow as rapidly as possible, (4) the tax burden will be distributed based on the ability-to-pay principle, (5) the tax laws will be much, much simpler, (6) taxpayers earning the same income will pay the same taxes, and (7) America will pay down its national debt to manageable levels. Each element of my Ameri-Share Tax Plan is borne of a one-time conservative proposal. Now, these same proposals are presented in a single coherent plan at the end of this book.

If America has been that good to me, then I see it as my duty to help others get a shot at success also. America cannot remain a great nation unless we create and educate a superior workforce, expand the middle class, and reduce our national debt. The only way for our country to stay number one is to invest in itself. This book will show readers how to safeguard the American Dream and equip them with the knowledge to help drive the public investment necessary for sustaining our country's standing well into the future.

CHAPTER 1

COMING UP IN THE GREAT AMERICAN MIDDLE CLASS

"We dare not forget today that we are the heirs of that first revolution… And so, my fellow Americans: ask not what your country can do for you—ask what you can do for your country…"
– President John F. Kennedy, *Inaugural Address, January 20, 1961*

Ask Not • When Public Schools Were Good • Climbing the Greasy Pole • Keeping the American Dream Alive

ASK NOT

The memories remain stark and vivid in my mind. I was 20, a college student studying history and government at Texas Christian University. I was in a special place, my hometown of Fort Worth, with a special person, my future wife of 54 years. I had met Jeanne at a student government meeting, and that cold and drizzly morning was our very first date. I picked her up at 7:00 a.m. and drove several miles from her parents' upscale neighborhood to downtown Fort Worth. I parked my Chevy Corvair as close as I could to the Texas Hotel, and fumbled with my umbrella, not wanting my date to get her hair wet.

Weaving our way through a crowd of several thousand excited people, we managed to get within a long baseball throw of the speaker's platform. I cannot say that I remember much of what President Kennedy said on the morning of November 22, 1963. There was a lot of noise, and the public address system was not very good. But I can remember how I felt. As the President spoke, the words I had memorized from his famed inaugural speech in 1961 ran through my mind:

"Ask not what your country can do for you, but what you can do for your country."

That morning in Fort Worth, the President put the world on notice that "the torch [had] been passed to a new generation of Americans, born in this century, tempered by war, disciplined by a hard and bitter peace, proud of our ancient heritage, and unwilling to witness or permit the slow undoing of those human rights to which this nation has always been committed." The words spoke to me then, and now.

President Kennedy defined patriotism in a new and inspiring way. His was a patriotism that called on us to mobilize and make America better. To me, John F. Kennedy embodied a nation of hope and confidence—the hope that America would continue to overcome whatever challenges might come our way, and the confidence that no matter what the obstacles, we would succeed. Seeing the young and active president in person, I did not need any more persuading. I bought in and I wanted to be a part of it. Despite the dark sky and drizzle, the morning of November 22nd could not have been brighter for me and my wife-to-be.

After the speech, I took Jeanne back to TCU, and I went to class. I left the campus at 11:55 a.m. and met a friend at his apartment for lunch. We made ourselves sandwiches, poured a couple beers, and turned on the television. Then we heard the news. As Walter Cronkite told the world about President Kennedy's assassination in Dallas, a short drive away, we sat in shocked disbelief. The tragic news would end America's age of unbounded optimism.

WHEN PUBLIC SCHOOLS WERE GOOD

Looking back, it is easy to understand why I believed so fervently in America's future. On that morning, no goal seemed beyond our ambition. The only limit to achievement was our national will and will was in plentiful supply. After all, we had survived the Great Depression, won World War II, and spearheaded the noblest example of a post-war peace plan in history.

Manufacturing, technology, global trade, and the rise of the American middle class had created the largest and most powerful economy in the world.

For families in the American suburbs, the 1950s and early 1960s were prosperous decades. Middle-class households were on a definite upswing, and each year seemed better than the year before. College educations were affordable, and well-paying jobs were plentiful. Our dads could earn good livings as gas station or grocery store owners, as bankers or bookkeepers, as auto or steelworkers, and as teachers, firemen or policemen. Households could manage on a single income, so moms were able stay home to rear kids. The only barrier to working was the unwillingness to work, and everybody I knew was more than willing.

Before the post-war economic boom took off, however, times were rough for millions of Americans, including my family. My father was a military veteran who served on the European front during World War II, fighting in the Normandy invasion against the Axis nations. After Daddy returned to Texas, he went to work for a federal government agency in Midland before moving us to Fort Worth to work for the U.S. Veterans Administration.

It was right after the war, so we lived with other families in temporary government housing. There were communal showers and bathrooms, and no electrical appliances. It looked like a military camp without the soldiers and barbed wire. The rundown military barracks lost their roofs during fierce windstorms, and I still can remember Daddy trying to hold on to the ceiling during one of those storms. We did not consider ourselves poor. This was just the way that people lived after World War II. It was almost like living out of a suitcase. It was hard on my mother, but she was used to that.

My mother, Louise Hinkel Moon, came from a hardworking and prosperous South Texas ranching family. The Hinkels were sturdy peasant stock who had emigrated two generations earlier from Germany. After a couple of moves, they settled in the early 1920s smack dab in the middle of La Salle County near Cotulla, a dusty old railroad stop and small agricultural town about 60 miles north of Laredo. Moving to La Salle County in the early 1920s meant that the Hinkels would have to live in a tent for several months while they dug a 20-feet-deep, brick-lined cistern to store rainwater. After completing the cistern, the Hinkels built a small wooden farmhouse and barn from lumber that they trucked in from Corpus Christi over 150 miles away. Life was not easy for the Hinkels.

During the 1920s and 1930s, the Hinkels eked out a living as ranchers raising cattle, chickens, goats, and hogs. It was tough, but they survived the Great Depression years with a lot of hard work, even adding two more sections to the original family homestead. My mother, the first in her family to go to college, graduated from Southwest Texas State Teachers College in San Marcos, Texas (a few years after its most famous graduate, President Lyndon B. Johnson).

When I was four years old, we moved into our first house. It was a small, wood-frame residence—all of two bedrooms, one bathroom, and 850 square feet—at the base of Seminary Hill, near the Southwestern Baptist Theological Seminary in southwest Fort Worth. I can still remember my mother sitting on her new bed and mattress, the only furniture in that empty house. She was so proud to have her own house and her very own "Hollywood" bed. In the post-war era, moving into that house was the start of our middle-class American Dream. Fifteen years later, we moved to an air-conditioned, brick house in Wedgewood, a neighborhood several notches above the old one. I still can remember the thrill of sleeping in an air-conditioned house!

My parents were not rich but their love and support were well above average. This put me and my younger brother, Bill, on equal ground with the children of the well-off who had much more money and far more privileges than the kids of a schoolteacher and a government worker from a lower-middle-class neighborhood. So, in some important ways, we were blessed with the same opportunities for upward mobility as the wealthier kids. For me and other children of modest backgrounds, education equaled opportunity.

In Fort Worth, we had plenty of public schools (B.H. Carroll Elementary, Rosemount Junior High, and Paschal High School) that prepared the willing and hardworking with the tools to take full advantage of college and beyond. In Paschal High, the rich kids bragged about going to Rice University and Ivy League schools, but there were plenty of affordable state universities and colleges for the rest of us. Any high-school graduate with a summer job or part-time job could get all the higher education they could stand, with little or no debt after graduation.

In the early 1960s, I attended TCU on what I called a "Sears & Roebuck scholarship." When I was not studying, I worked as a stock boy for minimum wage. With free room and board at my folks' home, I could earn my bachelor's and master's degrees in government with no debt.

Before going to law school, I served in the U.S. Air Force as an intelligence officer during the Cold War. I supervised the preparation of target folders on old Soviet Union military and industrial targets for our B-52 bombers. I am very proud of my service. The military took a kid from barely the right side of the railroad tracks and helped him take his first steps toward being a man.

Money in law school was a challenge, but I was fortunate to graduate from the University of Texas School of Law in two and a half years with no debt. For the cash-strapped college graduates of today, let me repeat: I earned three degrees *with no debt,* thanks to help from my wife, Jeanne, who worked as a receptionist/typist at the local paint store, and the GI Bill of Rights, which helped military veterans with education and housing costs. My tuition and books came to $150 a semester—surely the best deal in education on the planet. As much as I appreciated the boost from our government and generous taxpayers then, I appreciate it even more now, 50 years later.

CLIMBING THE GREASY POLE

After the military and law school, I spent the next 40 years building my career. For me, the path to success was not linear. With each new job, I started at the bottom. Rather than climbing a straight career ladder, it was like climbing up a greasy pole on which I would make a little progress, and then slip backwards. Every time I finally got enough feel for what I was doing, I would resume the climb upward, usually to slip back down a little before pulling myself back up. Learning to climb a greasy pole can be a great life experience if you make the climb. Luckily, I made it high enough.

In my first job out of law school, I worked as a legislative aide and later as a political campaign aide to the late Wayne Connally, former state senator, Texas lieutenant gubernatorial candidate, and younger brother of the late John Connally, former Texas governor and U.S. Treasury Secretary. Working in the wild-and-wooly Texas Legislature, and on a major statewide political campaign, provided me with practical insight into the world of politics and public policy that no academic degree can confer. Learning how things work in practice, as opposed to theory, proved an invaluable lesson in policymaking.

When Connally lost his race, I got a job as an attorney with the Internal Revenue Service in Philadelphia, Pennsylvania. As a native Texan, I was a fish out of water in Philly, but after a year and half, I landed a job as an enforcement attorney with the Securities & Exchange Commission in its Fort Worth Office. Later, I was promoted to chief enforcement attorney and then to assistant regional administrator for the Houston office.

While with the SEC, I worked on some big cases. I saw how fraud and manipulation affected the capital markets, and I saw that if you accept that kind of behavior, you are taking money from the good guys and giving it to the bad guys. If the market is left to the law of the jungle, those who cheat will beat out those who play by the rules, and instead of money being allocated based on effort and innovation, it will be allocated based on lies and deceit. Real capitalism abhors lying and cheating, but without regulations that prevent them, capitalism can degenerate into theft. As an SEC enforcement attorney, it was my job to stop lying and cheating in the capital markets. In fact, my role there remains the favorite of my career.

After working in the government, I spent three decades in private practice as a public finance lawyer and partner at law firms in Dallas, including my solo practice in 1996. In public finance, I worked with cities, states, and public agencies to raise billions of dollars in the municipal bond market to finance projects such as schools, hospitals, housing, office buildings, manufacturing plants, and college dorms. In doing municipal bond deals, I worked closely with local, state, and national-level politicians; commercial and investment bankers; auditors and accountants; Wall Street analysts; and business executives of all kinds. As a legal insider and a government regulator, I saw firsthand how power and money worked.

Deal-making has taught me how government and private business work from the inside out and how they relate to capitalism. Success in private business depends on getting an edge. Any edge in business based on effort and innovation makes capitalism work better, but any edge in business based on cheating corrupts capitalism. Speaking as a veteran of both government and private business, capitalism works best when cheating is kept to a minimum.

KEEPING THE AMERICAN DREAM ALIVE

A half-century of life experience after November 22, 1963, has sobered my thinking on many topics, but one conviction has remained constant: my belief in JFK's famous call to action to our nation, "Ask not what your country can do for you, but what you can do for your country." How could it be otherwise? America made it possible for me to lead the life of my choice. The only limit to achieving my aspirations was my ability and my industriousness. As sappy as it may sound to cynics, I have truly lived my version of the American Dream.

However, in recent years, globalization, technological innovation, and the up-and-down economy have taken their toll on our national psyche and our pocketbooks. Recessions and stock market crashes, mass layoffs of the American workforce, fierce competition from foreign companies, and other factors have led to the long and steady decline of the middle class—the driving economic force of our nation. All this makes it harder for a middle-class kid today to have the same faith in the future that my generation had in the early 1960s.

Many of today's upper-middle-class consumers and homeowners are the children of middle-income and low-income families of the 1950s and 1960s. Many of my generation took advantage of a great public education and easy accessibility to college to have successful careers that made their parents proud. Unfortunately, many of the well-paying, middle-class jobs of the post-World War II era have faded into history. Nowadays, students and workers must be smarter and better educated than ever before to get ahead. Hard work and smarts may make them good night managers at fast-food restaurants, but without good educations and specialized skills, this generation has little or no chance of landing a job capable of supporting a family while also saving for college.

Regrettably, just as college has become more critical for economic success, it has become far more expensive. Only the children of the rich can graduate without financial help from the federal government or the universities.

Children of low-income and middle-income families are losing out, and they will find themselves sinking lower on the income rung for decades to come.

A divided America in which millions have lost hope in their future would mean a country incapable of making the political changes necessary to maintain its status as an economic, political, and military superpower. In a world of American decline, American exceptionalism will only be a fading memory for those who remember a better day. Only by preserving the American Dream for all who are willing to work can America avoid economic decline and a resulting splintered political landscape.

Just a half-century after America's golden economic era, the middle class could become an endangered species—a lost economic generation. Restoring the spirit of upward mobility that is the American Dream is among America's most critical challenges for the future. We still have an opportunity to turn this around, but it will be up to us citizens to learn about the forces that are defining our present and near future, and to take the actions necessary to mitigate the effects before it is too late. Tax policy—what the level of taxes will be and who will pay them—will play a leading role in what kind of future America's middle class can expect.

CHAPTER 2

THE MIDDLE CLASS IN THE NEW ECONOMY

"It is entirely reasonable… to make the case that the collapse of the middle class and concurrent breakdown of the American Dream is the biggest story of the nation's history over the last half century."
– Lawrence R. Samuel, *The American Middle Class: A Cultural History*

Who is the Middle Class? • The Rising Cost of Rare Skills • The Ordinary and the Extraordinary • The Super Extraordinary • The Capitalists • The Iron Law of Wages • The Middle-Class Squeeze • Petitioning for Relief • A Stark Choice

WHO IS THE MIDDLE CLASS?

Since WWII, membership in the middle class in America has increasingly opened to anyone, regardless of status or social station. Money is no longer the primary thing that determines who is in—it's the only thing.

For those who wonder where they rank in terms of socioeconomic strata, here are a few broad strokes. Those in the upper-middle class have enough savings to last a year or so if the head of the household loses his or her job; live in upscale housing with modern amenities; have access to quality medical and dental care under generous health insurance programs; educate their children at private schools from K-12, possibly even through graduate school; regularly attend cultural and sporting events; take regular vacations; enjoy a comfortable retirement; and are generally well-educated.

By contrast, those in the lower middle class are generally not well-educated; typically live from paycheck to paycheck; rent marginal housing; drive junkers (or own no car); frequently rely on fast food for meals; have no savings; see doctors only in the emergency room; go to an occasional dollar movie for entertainment; enroll their children at public schools; don't pay for their children's educations beyond high school; and will struggle with a subsistence retirement.

While most members of the lower-middle class today own big-screen TVs and live in air-conditioned dwellings (luxuries that would be envied by the upper-middle class of 50 years ago), these basic amenities are not a measuring stick for contentment. We judge ourselves according to how the people around us are doing now, not how we are doing compared to people who lived centuries or even decades ago. Fortunately, any member of the lower-middle class with the ability to learn and the willingness to apply it, coupled with a fair amount of effort and good luck, can still move into the upper-middle class. In fact, any member of the lower-middle class with exceptional skill and effort (or great luck) can even become rich.

However, for the vast majority of Americans, whatever success their parents may have had no longer guarantees their children's success. Although the children of the upper-middle class will have a head start on the children of the lower-middle class due to better access to higher education and a better grubstake to start life on their own, very few are immune to failure if they do not learn to produce on their own. Mom and dad cannot fight the way through the economic jungle for them. Success for the lower-middle class is especially precarious. For the 25% or so who make anywhere from $25,000 to $50,000 a year, the loss of a job, or a streak of bad luck, could plunge them into poverty.

In economic terms, income data provides a snapshot of who is in the middle class and how much money they have. Three government agencies—the BEA, the Census, and the IRS—measure income. The BEA tracks "personal income," which includes almost all types of income, but excludes, among other things, gain or loss on the sale of assets. The Census tracks "household money income," which includes most types of income, except it excludes, among other things, both the employer contributions to social insurance programs and the social insurance benefits provided to recipients in kind, such as food stamps and those relating to health care.

The IRS tracks "adjusted gross income," which includes only those types of income that the politicians choose to tax, and which excludes, among other things, certain government transfer payments to individuals, employer contributions to pension and insurance funds, investment income retained by life insurance and pension plans, state and local bond interest, and various other types of income exempted by law. In measuring and tracing income, the BEA relies on data gathered from a wide variety of economic sources; the Census relies on data gathered through surveys of households; and the IRS relies on data obtained from tax returns.

Personal income, as tracked by the BEA, applies only to the national economy and is not broken down among households by income level. The Census and the IRS do, however, break down income among households based on income levels. Underscoring that personal income is the most comprehensive measure of income—in 2010, adjusted gross income amounted to only 65% of personal income, and household money income amounted to only 66% on a *per capita* basis of personal income. For tax purposes, the amount by which personal income exceeds adjusted gross income represents the income that the politicians have chosen not to tax (it is about one-third of what could be taxed and one-half of what is taxed).

Other government agencies, such as the CBO, Congressional committees, the OMB, and the SSA Chief Actuary, use income data compiled from the BEA, Census, and IRS in preparing their studies and reports. National averages regarding income and what it will buy in terms of a standard of living must be considered carefully—after all, what a dollar will buy in small-town America differs dramatically from what it will buy in the Big Apple. Therefore, statistics regarding income based on data from the BEA, the Census, and the IRS should not be taken as anything other than reasonable approximations of reality.

Census data breaks down annual income among households (which may include one or more individuals) as shown in Table II-1. Tables II-1 through II-4 show that about 20-25% of all Americans live in or close to poverty and less than 5% make up the upper-middle class and above, leaving the other 75% or so falling somewhere in between.

Table II-1 Total Money Income by Household – 2012		
Annual Income	Households*	%age
Under $5,000	4,204	3.43%
$5,000 to $9,999	4,729	3.86%
$10,000 to $14,999	6,982	5.70%
$15,000 to $19,999	7,157	5.84%
$20,000 to $24,999	7,131	5.82%
$25,000 to $29,999	6,740	5.50%
$30,000 to $34,999	6,354	5.19%
$35,000 to $39,999	5,832	4.76%
$40,000 to $44,999	5,547	4.53%
$45,000 to $49,999	5,254	4.29%
$50,000 to $54,999	5,102	4.17%
$55,000 to $59,999	4,256	3.48%
$60,000 to $64,999	4,356	3.56%
$65,000 to $69,999	3,949	3.22%
$70,000 to $74,999	3,756	3.07%
$75,000 to $79,999	3,414	2.79%
$80,000 to $84,999	3,326	2.72%
$85,000 to $89,999	2,643	2.16%
$90,000 to $94,999	2,678	2.19%
$95,000 to $99,999	2,223	1.82%
$100,000 to $104,999	2,606	2.13%
$105,000 to $109,999	1,838	1.50%
$110,000 to $114,999	1,986	1.62%
$115,000 to $119,999	1,464	1.20%
$120,000 to $124,999	1,596	1.30%
$125,000 to $129,999	1,327	1.08%
$130,000 to $134,999	1,253	1.02%
$135,000 to $139,999	1,140	0.93%
$140,000 to $144,999	1,119	0.91%
$145,000 to $149,999	920	0.75%
$150,000 to $154,999	1,143	0.93%
$155,000 to $159,999	805	0.66%

$160,000 to $164,999	731	0.60%
$165,000 to $169,999	575	0.47%
$170,000 to $174,999	616	0.50%
$175,000 to $179,999	570	0.47%
$180,000 to $184,999	502	0.41%
$185,000 to $189,999	364	0.30%
$190,000 to $194,999	432	0.35%
$195,000 to $199,999	378	0.31%
$200,000 and over	5,460	4.46%
Total	122,459	100.00%
Median Income – $51,017		
Source: U.S. Census Bureau, Current Population Survey, 2013 Annual Social and Economic Supplement.		
* Numbers in thousands.		

IRS data breaks down Adjusted Gross Income (AGI), among taxpayers, as shown in Table II-2.

Table II-2
Size of Adjusted Gross Income (AGI)*, Number of Tax Returns, % of Total Taxpayers, and Average AGI – Tax Year 2011**

Size of Adjusted Gross Income, Tax Year 2011	Number of Returns	% of Total	Average
All returns	**145,370,240**	**100.00%**	**$57,606**
No adjusted gross income	2,450,924	1.70%	$0
$1 under $5,000	10,692,838	7.40%	$2,574
$5,000 under $10,000	12,386,716	8.50%	$7,611
$10,000 under $15,000	12,925,831	8.90%	$12,490
$15,000 under $20,000	11,880,059	8.20%	$17,422
$20,000 under $25,000	10,210,706	7.00%	$22,445
$25,000 under $30,000	8,987,613	6.20%	$27,423
$30,000 under $40,000	14,520,079	10.00%	$34,784
$40,000 under $50,000	10,983,973	7.60%	$44,767
$50,000 under $75,000	18,949,278	13.00%	$61,523
$75,000 under $100,000	11,926,401	8.20%	$86,498

$100,000 under $200,000	14,755,766	10.20%	$134,009
$200,000 under $500,000	3,801,641	2.60%	$284,333
$500,000 under $1,000,000	597,525	0.40%	$675,429
$1,000,000 under $1,500,000	134,907	0.10%	$1,208,949
$1,500,000 under $2,000,000	55,986	>.5%	$1,719,779
$2,000,000 under $5,000,000	79,363	0.10%	$2,974,631
$5,000,000 under $10,000,000	19,189	>.5%	$6,814,506
$10,000,000 or more	11,445	>.5%	$28,102,760
Source: IRS, Statistics of Income Division, July 2013.			
* AGI is a broad measure of income but excludes among other types of income: tax-exempt interest on bonds, employer fringe benefits, and Medicare, Medicaid, food stamp, and other similar types of benefits.			
** Includes returns with two earners.			

Census data measures poverty as shown in Table II-3.

Table II-3 Poverty Income Levels for Individuals and Households – 2011		
Unrelated Individuals	Underage 65	$11,702.00
	Aged 65 or older	$10,788.00
Families of 2 people	Householder under 65	$15,139.00
	Householder aged 65 or older	$13,609.00
Families of 3 people or more	3 people	$17,916.00
	4 people	$23,021.00
	5 people	$27,251.00
	6 people	$30,847.00
	7 people	$35,085.00
	8 people	$39,064.00
	9 people or more	$46,572.00
SOURCE: U.S. Bureau of the Census, Current Population Survey, Annual Social and Economic Supplements.		

Table II-4 compares Census data and IRS data by selected income group.

Table II-4 **Comparison of Census and IRS Income Data By Income Group**		
Annual Income	Census	IRS
$0 to $24,999	24.66%	41.70%
$25,000 to $49,999	24.28%	23.80%
$50,000 to $74,999	17.49%	13.00%
$75,000 to $99,999	11.66%	8.20%
$100,000 to $199,999	17.45%	10.20%
$200,000 and over	4.46%	3.01%
Source: Extracted from Tables II-1 and II-2.		

Sifting through this data, the median annual income nationally for a family of four is somewhere around $55,000, and the poverty level is about $23,000. These income and poverty numbers vary significantly depending on location. Families who earn a median wage live on a tight budget and do not have much, if any, savings. In fact, the loss of a job can send a median-wage family into poverty within a few months or less. Therefore, for most median-wage families, chronic economic insecurity and anxiety are just a normal part of life.

A growing middle class offers hope for those who have not made it there to get in—and makes those who are already there feel more secure. Both this hope and the feeling of security contribute to a healthy set of political beliefs, which is at the core of a society's internal strength. However, with two generations of growing national wealth accompanied by increasing income inequality, many low-income Americans are losing hope. Unfortunately, the road to the American Dream is narrowing.

THE RISING COST OF RARE SKILLS

In the early 1960s, a high-school graduate could make a decent living selling American-made TVs at Sears. Today, that same high-school graduate can barely earn a minimum wage selling foreign-made TVs at Best Buy. The causes for the widening income gap are complex but come down to the convergence of well-documented forces: globalization, technological innovation, the increasing cost of education and healthcare, and stagnating wages.

Beginning in the 1970s and continuing at an accelerating rate, many of the jobs and small businesses that made and preserved the middle class have faded into history, never to return. The new jobs and new types of businesses that succeeded them have created a new economy that disfavors the ordinary, favors the extraordinary, and richly rewards capital. During this same period, commerce also expanded from being predominantly regional and national to becoming predominantly national and international. American capital now roams all over the world and can be invested in almost any business anywhere that offers the highest return. For example, a 15% return on a manufacturing business in Communist China's Shanghai beats an 8% return on an apartment building in Dallas.

With globalization, almost all goods and services produced by American businesses compete with those produced by businesses all over the world. To win this competition, American workers and businesses must compete with an intensity not known before. At the same time, digitization and automation have eliminated millions of jobs of ordinary workers engaged in activities relating to the processing, analysis, and transmission of information, as has the robotization of manufacturing and assembly line work.

While entrepreneurship is alive and well in America, most workers displaced by globalization and technology cannot reasonably be expected to transition into running a profitable small business. Not everyone is an entrepreneur. Once upon a time, ordinary entrepreneurial Americans could start up and make work any number of viable small businesses like cafes, barbershops, TV repair shops, gas stations, bookkeeping firms, corner grocery stores, used car dealerships, local real estate brokerage firms, hardware stores, bakeries, and other similar types of businesses. However, the competitive landscape has changed dramatically as big business, big-box stores, national chains, and international business organizations have forced many small businesses out of business.

Today, each ordinary job and small business that becomes obsolete leaves those who are displaced with the choice of either getting an extraordinary skill or joining a growing pool of ordinary workers who compete for fewer and fewer ordinary jobs—a downward spiral. As politicians and policymakers ponder solutions to these complex problems, individuals who want to stay in the middle class might focus on one thing they can control: getting a rare skill.

A rare skill does not mean a skill required to become a brain surgeon or an astronaut, but it does mean getting trained for a job that cannot be automated, outsourced, or off-shored. Unfortunately, the cost of getting a rare skill has been increasing. Table II-5 shows that since at least 1982, the cost of post-secondary education at colleges and universities has increased much more than other categories that make up the total cost of living.

Table II-5
Current Year 2011
Increases in the Consumer Price Index for Various Categories of Expenditures Since 1982-1984
(1982-84=100)

All Expenditures	Food and Beverages	Housing	Transportation	Medical Care	College Tuition and Fees
225.672	231.130	220.193	208.585	405.629	691.768

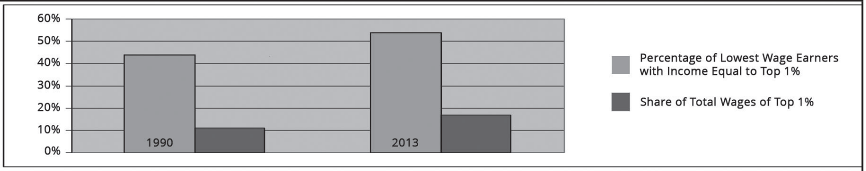
Source: U. S. Bureau of Labor Statistics, CPI Detailed Report-December 2011, Table 3. Consumer Price Index for all Urban Consumers.

From 1984 to 2011, the overall Consumer Price Index doubled while the costs of college more than tripled, making college far less affordable now than it was a generation ago. So, just as ordinary workers have come under more pressure to get extraordinary skills, the cost of getting those skills has risen **at least three times faster** than their income.

As the cost of education continues to soar, wages for most workers have been largely static, or falling, for over a generation. In the new post-1980 American economy, workers possessing rare skills prized by labor markets have been steadily widening their wage advantage over ordinary workers. An increase in the wages of the relatively few extraordinary workers raises the average wage while static and falling wages of the many ordinary workers depresses the median wage (50% of all workers earn more than the median wage, and 50% earn less), and the resulting gap reflects the disparity between the relative values of rare skills compared with common skills.

Graph II-1 shows how steady the trend of the median wage lagging the average wage has been over the last 23 years.

Graph II-1
Average Wage and Median Comparison



Source: Data extracted from Table II-6, below.

The greater the spread between the average wage and the median wage the less prized the ordinary workers become. To appreciate the difference between the average wage and median wage, imagine three workers: a CEO who makes $2 million per year, and two employees, one who makes $25,000 per year, and the other who makes $15,000 per year. Here, the average wage is $680,000, the median wage is only $25,000. Statistics can both reveal and mislead, depending on the care devoted to understanding them.

Labor markets, like capital markets, ruthlessly reward return. In the economy of the 21st century, American workers compete with workers all over the world. Being an American does not entitle the worker to a higher wage than a competing foreign worker. Since business and sentimentality do not mix, foreign workers with better skills will get work that American workers will not get. So, many non-competitive American workers will lose out in the contest for better jobs. This leads to a more crowded low-skill labor market that further depresses the median wage.

Table II-6 tracks the spread between the median wage of all wage earners and the average wage of all wage earners. As Table II-6 shows, from 1990 through 2013, the average wage increased by 113.31% while the median wage increased by only 93.3%, and the ratio of the median to the average wage fell from 71.88% to 65.13%.

Table II-6

Average and Median Amounts of Net Compensation*

	Average Net Compensation			Median Net Compensation **			
		Change			Change		
Year	Amount	Annual	Cumulative	Amount	Annual	Cumulative	Ratio of Median to Average
1990	$20,172	NA	NA	$14,499	NA	NA	71.88%
1991	$20,924	3.73%	3.73%	$15,076	3.98%	3.98%	72.05%
1992	$22,002	5.15%	9.07%	$15,610	3.55%	7.67%	70.95%
1993	$22,191	0.86%	10.01%	$15,691	0.52%	8.22%	70.71%
1994	$22,787	2.68%	12.96%	$16,118	2.72%	11.17%	70.73%
1995	$23,700	4.01%	17.49%	$16,650	3.30%	14.84%	70.25%
1996	$24,859	4.89%	23.24%	$17,403	4.52%	20.03%	70.01%
1997	$26,310	5.84%	30.43%	$18,277	5.02%	26.06%	69.47%
1998	$27,687	5.23%	37.25%	$19,157	4.82%	32.13%	69.19%
1999	$29,230	5.57%	44.90%	$20,102	4.93%	38.65%	68.77%
2000	$30,846	5.53%	52.92%	$20,957	4.25%	44.55%	67.94%
2001	$31,582	2.39%	56.56%	$21,767	3.87%	50.13%	68.92%
2002	$31,899	1.00%	58.13%	$22,153	1.77%	52.79%	69.45%
2003	$32,678	2.45%	62.00%	$22,577	1.91%	55.72%	69.09%
2004	$34,198	4.65%	69.53%	$23,356	3.45%	61.09%	68.30%
2005	$35,449	3.66%	75.73%	$23,962	2.60%	65.27%	67.60%
2006	$37,078	4.60%	83.81%	$24,892	3.88%	71.68%	67.13%
2007	$38,761	4.54%	92.15%	$25,737	3.40%	77.51%	66.40%
2008	$39,653	2.30%	96.57%	$26,514	3.02%	82.87%	66.87%
2009	$39,055	-1.51%	93.61%	$26,261	-0.96%	81.13%	67.24%
2010***	$39,959	2.32%	98.09%	$26,364	0.39%	81.83%	65.98%
2011	$41,211	3.13%	104.30%	$26,965	2.28%	85.99%	65.43%
2012	$42,498	3.12%	110.68%	$27,519	2.05%	89.80%	64.75%
2013	$43,041	1.28%	113.37%	$28,031	1.86%	93.33%	65.13%

Source: Obtained from the Social Security Website at "http://wwwsocialsecurity.gov/OACT/COLA/central.html" dated April 7, 2015.

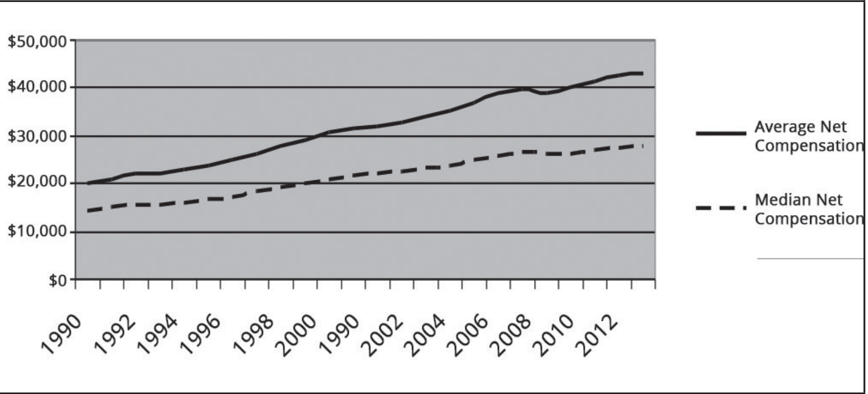
Notes:

* As indicated in the explanation of the determination of the national average wage index (AWI), the latest annual change in the "raw" average wages is applied to the last AWI to obtain the next one. Such raw average wages are the average amounts of net compensation (as distinct from total employee compensation) listed in the table. An average is just one measure of central tendency for any set of data. Another measure is the median. For our wage data, the median wage (or net compensation) is the wage "in the middle." That is, half of the workers earned below this level. The table below shows that the median wage is substantially less than the average wage. The reason for the difference is that the distribution of workers by wage level is highly skewed.

** Median net compensation is estimated.
*** %age change in average compensation for 2010 is different from the %age change in the AWI due to improvements in the data edits we made for the AWI calculation.

Graph II-2 shows the extent to which the median income of wage earners fell behind the average wage earners during the period between 1990 and 2013.

Graph II-2 Comparison of the Median Wages and Average Wages of Workers from 1990 through 2013



Source: Data extracted from Table II-6.

The data contained in Tables II-1 through II-6 shows that high incomes are intensely concentrated in a very few with the overwhelming majority having much less. According to the SSA Chief Actuary, in 2013 about 67% of wage earners earned less than the average wage of $43,000, and only about 1% of wage earners earned wages of $200,000 or more.

Few Americans know that the top 1% of wage earners earn as much wage income as the lowest 54% of all wage earners combined. Over the 23-year period from 1990 through 2013, extraordinary wage earners put substantially more distance between themselves and ordinary workers in terms of share of total wages, and nothing on the horizon indicates any change in this trend. The lesson for those who want to make more money: learn a rare skill prized by the market, stay current in that skill, and work harder for a lower wage than competitors all over the world.

THE ORDINARY AND THE EXTRAORDINARY

Being average or below average in the amount of wages earned, not having any significant wealth, and being part of a group comprising over two-thirds of all wage earners, qualifies a person as being ordinary in their moneymaking and wealth accumulation ability. In the moneymaking and wealth accumulation aspect of life, most people are ordinary or everyone would have an exceptional income and be wealthy. Almost all the ordinary live paycheck to paycheck and accumulate no significant wealth.

Moneymaking ability, however, is only one aspect of life and ignores other aspects like character and how one gets along with others. For most Americans, once they have a decent standard of living and the ability to realize their potential, then quality of life matters more than accumulating more money. Many (although not all) Americans are willing to get the best job they can, but they would rather spend their non-working time with their families or in recreation than running a payroll. The ordinary are not consumed with getting the next promotion so much as with getting by in a job that pays the bills and offers some hope for the future, so long as they remain willing to work. Taking all of this into account, it is the ordinary who are the backbone of the middle class.

Meet the Middleton Family

Generalities about how the middle class live based on statistics are one thing, but the tough daily choices a middle-class family must make about money are quite another. No family typifies the middle class better than a family of four with a husband and wife who both work full-time, who have two preschoolers, and whose $65,000 annual income matches the median income for a household of four in their community. Consider such a family, the Middletons, who live in Dallas, Texas. The family includes Joe, a commuter college and trade school-educated computer IT tech in his mid-30s, his wife, Sue, a high-school graduate in her early 30s with an associate's degree from a community college, their four-year-old son, Joey, and their two-year-old daughter, Suzy.

The Middletons live in a 1,850 square-foot house whose value is about 90% of the median value of a house in Dallas. Joe drives a five-year-old SUV, and Sue drives a four-year-old compact car. Sue sets the thermostat at 68 in the winter and 80 in the summer. The family buys their groceries and clothes at

Walmart, the local dollar store, and garage sales. They get health insurance through Joe's job. The family gets their childcare, when they can afford it, from a preschool at their church. When they cannot afford the church preschool, they rely on help from a neighbor or relatives. The Middletons watch TV for entertainment. On rare occasions, the family goes to the movies and eats out at modest restaurants for hamburgers and Tex-Mex. For recreation, Joe plays softball and basketball on his church's team and Sue gardens. The family vacations once a year at Joe's parents' lake cabin.

The Middletons have no savings account and live paycheck to paycheck. Joe and Sue religiously pay their bills on time if they possibly can but maintain a credit card with a $2,500 credit line for emergencies. Their monthly budget in the following chart shows how tough it is to make ends meet before they pay taxes.

Table II-7
Middleton Family Monthly Budget Based on A $65,000 Annual Income[1]

Monthly Pre-Tax Income			**$5,417**
Expenses			
Non-Discretionary Monthly Expenses			
Food and Clothing			$900
Child Care[2]			$1,000
Housing[3]			$1,250
Transportation[4]			$900
Health Care[5]			$1,250
Total Non-Discretionary Monthly Expenses			**$5,300**
Monthly Pre-Tax Income after Non-Discretionary Expenses			$117
Federal Taxes			
FICA Tax[8]		$414	
Income Tax[9]		$326	
Total Tax		**$740**	
Shortfall of Monthly Pre-Tax Income to Cover Federal Taxes and Non-Discretionary Expenses			$623
Discretionary Monthly Expenses			
Emergencies[6]		$500	
Retirement Savings[7]		$400	

Savings for Children's Higher Education		$500	
Entertainment		$400	
Total Discretionary Monthly Expenses		$1,800	
Shortfall of Monthly After-Tax Income to Cover Discretionary Expenses			**$2,423**
Notes:			
(1) An estimated budget for a middle-class family of four in Dallas, Texas-based on U. S. Census Data estimating $65,000 as the pre-tax median income for a household of four in Dallas, Texas.			
(2) Assumes childcare costs of $500 per child per month.			
(3) Assumes a house with a value of 90% of the median value of a house in Dallas, Texas, with a mortgage payment based on a 30-year mortgage at 4% and includes property taxes, utilities and homeowners' insurance but does not include maintenance.			
(4) Assumes two compact cars and includes amortization, fuel, maintenance expenses, and insurance.			
(5) Includes the cost of a group health insurance plan and does not include the costs of non-reimbursed medical and dental costs.			
(6) Assumes a rainy-day fund in the amount of 5% of adjusted monthly income.			
(7) Assumes contributions to a tax-advantaged retirement program.			
(8) The Federal Insurance Contributions Act (FICA) tax is a 15.3% payroll tax assessed against gross wages of which 12.4% pays for Social Security and 2.9% pays for Medicare. The employer and employee each pay 50% of the tax resulting in the Middleton's share being $4,973.			
(9) Assumes the Middletons took the standard deduction and participated in an employer-sponsored childcare deduction program.			

If they are careful, the Middletons can make do from month to month. That is, until someone in the family must see the doctor or dentist, one of the cars breaks down, a washing machine or A/C needs fixing, or some similar woe arises. If the Middletons are beset by too many woes, they must resort to a skip, scrimp, and borrow strategy. Skipping means doing without, like taking their kids out of daycare, depending on neighbors and relatives, and not going to the doctor or dentist when someone is sick. Scrimping means eating more rice, potatoes, and beans, not eating out or going to any movies, and getting whatever clothes they have to have at garage sales. Borrowing means dipping into their credit card line. Each of these strategies carries a cost and inflicts instant and sometimes lasting pain.

If things go well, the Middletons can barely stay in the middle class, but if they encounter a little bad luck, they will fall to the lower edge of the middle class. If Joe or Sue were to lose a job and not replace it within a month or two, the Middletons would face the loss of their house and become dependent on food stamps, relatives, and charity. In fact, any minor catastrophe could propel the Middletons into instant poverty.

Note that the Middletons are not poor. They are in the middle of the middle class. However, given their incomes and the cost of living, Joe and Sue can only fantasize about including in their regular budget amounts for emergencies, entertainment, and savings for retirement and college. Even before paying any taxes, the Middletons can make ends meet only by making scrimping a way of life.

To pay their taxes, the Middletons must up their scrimping game a few notches. Every tax dollar paid by the Middletons means that, among other things, they eat more beans and rice, depend more on their neighbors and relatives for child care, go without seeing the doctor when they are sick, have no hope of saving for their retirement or their kids' college, and make do without repairing the A/C in the summer for weeks at a time. Serious scrimping and some skipping come at a high price in family stress over money, which pushes many couples toward divorce.

In terms of moneymaking and wealth accumulation ability, Joe and Sue are as ordinary as vanilla ice cream. Each works hard but at the end of the day, each goes home and leads a normal family life enjoying both recreation and social relationships ahead of plotting how to get ahead at work. However, if Joe and Sue could consider the future, they would see that their children have the potential to be extraordinary if they can get the proper education. Talent and drive, like other personal traits, often skip a generation or two. In most families, it is not unusual for the ordinary to sire and rear the extraordinary, and conversely, for the extraordinary to sire and rear the ordinary.

Displaced Workers

Ordinary workers now live with the risk of becoming displaced workers, which the BLS defines as "persons 20 years of age and older who lost or left jobs because their plant or company closed or moved, there was insufficient work for them to do, or their position or shift was abolished." Workers have always been at risk of displacement because of the failure of an individual business or an economic recession, but as never before, the access to cheap foreign labor and the ability to substitute robots and computer programs for labor now cause much of displacement. Any worker whose work can be done by cheap foreign labor or whose work can be automated now lives under a growing threat of displacement.

On August 25, 2016, the BLS reported (for the period January 2011 to December 2013) the following facts:

- 7.44 million workers were displaced of which 3.2 million were long-tenured in that they had held the jobs for at least three years and 4.2 million were short-tenured in that they had held their jobs for less than three years.

- As shown in Table 8, 33.5% of all displaced workers were either unemployed or not in the labor force in January 2016.

- As shown in Table 7, only 16% of all long-tenured displaced workers were earning wages or salaries equal to or above the jobs from which they were displaced.

- As shown in Table 8, workers were displaced in all sectors of the economy with the most affected sectors being in manufacturing, wholesale and retail trade, and professional and business services.

For many workers, being displaced means not getting a job, or getting a job at lower wages than their prior job. Neither Joe Middleton, as an IT tech under the professional and business category, nor Sue Middleton, as a clerk under the wholesale and retail trade category, can take much comfort from the BLS report. They each know that they are at risk of losing their jobs, and if they do, may go quite a while before getting another job and maybe never getting another job that pays as well as the jobs they lost.

Put in its simplest form: Globalization + Automation = Increased Worker Anxiety.

In today's workplace, simply working hard can still cut it for ordinary workers, but it is not nearly enough to be extraordinary. What separates most extraordinary workers from ordinary workers is personal drive and ambition. The extraordinary lead the middle class and are the exemplars of what it takes to get ahead.

To be extraordinary, a worker must consistently make above-average wages and be willing to do whatever is necessary to learn more to get ahead in whatever work they do—as with a salesman who wants to become sales manager, a bank clerk who wants to become branch manager, a chef who wants to own his own restaurant, a lawn care worker who wants to own his own lawn care business, a teacher who wants to become a principal, and many other similar examples. For those who want to get ahead, they must work harder and smarter than those around them and continuously learn new skills, almost always at the cost of their personal lives and family time.

In terms of income, the extraordinary earn above-average wages (over $43,000) but less than that which those in the top 1% earn (about $300,000 or more). Unlike the ordinary, the extraordinary can accumulate a little wealth, usually no more than about $100,000, primarily tied up in home equity. The more upwardly mobile have some mutual funds and some money for retirement saved in a 401k as well. Having a little wealth provides the extraordinary with a cushion if they face an emergency, so long as the emergency is not too serious and does not last too long.

While the moneymaking trajectory of the ordinary is at best flat, that of the extraordinary tilts slightly upward. All in all, the extraordinary are better off financially than the ordinary, but few can have a middle-class standard of living, pay for their own unsubsidized health care and retirement, and pay for their children's post-secondary education. Even the extraordinary depend on government subsidies for more than a little of their health care and retirement and for the post-secondary education of their children.

THE SUPER EXTRAORDINARY

Paraphrasing F. Scott Fitzgerald's observation about what separates the rich from everyone else, the "super extraordinary" are just like everyone else except they have more money, in fact much, much more money than the rest of us. But, apart from their moneymaking ability, the super extraordinary share most of the same human foibles that afflict everyone else.

The super extraordinary include: (1) those with a special knack for making money like successful entrepreneurs and businessmen; (2) those who clawed their way into becoming big-time professionals, such as very successful lawyers, doctors, and architects; (3) those who used their inherited and acquired talent to succeed as entertainers, athletes, or media personalities; (3) those who have acquired and employed rare skills that enable them to consistently earn wages somewhere in or near the top 1% (about $350 thousand in 2012 dollars); and (4) those who won life's lottery by either being born into wealth or winning the sweepstakes.

Unlike the ordinary and some extraordinary who suffer from chronic economic insecurity and anxiety, the super extraordinary do not. But like everyone else, they do suffer from the same non-economic insecurities and anxieties that plague the rest of humanity. What does distinguish the super extraordinary from everyone else is their exceptional self-motivation and ambition awarded to them by their genes and enhanced, in many instances, by an encouraging environment. These traits, when fused with imagination, ingenuity, intellect, effort, persistence, and talent, account for why the super extraordinary are the motive force that drives America's economy.

Without the super extraordinary, America would not be America—a land where any person can soar as economically high as their talent, effort, and luck take them. Consistent with the principles of capitalism and democracy, nothing should be done to deter the super extraordinary from being as productive as their ability permits and reaping the financial rewards commensurate with their achievement. All others do better when the super extraordinary do best.

The ability of those with talent to rise from rags-to-riches is a core American value memorialized by the 19th Century novelist, Horatio Alger. Although Alger's many melodramatic tales of poor, yet industrious lads, making it to the top through hard work and persistence seem corny now, they still reflect what makes America great. Anyone of merit can make it.

But times have changed. About 30 years ago, the path of those who had all that was necessary to become economically super extraordinary (except skills only obtainable in post-secondary education) began to seriously narrow. With the developments in technology and globalization of markets, the path to becoming super extraordinary without a quality post-secondary education has narrowed considerably and is likely to narrow further.

In making money, one ascends from the mere extraordinary to the super extraordinary by making and/or accumulating much, much more money than the extraordinary. If making an above-average income qualifies one as extraordinary, then making an income in the top 1% should qualify one as super extraordinary. And, if having an investment portfolio worth in the range of $100-200 thousand qualifies one as extraordinary, then having a portfolio worth at least $3-$4 million (in about the top 1%) qualifies one as super extraordinary.

THE CAPITALISTS

Making a super extraordinary wage is great, but having a super extraordinary income without wages is even better. Having wealth, as opposed to merely having income, makes a person a capitalist. Except for wealth that is inherited or won in the lottery, most wealth comes from success in business as a result of shrewd investing (Warren Buffet who invests in companies of all kinds all over); cleverness in the trading of assets (Carl Icahn who trades companies, Jerry Jones who trades in pipeline companies and sports franchises, T. Boone Pickens who traded in energy commodities and companies, and George Soros who trades in currencies); entrepreneurial skill (Rupert Murdoch who built a media empire, Jay Z, Beyoncé, and Madonna who have pioneered in entertainment, and Arianna Huffington who has developed online publishing); and/or building a super profitable business (Jeff Bezos at Amazon, Steve Jobs at Apple, Bill Gates at Microsoft, and Mark Zuckerberg at Facebook).

For 30-plus years, America has increasingly rewarded its most successful capitalists. Table II-8 shows the concentration of wealth in the top 1% compared with the bottom 90% in 1978 and 2012.

Table II-8
Percentage Ownership of Wealth of the Top 1% and Bottom 90% in 1978 and 2012

	Bottom 90%	Top 1%
1978	33.2%	22.9%
2012	22.8%	41.8%
Change	**-31.3%**	**+82.5%**

Source: Data extracted from S&Z Study, Appendix, Table B1

As Table II-8 shows, the last 34 years have been generous to America's capitalists relative to everyone else. In 1978, the bottom 90% owned about a third more wealth than the top 1%, but by 2012, the top 1% owned almost twice as much wealth as the bottom 90%. The economic health of America's capitalists is not at risk, but the economic health of millions of ordinary Americans is.

The super extraordinary, America's top earners of labor income, and the capitalists, as America's top earners of capital income, lead the way in making America's economy productive, and in financing business growth. Without the super extraordinary and the capitalists, the ordinary and extraordinary would have fewer jobs and less income. However, as important as the super extraordinary and capitalists are to the American economy, they should be mindful that without the ordinary and the extraordinary there would be too few consumers and an inadequate workforce to make America's economy work. Another humbling fact is that many of the antecedents of the super extraordinary and capitalists were (and many of their descendants will be) ordinary.

THE IRON LAW OF WAGES

Joe and Sue Middleton have never heard of The Iron Law of Wages, yet it has imprisoned their standard of living for an indeterminate sentence. The Iron Law of Wages dictates that wages will be driven down to a subsistence level if the pool of available labor exceeds the demand (see classical economists, Adam Smith, and David Ricardo.) The twin forces of globalization and technological innovation have conspired to cut the demand for workers in that segment of the American labor market that applies to most workers with ordinary skills, while at the same time, inundating the market with more competing foreign workers and robots. Nothing hints at these forces losing their potency.

Since the end of World War II, America has promoted free trade by entering into numerous international agreements. Promoting free trade has led to the American economy being flooded with goods produced by foreign labor which has made winners of American capitalists and American consumers at the cost of making losers out of many displaced workers lacking extraordinary skills. About a generation ago, American manufacturers started taking advantage of an ocean awash with cheap foreign labor, and moved their factories overseas. At about the same time, China and other Asian countries also rapidly developed their own manufacturing capacity based on the same seemingly limitless supply of cheap labor. These shifts cut millions of American manufacturing jobs, which had been filled by median-wage workers and left them to compete with low-wage workers in the low-skill labor market.

According to BLS data, there were almost 18 million manufacturing workers in 1967. By late 2011, there were fewer than 12 million. Not only were manufacturing jobs hit hard by technology and globalization, but many median-wage American service jobs were also cut. The internet has made it possible for any information or knowledge business to locate anywhere in the world. Many of these businesses have had no trouble finding low-wage skilled labor among foreign workers. (Consider the location of the call center that fixes your computer software problem or the location of the radiologist who interprets your X-ray.)

Although The Iron Law of Wages drives wages down, it also contributes to increasing business profits. Over at least the last generation, employee compensation (as a share of the GDP) has been falling, while after-tax corporate profits (as a share of the GDP) have been growing. By 2014, after-tax corporate profits (as a percentage of the GDP) had risen from about 5.2% in the 1980s to about 9.3%, representing an increase of almost 75%. Also by 2014, employee compensation (as a percentage of the GDP) has fallen from about 55.6% to about 53.2%, representing a decrease of almost 4.3%. The last generation has been kind to capital and unkind to labor.

So, Joe and Sue find themselves in a world in which technology has decreased the number of jobs available to median-wage workers while globalization has subjected both median-wage workers like Joe, and low-wage workers like Sue, to intense competition from comparably skilled workers all over the world. As a computer IT tech, there is nothing that Joe knows and nothing that he can do that is not known or could not be done over the internet by foreign workers in more than a dozen countries. There are plenty of skilled IT techs in China, India, the Philippines, Taiwan, Korea, etc. who can do what Joe does, and do it more cheaply.

Furthermore, a growing glut of able workers willing to work for less guarantees that Sue's wages will stagnate, and she will be lucky to keep her job as a clerk. In fact, much of Sue's competition for her job used to work in higher paying jobs like Joe's, because they have been displaced by foreign workers.

As long as surplus workers are available to Joe's and Sue's employers, The Iron Law of Wages ordains that Joe and Sue will be paid the least possible and their employers will pocket the difference. Such is the free market at work, and its continuation is inevitable.

CBO data bears out the effects of The Iron Law of Wages on workers with less than extraordinary skills, as shown in Table II-9.

Table II-9
Percentage Share of Pre-Tax Income by Quintile (Lower to Higher) with the Highest Quintile by Percentile
For the Period 1979-2009

Year	Lowest Quintile	Second Quintile	Middle Quintile	Fourth Quintile	81st – 90th %iles	91st – 95th %iles	96th – 99th %iles	Top 1 %
1979	6.2	11.2	15.8	22.0	15.0	9.7	11.3	8.9
1980	6.2	11.1	15.8	22.1	15.1	9.8	11.4	8.8
1981	5.9	11.0	15.9	22.1	15.3	9.9	11.5	8.9
1982	5.7	10.7	15.7	22.1	15.4	10.0	11.5	9.4
1983	5.4	10.4	15.5	22.1	15.4	10.0	11.7	10.1
1984	5.5	10.4	15.4	22.0	15.2	9.9	11.6	10.5
1985	5.3	10.2	15.2	21.8	15.2	9.9	11.8	11.2
1986	5.0	9.8	14.7	21.1	14.7	9.8	12.0	13.7
1987	4.9	10.1	15.3	22.0	15.3	10.0	12.0	11.0
1988	4.7	9.9	14.9	21.4	15.0	9.8	11.9	13.1
1989	4.9	10.0	15.0	21.5	15.1	9.9	12.1	12.2
1990	5.2	10.2	15.0	21.5	15.0	9.9	12.0	11.9
1991	5.4	10.3	15.4	21.6	15.1	10.0	12.1	11.0
1992	5.1	10.1	15.1	21.3	15.0	10.0	12.2	12.0
1993	5.3	10.2	15.1	21.4	15.0	10.0	12.2	11.6
1994	5.1	10.2	15.2	21.5	15.0	10.0	12.1	11.7
1995	5.3	10.2	15.0	21.1	14.8	10.0	12.3	12.2
1996	5.0	9.9	14.6	20.7	14.7	9.9	12.4	13.4
1997	4.9	9.7	14.3	20.2	14.6	9.9	12.5	14.5
1998	4.9	9.5	14.1	20.0	14.4	9.8	12.5	15.3
1999	4.8	9.3	13.8	19.7	14.2	9.7	12.8	16.3
2000	4.6	9.0	13.5	19.5	14.1	9.7	12.7	17.4

2001	4.9	9.6	14.2	20.6	14.6	9.9	12.5	14.4
2002	5.0	9.9	14.6	21.0	14.8	10.0	12.6	13.1
2003	4.9	9.7	14.4	20.7	14.8	9.9	12.5	13.8
2004	4.7	9.5	14.0	20.2	14.4	9.7	12.4	15.6
2005	4.7	9.1	13.6	19.6	13.9	9.6	12.7	17.4
2006	4.5	9.0	13.4	19.3	13.8	9.6	12.8	18.1
2007	4.8	9.0	13.3	19.1	13.7	9.5	12.7	18.7
2008	5.0	9.4	13.9	20.1	14.3	9.8	12.6	16.0
2009	5.1	9.8	14.7	21.1	14.9	10.1	12.5	13.4
Source: Data extracted from Table 3. Number of Households, Average Income, and Shares of Income for All Households, by Before-Tax Income Group, 1979 to 2007. Congressional Budget Office.								

Table II-9 shows that since at least 1979 there has been a slow but steady migration of pre-tax income to both the top 96th – 99th percentiles and the top 1 %. Outside of the top 5%, all other income groups have either barely kept up or fallen behind. Also, Graph II-1 and Table II-6 show the steady and widening gap between the average wage and the median wage, which indicates that above average-wage workers are prospering while median and low-wage workers are struggling. Stagnating and falling wages for below-average wage earners are products of The Iron Law of Wages.

Any worker who wants to escape from the effects of The Iron Law of Wages must acquire an extraordinary skill, which means a skill that is rare and in demand. To get a high paid job (one that is exempted from The Iron Law of Wages), a worker must, (1) find out what skills the labor market craves, (2) acquire and master those skills, (3) prove to a prospective employer that the worker can do the job better than any competitors, (4) do the job at a competitive wage, and (5) stay current on the evolving skills that are necessary for the worker to do the job.

THE MIDDLE-CLASS SQUEEZE

Together, the rising cost of getting rare skills and The Iron Law of Wages—forces over which ordinary workers have no control—will condemn ordinary, and increasingly extraordinary, workers to a standard of living based on static and/or declining real incomes. Only those workers who have exceptional abilities, fierce ambition, and the financial resources to get the post-secondary education needed to develop their abilities to the fullest will be able to acquire and employ extraordinary skills. Unfortunately, many American workers lack one or more of these traits, and so they are likely to spend their working lives imprisoned by The Iron Law of Wages—a natural (but sad) result of a free market. While the free market is fair, it is also brutal.

Changing an ordinary worker into a highly skilled worker requires that a worker have exceptional ability, and, unfortunately for most, exceptional ability is not an acquired trait. Most rare skills in today's labor market require high-end academic skills which in turn require exceptional IQs or some other very special trait that the market happens to crave at the moment. The rejection rate for well-above-average applicants to high-end professional and graduate schools **proves the futility of the average becoming academically exceptional.**

While America is exceptional, it is a relatively small percentage of Americans who are exceptional in their moneymaking ability. In this respect, most Americans are ordinary, and no one is more ordinary than the Middletons. As ordinary moneymakers, they face the reality that neither Joe nor Sue may ever develop extraordinary skills or become successful entrepreneurs. For America to remain exceptional, however, it must not shut out millions of ordinary, hardworking Americans, like the Middletons, from living the American Dream. For the Middletons, living the American Dream means that if they work hard at the best job they can get then they ought to have a decent standard of living, which includes adequate health care, a dignified retirement, and the ability of their children to get a quality post-secondary education without being buried in debt. Despite their willingness to work hard, the chances of the Middletons ever getting a job that will pay enough for them to live the American Dream ranges from very, very slim to none.

PETITIONING FOR RELIEF

Although the Middletons are not economists or political scientists, they are smart enough to know that there are not any simple solutions to preserving what remains to them of the American Dream. Before asking what can be done, they have been cautioned about things the government could do which would make things worse. The Middletons have come to understand that over the long term, their standard of living, and that of all ordinary workers, depends on increasing labor productivity—the per hour output of a worker. Producing more goods and services with less labor enriches the economy and producing less goods and services with more labor impoverishes the economy. Common sense says that everyone is richer if 100 widgets can be produced with 10 workers instead of 20, but it also warns that something must be done with the 10 displaced workers if there are no jobs for them. The Middletons figure that they fit into the category of the 10 displaced workers who at best have iffy job prospects.

The Middletons know that any relief from the effects of The Iron Law of Wages that impedes labor productivity sooner or later will impoverish the economy and make everyone, including them, poorer. So, the Middletons want to know how best to make their life better without making anyone else's life worse.

By just looking around, the Middletons are painfully aware that they are now in fierce competition with both foreign workers and displaced American workers, and that many ordinary workers are losing their jobs to automation. Not surprisingly, there is plenty of historical and recent examples of frightened workers trying to stop technology from killing jobs and international trade from increasing competition.

In 19th century England, at the dawn of the Industrial Revolution, Ned Ludd led a band of disgruntled home loom operators, later referred to as "Luddites," in a forlorn fight to ban the use of mechanical looms. Banning mechanical looms would have saved the home loom operators for a short while but at the cost of destroying the competitiveness of the English cloth industry. Lamentably for the Luddites, but fortunately for consumers and capitalists, Parliament ignored their plea and the Industrial Revolution trampled their cause. As a result, the world has vastly cheaper and more plentiful cloth.

More recently in America, Pat Buchanan, a populist, has championed the cause of a restrictive trade policy as means of shielding American workers from foreign competition. In the 2016 presidential campaign, Donald Trump adopted Buchanan's cause by advocating a tough trade policy that would protect American workers. Making promises to protect American workers from foreign workers is easy, but keeping those promises is hard.

Trade Agreements—most notably the North American Free Trade Association (commonly known as NAFTA)—benefit consumers who buy cheaper and better foreign-made goods and services, workers in export industries, and capitalists who own businesses who profit from outsourcing part of their businesses to foreign producers. This only harms displaced workers. Restricting international trade would require changing treaties approved by Congress under which America (1) participates in the World Trade Organization, and (2) prescribes the terms of trade with individual countries. Any effort to change these treaties in a material way would encounter the opposition of those who have benefitted from them. In a political contest testing who has the most clout about keeping relatively free trade or junking it in favor of restrictive trade, it is by no means clear that displaced workers would win against consumers, workers in export businesses, and capitalists. So, a campaign promise to get tough on trade, when put to the test, is likely to suffer the same fate as a snowman on the first warm day after snowfall.

Even if it were possible to shield American workers from cheap foreign labor, it would ease life for American workers only for a short while, and at the cost of making American industry less competitive and inviting an international trade war. In a hyper-competitive world economy, loss of an economy's edge dooms it to a slow death.

As Parliament rejected the pleas of the Luddites to throw out technology, and as Congress is likely to reject Buchananite trade restrictions, the middle class should look for practical solutions that make America's economy grow as fast as possible.

Reasoning from the premise that things must not be made worse, Joe and Sue, with the help of a public advocate, have drafted on behalf of themselves and the entire middle class, a Petition for Relief from The Iron Law of Wages to their government, and plead the following:

FACTS

- America's future depends on a thriving and growing middle class in which all working Americans can live the American Dream.

- Fundamental to the American Dream is the belief that all able-bodied Americans who work hard full time and apply themselves should have (1) an opportunity to rise as high as their talent and effort will take them, and (2) a decent standard of living, which includes a dignified retirement and adequate health care.

- In 21st Century America in which the economy is driven by globalization and technological development, opportunity is an illusion unless all Americans can get a quality post-secondary education to enable them to realize their full potential.

- For 40-plus years, middle-class workers' share in America's prosperity has dwindled while the super extraordinary and capitalists have prospered.

- The super extraordinary and capitalists have profited from lagging middle-class wages far more than any other Americans because, (1) as capitalists, their businesses have reaped greater profits, and (2) as consumers they have benefitted from lower prices. Everyone except the ordinary worker benefits from cheap labor.

- The standard of living of the middle class has lagged the super extraordinary and capitalists not because of the lack of worker effort, but, in part, because of government trade policies that have lowered the wages of the middle class, and tax policies that have taxed the return on capital at lower rates than wages.

- Over at least the last 25 years, the cost of higher education has increased three times faster than middle-class wages, thereby making post-secondary education much less affordable to the middle class and depriving many of their ability to realize their potential.

RELIEF

Ordinary workers petition the government for relief from the effects of:

- The effects of the free trade policies that have caused The Iron Law of Wages to depress their standard of living.

- The disproportionate tax cuts that have, (1) widened the after-tax income gap between them and the best-off, and (2) deprived the government of the resources necessary to invest in America.

As petitioners on behalf of the ordinary workers—the largest component of the middle class—the Middletons understand they and other ordinary workers must learn more about taxes and how they affect their lives so that they can make their case to the politicians. Even though the Middletons know little of politics, they know that for their petition to be taken seriously, its claims must be persuasive to the politicians who will decide what is to be done.

A STARK CHOICE

A dying economy will not save America's median and low-wage workers. Technology and the broadest possible global competition for labor both lead to increased labor productivity, which in turn leads to a more productive economy. But both also lead to static and declining wages and job loss for many ordinary workers. Ordinary workers who can morph into high-skilled workers, highly sought-after celebrities, entertainers, or athletes, or ingenious entrepreneurs need not be troubled over either technology or globalization. However, for those workers who are stuck with being ordinary, they should be terrified about increases in labor productivity unless something is done to protect their interests.

A generation in which the cost of post-secondary education has risen far faster than inflation, coupled with the wages of ordinary Americans remaining static or falling, has resulted in only a minuscule number of Americans now being able to afford post-secondary education on their own. Imagine the tragedy of a person who has all the talent and ambition needed to become extraordinary or super extraordinary, but they do not have the money to get a quality post-secondary education. Not only does the individual suffer, but America also suffers from losing the talent needed for its workers to compete internationally for the best paying jobs.

The Middleton family illustrates the problem. Joe and Sue aren't likely to ever find enough in their budget to both maintain a minimally middle-class standard of living and simultaneously save for their kids' college. So, if the Middletons cannot pay for educating Joey and Suzy, then either the taxpayers will pay higher taxes to invest in their education, or their talent will be wasted. Wasted talent will deprive the economy of a productive workforce and demoralize those whose talent is wasted.

The more workers who develop and use extraordinary skills, the richer America will be. The more goods and services purchased by highly paid workers, the more jobs there will be for ordinary workers, and the more the economy will grow. So, America makes no better investment in the future than to spend whatever money is necessary to make it possible for every meritorious worker to get the best skills that they can get.

With economic opportunity now becoming increasingly dependent on getting a quality post-secondary education, America must find ways to help those of talent and drive to achieve it, and the help should they regard it as an investment in talent, not as a gift.

Although the economy has changed and now simultaneously heaps ever-greater rewards on the super extraordinary and capitalists while squeezing the ordinary, America's tax system has not. In this new economy, the extraordinary need little help, and the super extraordinary and capitalists need no help under the tax laws, but the ordinary need plenty of help.

Comparing what it would mean in the daily lives of middle-class families like the very ordinary Middletons and the super extraordinary/capitalists like today's crop of billionaires to shift more of the tax burden from one to the other, demonstrates the challenge of striking the right balance between taxing the middle class on the one hand and the super extraordinary and capitalists on the other hand. Taxing the super extraordinary and capitalists too much can rob them of their incentive to be productive and/or deprive them of their ability to make needed investments in the economy but taxing them too little puts too much additional stress on a middle class already under stress. Striking the right balance between taxing the middle class and the super extraordinary and capitalists in a way that will best strengthen America requires wisdom of the highest order.

For America to have a growing and thriving middle class, America must change its tax system to accommodate new economic realities. Depending on what choices are made, the middle class will grow or shrink. Such a quandary demands considerable thought about the future, as well as a look at the past. Chapter 3 will cover how past societies have dealt with the divide between the rich and everyone else.

CHAPTER 3

WHAT HISTORY SHOULD HAVE TAUGHT US

"The most perfect political community is one in which the middle class is in control and outnumbers both of the other classes."
– Aristotle, *Politics, Book IV, chap.11-16*

How the Great Recession Changed Us • The View from Ancient Athens • How Conservative Leadership Used to Look: Lycurgus and Bismarck • Ending Class Warfare • Investing in a Workforce Second to None

HOW THE GREAT RECESSION CHANGED US

For more than 40 years, the middle-class standard of living has been trapped in a slow but steady downward slide. Then, America and the world were hit with the recession of 2008, now known as the Great Recession. In a flash, the steady downward slide of the middle class's standard of living became a plunge into the deep. Far and away, the Great Recession posed the greatest financial threat to the American and world economy since the Great Depression of the 1930s, and years later its tremors still rumble.

In the fall of 2008, Wall Street's misdeeds precipitated the Great Recession. By early 2009, (1) unemployment was rising at a terrifying rate, (2) the GDP was plunging to as low as a negative 8.2% in the last quarter of 2008, and (3) the bottom had fallen out of the Dow Jones Industrial Average with it falling from over 13,000 to below 7,000. All of this imperiled the functioning of international capital markets. For many in the middle class, the Great Recession meant that, instead of suffering from a slow and steady decline in their standard of living, their loss was immediate and acute. A 2012 study by the FED found that in the aftermath of the Great Recession, the middle class took a double hit with median income falling by 7.7% and median wealth falling by 38.8%.

To prevent the Great Recession from collapsing into another Great Depression, the government increased spending dramatically to stabilize the economy and infuse liquidity into the credit markets. It further cut taxes to spur economic growth. This emergency action staved off a depression, but at the cost of ballooning the national debt. On top of more than a generation of substantial under-taxing relative to spending, the emergency spending and tax-cutting forced by the Great Recession increased America's national debt to a level that alarmed international credit markets. As much as the level of debt, credit markets by 2010 were troubled by the government spending about 24% of the GDP annually while taxing only about 15% with no immediate prospect of this gap closing.

From 1981-2012, except for an eight-year interlude from 1993-2001, the American government disconnected taxing from spending by cutting taxes substantially. While taxes were cut primarily for the very wealthy (the super extraordinary and capitalists) several times during this period, spending and the national debt grew. Because of this policy of low taxes, the national debt mushroomed from only 33% of the GDP in 1981 to over 70% of the GDP by 2009, and headed upward. Although the international debt markets tolerated a national debt-to-GDP ratio of 33%, they were not willing to tolerate a ratio of 70%, especially if the national debt was on an unrelenting growth path.

Before the Great Recession, America's burgeoning national debt went largely ignored for over a generation by both America's creditors, who believed America to be so wealthy that it did not matter, and America's taxpayers, who happily enjoyed the free ride. However, after the Great Recession, the economic aftershock left in its wake, coupled with the magnitude of the national debt, led America's creditors to demand a change of culture. Going forward, if America was to retain its credit, America must start paying for what it spends with tax dollars instead of borrowed dollars.

Realizing that America's borrowing power was in jeopardy, President Obama appointed The National Commission on Fiscal Responsibility and Reform to propose a solution. The Simpson-Bowles Commission was a bipartisan commission co-chaired by its two namesakes, former Republican Senator Alan Simpson, and former Chief of Staff to President Bill Clinton, Erskine Bowles. The report, aptly named *The Moment of Truth*, approved by a majority of the commission, recommended that the government bend the national debt curve downward and reduce the debt to below 40% of the GDP by 2040. To do this, spending would have to be cut from 24% to 21% of the GDP, and taxes must be increased from 15% to 21% of the GDP. This means that about $4 trillion would have had to be taken out of the economy over the next 10 years, in which about $2.5 trillion would be in spending cuts and $1.5 trillion in tax increases.

Cutting spending by 3% of the GDP would mean that not only run-of-the-mill government programs would be on the chopping block, but so would almost all programs on which the standard of living of the middle class in retirement, particularly Social Security and Medicare, and the opportunity of their children to get the post-secondary education they need to earn a decent income, depends. Increasing taxes by 6% of the GDP would mean that a generation-old culture of current taxpayers getting a free ride at the expense of future taxpayers would have to end. If borrowing (as a substitute for taxing) is taken off the table, then spending must be paid for with taxes. Reestablishing financial responsibility, as discussed in *The Moment of Truth*, would require that for the next generation or so, Americans would have to suffer through a period of combined increased taxes and/or dramatic cuts in the types of spending that would affect all the middle class.

This new culture of lower spending and higher taxes would pit the middle class, who benefits the most from spending, against the wealthy and those with the highest incomes, who benefit the most from low taxes. This split would be complicated enough, but that split is only a small part of the divisions that are likely to erupt in this new culture. Within both the middle class and those with wealth and/or very high incomes, there are innumerable individuals and groups that have sharply divergent interests. Among groups in both classes with divergent interests, there are lobby organizations and trade and professional associations representing all parts of the American economy, including all types of small and big business interests; public and post-secondary education organizations; medical providers; the real estate industry; labor unions; and countless other groups. In the new culture of having to tax in order to spend, these individuals and groups will be in fierce competition for scarce resources. If middle-class citizens want to keep the programs that benefit them, they will have to fight for higher taxes to pay for them.

THE VIEW FROM ANCIENT ATHENS

Disputes between the haves and the have-nots are nothing new. Ancient Athens in the 6th century B.C. was a society that was transitioning from a predominantly agrarian society to an aboriginal commercial society, in which most wealth was still based on the ownership of land. Only the most primitive elements of a commercial and money-based economy were beginning to appear. Most wealth was accumulated in ancient Athens through inheriting land, being an able farmer, merchant, or trader, or being lucky. As economies evolve from agriculture, then to commerce and industry, and now to information and technology, knowledge increasingly accounts for wealth creation. Since knowledge and skill have never been the exclusive traits of any social or economic class, those members of the lower class who took the trouble to learn a scarce skill gradually edged their way into the middle class.

During the 6th and 7th centuries B.C. in Athens, economic class warfare between its haves and have-nots erupted in what historians refer to as the "Social War." At this time, Athens was a developing commercial society with a promising future as a center of commerce. Its society was composed of a "wealthy class" of landowners, merchants, and traders; a "middle class" of craftsmen, artisans, smaller merchants, and traders; and a "lower class" of peasants who owned small tracts of land. How the Athenians ended their Social War can teach us much about what it takes to have a healthy political landscape when the wealth and income disparities between the haves and have-nots get out of control.

The wealthy landowners controlled the Athenian government. No governmental over-regulation or restrictions disturbed the workings of the marketplace or impaired the legal right of contract among merchants and other parties in economic matters, nor did the government provide public services such as education or welfare. The wealthy landowners, merchants, and traders used slaves and cheap labor to do their work. As Athens grew, slaves and cheap labor contributed to the ever-increasing prosperity of the wealthy class. However, the fate of Athens' land-owning peasants worsened over time because their land was limited in size and their small tracts were broken into smaller parcels through inheritances. Eventually, these tracts became so small that they would not support a family. The tiny tracts, and a few years of bad crops, forced the peasants to mortgage their land to wealthy landowners to survive.

Inevitably, the peasants were unable to pay their mortgages. Lenders foreclosed on their properties. Many of the desperate peasants, in a futile effort to retain their land, mortgaged themselves and their children. As they defaulted on the mortgages, the lucky peasants fell into work as sharecroppers and the unlucky as slaves. The addition of many new slaves and sharecroppers to the labor market markedly reduced the cost of labor. The wealthy became wealthier, and the marginally poor became poorer. Given this chain of events, it is not surprising that Athens broke out into bloody class warfare between the rich and the poor.

By 594 B.C., the bloodshed had gotten so bad that the warring factions brought in a respected merchant, Solon, to save Athens. The rich upper class accepted Solon because he was one of them—a man of substantial wealth. The middle class and peasants accepted Solon because he was a man of unquestioned honesty and integrity. After consulting with many parties, Solon imposed a number of sweeping and fundamental reforms, which included:

- Cancellation of all debts owed to private lenders and the state
- Forbidding individuals from mortgaging themselves and their families
- Freeing from slavery those who had mortgaged themselves and their children
- Instituting what amounted to a mildly progressive income tax
- Adopting a coinage intended to promote commerce that favored debtors over creditors (an ancient way of inflating the currency to devalue debt)

- Permitting some of the lower classes to participate in the political process and serve on juries.

The wealthy disliked the cancellation of debts owed by the middle class and lower class, and the middle class and lower class were disappointed that they did not receive more property. But grudgingly, all classes accepted and lived with the reforms. Essentially, Solon solved Athens' problem by redistributing wealth.

About 250 years after Solon's reforms, Aristotle, with the benefit of knowing how Athenian society and the other Greek city-states dealt with the battles between the haves and have-nots over wealth disparities, prescribed his solution for avoiding strife. In Book IV, chapter 11 of *Politics*, Aristotle said that the best prospects for political stability and virtuous laws depend upon a large middle class. Aristotle reasoned that, in a society made up of only the rich and the poor, the rich would connive to enact laws to protect their wealth, and the poor would connive to enact laws to confiscate the wealth of the rich. Such a society, Aristotle believed, would be a perpetual contest between greed and envy with little room left for virtue.

Since wealth variations among the middle class would be moderate, Aristotle thought that there would be less greed and envy among the middle class, and a greater willingness to have laws that benefitted the entire society, as opposed to either the rich or the poor. With respect to political stability, in Book IV, chapter 6 of *Politics*, Aristotle observed that the conflict between the rich and the poor caused political revolution in a number of societies. Any time the wealth disparity between the rich and the poor grows, so too does the risk of revolutionary change. Comparing Solon with other of Greece's ancient lawgivers, each of whom dealt with problems that have since bewildered governments, Aristotle, in Book II, chapter 12 of *Politics*, ranked Solon as the best, because he mediated the dispute between the rich and the poor, and pointed them both to a course of moderation and virtue.

Regarding the lesson of the Social War, Will Durant, in his book, *The Life of Greece* (p. 112), reminded those who did not know: equality is unnatural; and where ability and subtlety are free, inequality must grow until it destroys itself in the indiscriminate poverty of social war; and liberty and equality are not associates but enemies. The concentration of wealth begins by being inevitable and ends by being fatal.

The principles necessary to manage the perennial conflict between the few haves and the many have-nots—all derived in one form or another from enlightened sharing—were known no later than 23 centuries ago. Today, many of these principles are forgotten and languish in dusty old history books. Unfortunately, each generation must learn the principles anew.

HOW CONSERVATIVE LEADERSHIP USED TO LOOK: LYCURGUS & BISMARCK

Looking at several other historical examples, two leaders, Lycurgus in Sparta and Bismarck in Germany, arose who understood the challenges confronting their societies. Both leaders undertook a mission to strengthen their societies, and each understood that change was essential to mission accomplishment. Both Sparta and Germany were deeply conservative societies, ruled by wealthy, landed aristocracies who were jealous of their prerogatives, distrusted change, and were afflicted with class warfare between haves and have-nots. Sparta's mission was to build a warrior force superior to its competitors; and Germany's mission was to secure the political support of its rising industrial working class in its quest to become a leading world power. Neither Sparta nor Germany could accomplish its mission without dramatic social, economic, and political change.

Both Lycurgus and Bismarck emerged as leaders in a time of crisis; and both made their mark in history by responding to their respective crises with wisdom, courage, and skill—wisdom in that both recognized the need for fundamental change in their societies; courage in that both risked their political futures in challenging the orthodoxy of their time; and skill in that both overcame long odds in convincing the powers that be to accept harsh change. The changes wrought by both required that the wealthy, ruling aristocracies of Sparta and Germany agree to give up a significant portion of their wealth in the interest of inducing many of those who were disadvantaged to "bond" in such a way as to accomplish the mission of advancing the interest of each society.

Lycurgus found Sparta with many indigents and only a few with extreme wealth. Its people were plagued by the arrogance of the few, and the envy of many, resulting in indulgent luxury for some, and poverty and crime for many more. A society splintered by extreme wealth disparities made it impossible for Sparta to field a formidable force of warriors. Lycurgus knew a great truth: inequality of wealth among its warriors would destroy the unity of purpose that was necessary for them to become an indomitable fighting force. To encourage all Spartans to bond, Lycurgus' laws eliminated wealth inequality by redistributing property and made individual merit as warriors the sole basis for its citizens to gain eminence. Lycurgus' laws led to the creation of a powerful warrior state, making Sparta the preeminent power among its competitors.

Bismarck found Germany in transition from an agricultural-peasant economy to an industrial-worker economy. The country was fraught with social, economic, and political friction between a wealthy, landed aristocracy who liked the status quo, and industrial workers clamoring for a bigger slice of the economic pie. Having been unified only a decade before, Germany was eager to become a leading world power militarily, economically, and politically. Without a citizenry who supported its quest for national greatness and who were willing to spend the money to make it so, Germany could not succeed. Realizing that German workers would not forever accept a small slice of a growing economic pie, Bismarck implemented many costly social and economic reforms that guaranteed workers retirement income, insurance against disability, and subsidized health care.

Bismarck knew a great truth: social friction at home would preclude Germany from projecting power abroad. He has been quoted (in Emil Ludwig's biography) in justifying the cost of his reforms by observing that "money thus spent is well invested; it is used to ward off a revolution, which […] would cost a great deal more." Bismarck's social reforms, which led to the redistribution of wealth from the haves to the have-nots, salved much of the friction between industrial workers and the state that afflicted many industrial powers in the late 19th and early 20th Centuries and contributed to Germany becoming the preeminent industrial and military power in Europe on the eve of World War I.

The challenges that confront societies change as different circumstances arise, so the changes made by Lycurgus and Bismarck are specific to their time. Even so, modern leaders can learn from their examples. Even though each was conservative, neither Lycurgus nor Bismarck shied away from doing whatever was necessary to give their societies an edge over their competitors. As change agents, both Lycurgus and Bismarck put patriotism above political ideology and class preference, and both enacted laws that subordinated domestic social, economic, and political goals to the paramount goal of enabling their societies to prevail over their competitors.

ENDING CLASS WARFARE

Brewing resentment among the English peasantry resulted in the Peasants' Revolt in the 14th Century. Increasing awareness of wealth and political disparities among a rising middle class ignited the French Revolution in the late 18th Century. The accumulation of centuries of grievances of the serfs and the urban proletariat against the landed aristocracy and emerging capitalists, coupled with no hope for peaceful reform, resulted in the Russian Revolution in the early 20th Century. These bloody episodes that linger on the pages of history books could be ignited once again, and most certainly will be, given the right set of circumstances.

Lycurgus' Ancient Sparta of the 7th century B. C. and Bismarck's Germany of the late 19th century responded to the competitive challenges of their time and won. Both were in intense competition with other surrounding states, and both won by mobilizing their resources to achieve a common goal. Sparta was a small Greek city-state beset by internal division and surrounded by other covetous city-states, all competing for the same turf. Germany was a burgeoning economic power competing for its place in the sun against other world powers, and had an emerging class of industrial workers who were demanding a better standard of living.

To surpass their rivals, Sparta and Germany used a time-honored strategy that some modern-day military leaders would call "unit cohesion." Former Army Chief of Staff, General Edward C. Meyer, described unit cohesion as "the bonding together of soldiers in such a way as to sustain their will and commitment to each other, the unit, and mission accomplishment." Unit cohesion applies anytime one unit competes with others to achieve the mission—victory in the case of war, and supremacy in the case of economic competition. In the world of military competition, unit cohesion means one military group competing against others; while in the world of international economic competition, unit cohesion means one nation competing against others. In both cases, it is units that compete, not individuals. Individuals participate in such contests as members of a unit—team members united by a common purpose.

For a nation to win a military or economic contest against one or more well-equipped and motivated competitors, it must mobilize all its resources. Sparta and Germany both succeeded in mobilizing their resources to accomplish their mission. As a reminder, Sparta's mission was to develop and maintain a warrior force superior to all competitors, and Germany's mission was to win and maintain the loyalty of its industrial workers to support its national goals. A nation cannot mobilize all its resources unless a substantial majority of its citizens can be convinced to bond "in such a way as to sustain their will and commitment to each other, the unit [nation] and mission accomplishment [supremacy in a given sphere]."

More than ever, globalization and technological innovation make economic competition in today's world a contest among nations and multi-national corporations. Nations, not individuals or companies, enter into trade agreements that provide for the rule of law in international commerce; maintain open access to sea and air lanes, and e-commerce on which international trade depends; set financial regulatory standards that prescribe the terms of international finance; set tax policies that affect each nation's competitiveness; educate the workers that comprise each nation's workforce; and provide the transportation and communication infrastructure that enables each nation's businesses to market their goods and services in international commerce. Without a nation's full support in competing in world markets, its businesses would be certain to fail.

Now, the twin challenges of globalization and technological innovation threaten the standard of living of millions of Americans. As other societies have in the past, America must respond to these threats or fail. The question remains whether or not Americans will choose to bond together to stave off these threats, and take the necessary action of strengthening our society from within. We might draw some inspiration from the military concept, "leave no one behind," which refers to the idea that in battle, everyone must be carried forward as a member of the unit. We could apply this ethos in order to cohere the unit of the American workforce to advance America's economy in the 21st century, and, thereby, remain competitive internationally.

Fortunately, history also offers examples of times where reason and mutual understanding between the haves and the have-nots has led to moderation, compromise, and lawful change. The Great Depression of the 1930s almost destroyed the middle class in America and Western Europe by threatening to force approximately half of all Americans and Western Europeans into the lower class. Franklin D. Roosevelt's New Deal gave hope to the many have-nots that the government would help them through troubling times, such that they resisted calls by political extremists to resort to lawlessness and violence.

As disparities in individual wealth grew to an alarming level, the New Deal provided the haves and have-nots with a way to work out their differences within the rule of law without resorting to violence. Over a period of 15 years, the American political process enacted laws creating Social Insurance, and establishing a progressive economic policy that not only saved, but also broadened, the middle class.

While America worked its way through the Great Depression relatively peacefully, the Great Depression led many European nations to abandon moderation, compromise, and the rule of law for the false promises of demagogues. The most infamous demagogue in modern history, Adolph Hitler, seized upon the Great Depression's threat to the middle class to grab power in Germany, and the result was World War II.

Due process of law, respect for the interests and rights of others, and reasonable patience and forbearance account for why America has avoided much of the violence and strife that has afflicted other societies confronted with class warfare. The fact that the America of the 1930s worked its way through a time of economic and social turbulence does not guarantee that some future America confronted with another depression will be so fortunate.

INVESTING IN A WORKFORCE SECOND TO NONE

America faces international economic competition more intense than any other time since the beginning of the 20^{th} century, threatening its future as a superpower and the standard of living of most of its citizens. All businesses are now free to pick and choose whom they wish to hire from employees anywhere on Earth based on what is best for their bottom line. Moreover, any business that does not hire the highest skilled workers for the best value is setting itself up for failure. In this new age of international commerce in which businesses are free to seek out and find the highest skilled, lowest cost labor, American workers must compete as never before.

Every American worker who loses out in the competition with a foreign worker for a high-paying job not only suffers from the loss, but other workers, who would have benefitted from the money that the losing worker would have spent on goods and services in America, also suffer. America must be prepared to make whatever changes are necessary to enable its workers to win the contest, and that includes raising the revenue to ensure that its workforce is armed with “second to none” skills.

In a dynamic economy driven by technology and global competition and discriminating, non-sentimental capital on the prowl for its highest return, only workers and businesses who are better than their competition will win; and to the winner, the spoils will go. So, to be an economic winner, workers must acquire the skills that enable them to do things that their competitors cannot do, and businesses must be able to produce goods and services demanded by consumers more cheaply and of a higher quality than their competitors. All of this means, both workers and businesses, to be economic winners, must be extraordinary. To succeed in the 21st-century global economy, America must invest whatever is required to provide all workers with the opportunity to become the most skilled and highly motivated workers in the world.

I was privileged to have all the support I needed to join the great American middle class. The easily affordable, high quality, higher educational opportunities that were available to me and others like me enabled us to get the education necessary to have successful professional and business careers. Sadly, as a quality post-secondary education has become even more critical to achieving economic success, it has also become much less affordable to those from low and middle-income families. For all Americans to have a fair shot at realizing their full economic potential, America must do much better in making quality post-secondary education affordable to all. Whether or not those from low and middle-income families will have the same opportunity that I had to get a quality post-secondary education will play out in tax and budgetary policy.

CHAPTER 4

HOW DID WE GET HERE?

"I like to pay taxes. With them I buy civilization."
– Chief Justice Oliver Wendell Holmes, 1927

A Brief History of Taxation • Effects of Moving from Consumption Tax to Income Tax • Complexity and the Cost of Government • The Libertarian Bargain • Why "No New Taxes" Is Not the Answer

A BRIEF HISTORY OF TAXATION

Upon gaining independence in 1781, America was a newborn nation tucked away in a remote corner of the world, with a largely rural population of about 3.5 million people. Agriculture was the primary source of wealth, and industry was virtually non-existent. Most manufactured goods were imported, and capital for economic development also came from foreign sources. In this primitive financial environment, there was no national banking or monetary system, commerce was rudimentary, and barter was the leading medium of exchange.

For early Americans, life was simpler and more difficult at the same time. Farmers, tradesmen, and small-scale merchants did not require much formal education beyond bare literacy and the ability to do simple arithmetic. Public education did not exist, and higher education was reserved for a select few. Healthcare was similarly scarce since medical science was still in its infancy. Most early Americans accepted that if they had an accident, got sick, or suffered from a chronic illness, it was their fate to endure the consequences. In fact, few lived to cope with retirement, and those who did were either taken care of by their children or died quietly in poverty.

Despite their privations, early Americans enjoyed the luxury of having the expanse of the Atlantic and the Pacific to protect them from foreign encroachments. Except for the War of 1812, the Mexican War of 1845, and the Spanish-American War of 1898, the US managed to stay out of foreign conflicts, and as a result, avoided the maintenance of a costly military. For the first few decades, about all the government maintained was a national judiciary, a postal system, a skeletal navy and army, a patent office, and a tiny treasury to collect the small amount of taxes that were needed to pay for the national government. Although the numbers are only best guesses, the Census Bureau, in the Historical Statistics accompanying its Statistical Abstract published in 1949, estimated that the total cost of government as a percentage of "National Income" was only about 2% before the Civil War, and afterward, about 3%. National income, as calculated by the U. S. Department of Commerce, is a forerunner of GDP as a standard for measuring the size of the national economy and, because of imprecise and incomplete data, is less reliable than GDP.

The Consumption Tax Period, 1781-1918

For the first 140 years, except for the Civil War and a few years afterward, America paid for almost all of the cost of government through a variety of consumption taxes and a few insignificant miscellaneous taxes. Consumption taxes included the tariff and a variety of excise taxes, including liquor and tobacco taxes. Having the few foreign exporters of goods and producers of liquor and tobacco pay the tax was much easier and cheaper to administer than collecting taxes directly from the consumers. In fact, an income tax would have been almost impossible to administer in the pre-industrial economy.

Taxing consumption worked reasonably well in a simple economy in which barter was the primary medium of exchange and most wealth was illiquid in the form of land. However, while consumption taxes could raise sufficient revenue to pay for government with a small bureaucracy, they were insensitive to taxpayers' ability to pay. Rich and poor, farmers, tradesmen, merchants, Northerners, Southerners, Westerners, and many other Americans paid varying amounts depending on how much they consumed of what was taxed.

Taxes have never been popular, and some taxpayers, no matter how little they pay, will fight like hell to pay less. For example, early Americans who purchased foreign manufactured goods that were subject to the tariff fought to exempt the goods that they purchased and to tax goods that others purchased. The tariff was popular among American manufacturers who were happy to have their competitors' goods made less competitive, as well as those who consumed little of what foreign manufacturers sold. At the same time, the tariff was unpopular among those who consumed a lot of what foreign manufacturers sold.

Prior to the Civil War, the amount of revenue needed to run the government was relatively small, but as the government began to spend more, the sting of taxes became increasingly painful. However practical taxing consumption once seemed, as early America evolved into a modern country with its higher overall level of taxation, the insensitivity of consumption taxes to the ability to pay became less and less tolerable. By 1913, a substantial majority of Americans had concluded that consumption taxes were too harsh on middle and low-income Americans. Going to war in 1917 coincided with the emergence of modern America, and the tax needs of modernization demanded an overhaul of the tax system.

The Income Tax Period, 1919-Present

As World War I ended, America's population had swelled to almost 120 million. After over a century of relative isolation, America suddenly found itself a global power with economic, political, and military interests spread throughout the world. As a leading superpower with a growing population and dynamic economy, modern America could no longer afford an inactive and cheap government. But with a more expensive government came the need for more revenue; and with the need for more revenue came the income tax.

America had levied its first income tax in 1861 because of a sudden need for a massive amount of revenue to fight the Civil War. The original income tax lasted only a few years until 1874 when the old mainstay tariff could raise enough revenue to pay for a peacetime government. However, at the dawn of modern America, consumption taxes could no longer provide enough revenues as the cost of government rose substantially above 3% of national income.

Increasing the tariff was not an option. As American commerce became more integrated with international commerce, increasing the tariff would have encouraged protectionism and discouraged the free flow of America's goods and services in world commerce. Insulating American manufacturers from foreign competition and isolating American commerce from international trade were not sustainable policies in the modern world. Rather, abandonment of the tariff cut the cost of many imported goods and kept the prices charged by American manufacturers in check because of foreign competition.

To pay for the increasing cost of a more active government, many Democrats and Progressives pressed for raising less revenue from consumption taxes and more from income taxes as had been done during the Civil War. For a brief time, the income tax became a casualty in the Gilded Age contest between Democrats and Progressives on one side, and conservative Republicans on the other side. Then in 1894, after earlier Supreme Courts had upheld the income tax on four previous occasions, a conservative Supreme Court found it unconstitutional in *Pollock v. Farm Loan and Trust Co.*

Despite the *Pollock* decision, the political and economic pressures for an income tax continued to grow. Reacting to new political and economic realities, in 1909, President Taft, a conservative Republican, submitted the 16th Amendment to undo the *Pollock* case. To the surprise of many conservative Republicans, the 16th Amendment was quickly approved and took effect in 1913. The adoption of the 16th Amendment made it possible for the income tax to replace consumption taxes as the dominant means of taxing in modern America.

The enactment of the Federal Reserve Act in 1913 also provided America with a national banking and monetary system, a prerequisite for economic expansion in an industrial economy with growing interstate and international commerce. Paper money replaced gold coins as the currency of commerce, and barter as a medium of exchange went the way of the buggy whip.

Finally, the adoption of the 17th Amendment that year also made the Senate a more democratic institution by replacing the election of Senators by the state legislatures with direct election by the voters. In very early America, the electorate had been restricted to property-owning males who elected the politicians who decided what to tax. It was not until the middle of the 19th Century that property ownership as a qualification for voting was eliminated. Women finally earned their right to vote with the 19th Amendment in 1919. It would take even longer for African-Americans to earn theirs.

EFFECTS OF MOVING FROM CONSUMPTION TAX TO INCOME TAX

The transition from consumption taxes to the income tax as the mainstay of paying for government was completed quickly. The first significant income taxes were collected in 1916, and by 1918, income taxes accounted for over 75% of total revenue. Income taxes marked a major change from consumption taxes in that they taxed what a taxpayer made and not what they spent; were paid directly by the taxpayer; and were sensitive to a taxpayer's ability to pay.

To understand the effects on taxpayers and America of taxing during the Consumption Tax Period and the Income Tax Period, it is necessary to know what there is to tax, what direct and indirect taxation is, and what the ability to pay a tax means. Taxes can tax (1) consumption, what people spend to consume, (2) income, what people make in terms of wages and the return on their assets, (3) wealth, the income that people accumulate, (4) the right of an individual or business to engage in commercial activity, (5) the right of an individual to do certain things, and (6) the use of public facilities.

Examples of these taxes:

- Consumption taxes include tariffs, excise taxes, and sales taxes.

- Income taxes include Social Insurance payroll taxes, the personal income tax, and the corporate income tax.

- Wealth taxes include the estate tax, inheritance taxes, and property taxes.

- Right to do business taxes include licensing fees, which confer on a business the right to engage in a commercial activity.

- The right of individuals to engage in certain activities such as poll taxes, which enable a person to vote.

- User fees include fees that entitle a business or individual to use public facilities like toll roads, parking lots, libraries, and swimming pools.

In direct taxation, taxpayers pay the tax directly to the government. Examples of direct taxes include the personal income tax, the corporate income tax, the employees' share of social insurance payroll taxes, estate taxes, inheritance taxes, property taxes, licensing fees, poll taxes, and user fees.

In indirect taxation, third parties pay the tax and pass the cost of the tax onto taxpayers in the form of higher prices on the goods and services that are taxed. Examples of indirect taxes include sales taxes on goods and services paid by retailers and service providers, tariffs paid by exporters, excise taxes paid by manufacturers, and the employers' share of social insurance payroll taxes. Unlike consumption taxes where taxpayers pay the tax in the form of higher prices on goods and services, the employers' share of social insurance payroll taxes is passed on to employees in the form of lower salaries.

It is easy for taxpayers to know how much they are paying in direct taxes, but it is not easy for them to know how much they are paying in indirect taxes. Since indirect taxes are oftentimes invisible to taxpayers, they are sometimes called "hidden" taxes. Taxpayers who do not know how much they are paying in taxes are not as likely to get riled up as taxpayers who do, and so often these taxpayers do not know how to get into the tax game to protect their own interests.

The concept of "ability to pay" relates to the comparative economic pain that paying a tax inflicts on low-income taxpayers relative to high-income taxpayers. All taxes that have a flat rate inflict more relative pain on low-income taxpayers than high-income taxpayers. The most practical way to increase low-income taxpayers' ability to pay a tax is to have graduated rates on whatever is taxed.

Suppose an income tax must raise $30 thousand from two taxpayers, and one taxpayer has an annual income of $50,000 and the other's income is $100,000. A flat rate of 20% would raise $30,000 but graduated or progressive tax rates can also be made to raise the same amount. For example, a 10% rate on a taxpayer with an income of $50,000 and a 25% rate on a taxpayer with an income of $100,000 would also raise $30,000. While graduated rates increase the ability of a low-income taxpayer to pay the tax, they shift more of the tax burden to high-income taxpayers.

COMPLEXITY AND THE COST OF GOVERNMENT

The cost of government in early America was low, for the most part costing less than 3% of national income. After World War I and until the Great Depression, the cost of government rose to about 5-6% of national income. During the Great Depression and leading up to World War II, the cost of government rose again from about 8-12% of GDP. Following World War II, the cost of government took another leap from about 15% in the late 1940s to as much as 25% during the Great Recession in 2009. Since then, the cost of government has hovered around 22-23% of GDP.

Taken out of context, these tax increases may appear to some as evidence of the takeover of "big government." These increases are the result of growing complexity in the country's economic system as well as shifts in the expectations of American citizens, which began taking shape over a century ago. As industry replaced agriculture as the dominant force in the economy, and as commerce became national and international, millions of Americans were abandoning the farms for jobs in new industries in the cities. Free public education across America enabled most Americans to get the education essential to participation in the early stages of modernity. America's institutions of higher education were well underway to making modern America the global technological leader of the world.

By the 1920s, the steel, energy, auto, and manufacturing industries dominated the economy and overshadowed agriculture. Modern America's commerce was no longer primarily local as it was in early America. In fact, almost all commerce had become interstate, with a growing percentage becoming international. Instead of a nation of small towns and small farmers isolated from each other, modern America had become a nation of growing cities with a national transportation and communications system of railroads, highways, the telegraph, radios, telephones, and thousands of newspapers that linked more and more Americans to each other.

Medical science had also advanced by the 1920s, and so too had the availability of doctors and hospitals. With these advances, infant mortality declined and life expectancy in old age increased. As people began to live longer lives, their economic needs also changed.

Along with a modern industrial economy came an increase in the business cycle that periodically leads to recessions accompanied by mass unemployment. In early America when an economic downturn hit farmers, they could still eat what they grew. But in modern America when a recession hit urban industrial workers, they lost their income and had no money to eat. Modern urban Americans proved less willing to quietly accept serious deprivation from economic cycles than rural early Americans.

Modern America's more democratic electorate demanded that when serious economic downturns inflicted too much pain on too many people, the government would no longer be a bystander. As a reaction to the Great Depression of the 1930s, the government enacted the Social Security Act of 1935, which saved millions of elderly Americans from spending their old age in poverty. It also softened the blow on those who were thrown out of work by instituting a national program of unemployment insurance.

In the 1960s, the government enacted Medicare and Medicaid to provide health care to the elderly and poor. It also enacted a range of income transfer programs to help the poor escape poverty and provide educational opportunities to those who could not afford it. Since 1962, government spending on social insurance and income transfer programs has risen from just over 4% of GDP to almost 12% of GDP while total government spending has risen from a little over 18% to a bit over 22%. **Social insurance and income transfer programs now account for all growth in government spending over the last 50 years or more.**

Today, modern America must cope with an aging population, which adds financial stress to Social Security and Medicare. Stagnant and falling wages for an overwhelming majority of Americans in turn adds financial stress to income transfer programs. With fewer and fewer Americans having enough income to pay for their own health care, save for their own retirement, and pay for their children's post-secondary education, the pressures for increased spending on social insurance and income transfer programs will continue.

Domestically, modern Americans have demanded a more active and expensive government, and modern Americans have gotten what they demanded. In foreign affairs, World War I and World War II have taught modern America the stern lessons of isolationism. Now, most Americans understand that as distasteful and expensive as it is, for the foreseeable future, America must spend substantial amounts on national security to protect its vital interests. As new challenges confront modern America, including everything from natural disasters to economic dislocations to increased pressures for more social insurance and income transfer programs, the government will have to do something about each of them if enough Americans believe that it should.

With the income tax came direct taxation, and to collect it, a bigger and much more intrusive bureaucracy, the Internal Revenue Service. For the IRS to administer the income tax, it must, (1) keep track of the income of all individuals and businesses, (2) administer an ever-changing patchwork of exemptions, rates, and deductions, and (3) collect all amounts due.

Also, as the need for more revenue grew to satisfy the needs and wants of modern Americans, more and more taxpayers demanded special treatment for their pet tax preferences. These tax preferences have made the administration of the income tax far more complex and have put more burdens on the IRS. Proper administration of an increasingly complex income tax means adding to the cost, staff, and intrusiveness of the IRS, but the failure to do so makes it less likely that tax cheats will be caught for failing to pay what they owe.

At the same time, in modern America, being sensitive to taxpayers' ability to pay has proved more important than a tax system with a relatively non-intrusive, less expensive, and smaller tax bureaucracy. While the income tax has inflicted an unpleasant bureaucracy on modern America, it has also accommodated millions of middle and low-income Americans in terms of taxing based on their ability to pay.

Unlike consumption taxes, the income tax can be fine-tuned to distribute the tax burden among different income groups with great precision. This fine-tuning can be done by exempting certain low-income taxpayers to avoid taxing them into poverty; setting rates to soften the blow to middle and low-income taxpayers; and providing middle and low-income taxpayers with deductions that keep their taxes low relative to higher-income taxpayers.

Summing up, in today's America, government spending accounts for about 22% or 23% of GDP and is on the rise, and to raise that amount of revenue, America has chosen income taxation over consumption taxation. The ability to pay a tax does not matter very much when the level of taxation is around 5% of GDP or less, but when the level of taxation approaches 20% of GDP, the ability to pay becomes politically decisive as was shown by the adoption of the 16th Amendment. Unless America decides to cut government spending dramatically, income taxation and the ability to pay are almost certainly going to be critical elements of tax policy.

THE LIBERTARIAN BARGAIN

For those Americans who want a cheaper government and a much simpler tax system, they should consider the Libertarian Bargain. Under the Libertarian Bargain, Americans would be given a choice: on the one hand, continue with social insurance and income transfer programs to help them pay for their retirement, health care, and the post-secondary education of their children, and for assistance in case of job loss and other emergencies, or on the other hand, give up all those government programs and do **without any help**. If Americans choose to continue getting government help, it will mean higher taxes, but if Americans choose to do without any government help, it will mean lower taxes. Under the Libertarian Bargain, Americans would do without help, and in exchange, pay lower taxes.

For those Americans who want a decent standard of living, adequate health care, a dignified retirement, quality post-secondary education for their children, and help if they lose their job through no fault of their own, they should consider the following:

- To provide for retirement, it cost about $1 million for a married couple (each aged 65) to purchase a lifetime annuity (from a rated insurance company) that guarantees a lifetime annual income of $44,000 beginning at 65. It would take about a $980 monthly payment into an investment account at 4.5% APR over a 35-year period for a 30-year-old to save the $1,000,000 needed to purchase the lifetime retirement annuity at 65. If the couple thinks that a $44,000 annual income will not be enough a generation from now when they retire, then they will have to save more. (Each individual is invited to shop the annuity market for themselves to see if they can beat the deal offered under Social Security and determine for themselves if they have the discipline and the assurance of continued income throughout their working lives to save to pay for it.)

- According to a June 14, 2014 report by the Peter G. Peterson Foundation, the national per capita costs of health care for each individual American (taking into account all costs) is about $9,000. For a family of four to pay for all their health care cost on a monthly basis, it would cost about $750 per person or $3,000 for a family of four.

- The cost of post-secondary education for each child ranges from a few thousand dollars a year to well over $100,000. Assuming that a family decides it will save $100,000 to pay for the entire post-secondary education of each of their children when they reach 18, it would take about a $300 monthly payment into a college-savings account at an APR of 4.5% over an 18-year period to save the $100,000 for each child.

While these costs are not exact, they represent a fair approximation of what a decent retirement, adequate health care, and the post-secondary education of children might cost in today's America; and these costs omit the costs of job loss and other emergencies that almost all Americans will face from time to time. If the American Dream is to include these things for all Americans who work full time at the best job they can find, then these are the costs that must be paid. To the extent that individual Americans cannot pay for these costs out of their market income or savings, then they must either get help from the government or learn to do without.

Fending for yourself without any government help harkens back to the frontier west where most Americans lived under the principle of "you eat what you shoot." As a personal aside, my grandparents lived all their lives under the principle of "you eat what you shoot;" my parents lived the first one-third of their lives under it; and I have lived my life free of it (I have had help when I needed it and am grateful for it). As an experiment in cheap government for libertarians who are confident that they can take care of themselves if they are not burdened by being over-taxed, they should think about what kind of standard of living they would have if they strike the Libertarian Bargain. So, imagine an America with no social insurance, including no Social Security and Medicare, and no subsidies for health care and the post-secondary education of children, and with Americans paying only one-half of current taxes.

Right now and for the last several years, social insurance and other income transfer programs have consumed about one-half of the total cost of government and that share is rising, as is shown in Table IV-1.

Table IV-1
Federal Budgetary Categories as a Percentage of GDP including Total Receipts, Total Outlays, Core Government, and Income Transfers

Year	Total Receipts as a %age of GDP	Total Outlays as a %age of GDP	Core Government as a %age of GDP	Social Insurance Programs as a %age of GDP
1979	18.50%	20.10%	12.25%	7.85%
1980	19.00%	21.70%	12.99%	8.71%
1981	19.60%	22.20%	13.07%	9.13%
1982	19.20%	23.10%	13.48%	9.62%
1983	17.50%	23.50%	13.43%	10.07%
1984	17.30%	22.20%	13.10%	9.10%
1985	17.70%	22.80%	13.56%	9.24%
1986	17.50%	22.50%	13.65%	8.85%
1987	18.40%	21.60%	12.85%	8.75%
1988	18.20%	21.30%	12.72%	8.58%
1989	18.40%	21.20%	12.77%	8.43%
1990	18.00%	21.90%	13.24%	8.66%
1991	17.80%	22.30%	13.11%	9.19%
1992	17.50%	22.10%	12.40%	9.70%
1993	17.50%	21.40%	11.60%	9.80%

1994	18.00%	21.00%	11.21%	9.79%
1995	18.40%	20.60%	10.82%	9.78%
1996	18.80%	20.20%	10.44%	9.76%
1997	19.20%	19.50%	9.87%	9.63%
1998	19.90%	19.10%	9.74%	9.36%
1999	19.80%	18.50%	9.55%	8.95%
2000	20.60%	18.20%	9.45%	8.75%
2001	19.50%	18.20%	9.21%	8.99%
2002	17.60%	19.10%	9.61%	9.49%
2003	16.20%	19.70%	10.04%	9.66%
2004	16.10%	19.60%	10.21%	9.39%
2005	17.30%	19.90%	10.50%	9.40%
2006	18.20%	20.10%	10.78%	9.32%
2007	18.50%	19.70%	10.12%	9.58%
2008	17.60%	20.80%	10.76%	10.04%
2009	15.10%	25.20%	13.41%	11.79%
2010	15.10%	24.10%	11.69%	12.41%
2011	15.40%	24.10%	11.97%	12.13%
2012	15.80%	22.80%	11.28%	11.52%
Average	17.92%	21.19%		
Source: Data extracted from Table 3.2,, Table 1.2, and Table 1.4 of the Historical Tables for the OMB Budget for 2014.				

Table IV-1 shows the following:

- Except for the years 1998-2001, America has consistently spent more than it has taxed;
- The cost of social insurance and income transfer programs, as a percentage of total outlays, has steadily grown from 39% in 1979 to 51% in 2012;
- The cost of core government was less in 2012 than it was in 1979; and
- All increases in the cost of government from 1979 through 2012 are attributable to the increased cost of social insurance.

Over the last several generations, the American people have chosen more and more social insurance and income transfer programs to hedge them against the vicissitudes of having bad luck like job loss and/or some catastrophic and costly emergency or illness, and just growing old. Since taxes are collected to pay for the cost of government, taxes cannot go down unless the cost of government gets cheaper.

Table IV-2 is a monthly budget based on the "eat what you shoot" principle in which a libertarian pays for his or her own retirement, health care, and the post-secondary education of his or her children, and would have to pay only about one-half of the taxes they now pay.

Table IV-2
Monthly Budget* For a Family of Four Who is an Extraordinary Libertarian
Based on the Eat What You Shoot Principle

Monthly Pretax Income	**$3,666 to $16,666**
Expenses	$?
Personal Responsibility	$?
Retirement Savings**	$980
Health Care***	$3,000
Post-Secondary Education of Children Savings****	$600
Total Personal Responsibility Monthly Expenses	**$4,480**
Non-Discretionary Monthly Expenses	$?
Food and Clothing	$?
Child Care	$?
Housing	$?
Transportation	$?
Total Non-Discretionary Monthly Expenses	$?
Discretionary Monthly Expenses	$?
Emergencies	$?
Recreation	$?

Total Discretionary Monthly Expenses	
Total Available for Taxes	
Total Available for Savings	
Notes:	
* The range of pre-tax monthly income is based on an annual income (at the bottom end) of $43 thousand and (at the top end) $200 thousand.	
** Retirement Savings is based on the monthly savings required over a 35-year period at an APR of 4.5% to purchase a $1 million lifetime annuity that would pay a monthly benefit of $3,666.	
*** The Personal Responsibility Health Care Expense is based on national averages and will vary from locality to locality.	
**** Post-Secondary Education of Children Savings is based on the monthly savings required over an 18-year period at an APR of 4.5% to provide a $100 thousand benefit to each child to access post-secondary education.	

The "eat what you shoot" budget shows that if a family of four with one or two wage earners expects to pay for their own retirement, health care, and the post-secondary education of their children, they need to be able to pay about $4,500 a month ($54,000 annually) before paying for whatever standard of living they can afford. According to the Chief Actuary of SS, only about 20% of wage earners made more than $55,000 in 2013.

So, while the "eat what you shoot" budget may work for some extraordinary wage earners and clearly works for super extraordinary wage earners and capitalists, it does not work for anyone else if they expect to have much of a standard of living and a decent retirement, adequate health care, and college for their kids. The libertarian bargain in which everyone *pays about one-half of their current taxes* in exchange for *getting no government help* would have very little appeal (if they fully understood the bargain's implications) among almost everyone other than super extraordinary wage earners and capitalists.

WHY "NO NEW TAXES" IS NOT THE ANSWER

"No new taxes" is the cry of many Americans, and like the tune played by the Pied Piper of Hamlin, it has a compelling allure to it. When George Herbert Walker Bush ran for President in 1988, he promised "Read my lips, no new taxes," and two years later as President, he backtracked and approved a significant tax increase. Political promises are one thing, and reality is quite another. Over the last 30 years or more, new realities have emerged in America which include the following:

- Income and wealth have intensely concentrated in the top 1%.

- America has refused to tax itself to pay for the full cost of government.

- The cost of government has grown to account for about 22% to 23% of GDP and is rising.

- The cost of social insurance and income transfer programs now account for over one-half of the cost of government and are increasing.

- Middle-class incomes have stagnated leaving almost all unable to save and pay for their own retirement, health care, and the post-secondary education of their children.

Given these realities, the middle class has become dependent on social insurance for its retirement, health care, and the post-secondary education of its children, as well as being a safety net for job loss. If social insurance is cut, so too will the standard of living of the middle class. Maintaining social insurance as it is will require increased taxes, and expanding social insurance above current levels will require an even greater increase in taxes.

Almost all middle-class workers, including all ordinary workers and most extraordinary workers, depend to a greater or lesser extent on social insurance (Social Security and Medicare for their retirement and Medicaid and other government subsidized programs for both their health care and the post-secondary education of their children, as well as food stamps and unemployment insurance to provide an income cushion if they lose their jobs). These social insurance programs rely on tax revenue to pay the beneficiaries, which means that income is being transferred from taxpayers to program beneficiaries. Without social insurance, hardly any middle-class workers would be able to retire, have decent health care, or provide for the post-secondary education of their children, or if they lose their jobs, hardly any middle-class workers would have any savings to enable them to make it to the next job.

Those who think America can do with less or no social insurance might put themselves in the place of median-wage families like the Middletons and prepare a monthly budget in which they pay one-half their taxes but have no social insurance and are responsible for saving and paying for their own retirement, health care, and the post-secondary education of their children, as well as providing for any family emergency or job loss. If such a family provided for its own retirement, health care, and the post-secondary education of their children, and maintained a cushion against emergencies, it is likely that the family would not have much of a current standard of living. If a median-wage family cannot make it on its wages without social insurance, imagine the stress that would be felt by below median-wage families and even some above median-wage families if they had no social insurance.

For those who think Social Security and Medicare for retirement and student aid for post-secondary education are too generous for median-wage workers, they should check with families like the Middletons to find out what it is like to have no income other than from these programs to live on in retirement, and what it is like for their children to try to get a post-secondary education with the funds provided by these programs. As tough as it is for median-wage families with social insurance, imagine what it would be like with none.

No one would dispute that life is better when one can pay one's own way with no help from anyone, particularly taxpayers. However, since private market wages no longer enable any but a few Americans to do without social insurance, and, since social insurance for a growing number of Americans is expensive for taxpayers, the financial quality of life for the middle class will depend on America's willingness to increase taxes to pay for it. As unpleasant as it is, The Iron Law of Wages has made the financial quality of life for the vast majority of middle-class Americans dependent on the maintenance and expansion of social insurance and America's willingness to increase taxes to pay for it.

CHAPTER 5

THE FEDERAL TAXES WE PAY

"The only difference between death and taxes is that death doesn't get worse every time Congress meets."
– Will Rogers, 1923

DOING OUR TAXES

Each spring, Americans endure the rite of doing our taxes. Grudgingly, we accept that taxes are required to provide for the public services that keep society functioning, even if we are loathe to admit it. Unfortunately, the negativity around taxes that pervades the American psyche leads many to resist or even despise an institution that has a profound, if misunderstood, effect on our lives.

Although taxes are paid at the federal, state, and local levels, for most taxpayers, federal taxes account for the bulk of the taxes they pay. For ordinary taxpayers who are ready to protect their own interests, learning the basics of federal taxation is a good starting point. Even if you are fortunate to have the means to shift the heavy lifting to a lawyer or an accountant, you still stand a better chance at coming out on top if you understand how taxation works.

Having a working knowledge of the tax system should be regarded as a life skill, as important as finding the best deals on cars, vacations, and home mortgages. As with buying consumer goods, uninformed taxpayers often end up paying more than well-informed taxpayers. Regardless of what a buyer is purchasing, anyone seeking to negotiate a better deal must start by knowing the price of what they are buying. Hardly any taxpayers have the slightest inkling of the price tag of their government.

For a glimpse into the cost of government per person, consider the fiscal year ending in 2014 (FY 2014), in which the federal budget showed spending of $3.5 trillion, federal tax receipts of $3.021 trillion, and a budget deficit of $.485 trillion. During this year, each of the 320 million Americans on average benefitted from approximately $10,956 worth of government spending on everything from Medicare to the military. However, on average, each American only paid approximately $9,440 in taxes in exchange for the government's services. Today's Americans are free-riding at the expense of tomorrow's Americans.

In an ideal world, the government would only spend on things in the national interest and tax only in ways that do not retard economic growth or treat taxpayers unfairly, but history shows that this ideal exists only in our imaginations. In the real world, people want to get as much from the government as they can get, while at the same time, wanting to avoid being taxed to pay for it. For current taxpayers, paying only 86 cents for each dollar of government spending beats paying the whole dollar, as paying the whole dollar would require a 16% increase in tax revenues. So, who pays the difference, and how does the current distribution of the tax burden affect you? This book was written to answer those questions.

As things stand now, politicians—influenced by lobbyists and special interest—divvy up the tax burden and decide what taxes Americans will pay when each new session of Congress meets. Lawmaking is too elegant a term to describe the divvying process. It should be likened more to a game: the tax game. Like other games, the tax game produces winners and losers with each round it is played. Winning or losing the tax game has nothing to do with fairness, and everything to do with knowing how to play it. The politicians and those who influence them are the players, and who wins the tax game determines who pays what in taxes.

Even though the odds clearly favor the politically powerful and wealthy taxpayers who can afford to hire influencers, ordinary taxpayers hold a trump card: we still live in a democracy and ordinary taxpayers greatly outnumber the rich ones. Taxpayers that fail to learn about tax policy and how to protect their interests will continue to pay a larger percentage of their income on taxes than those who know how to work the system.

PAYING FOR GOVERNMENT

Since at least the 1930s, taxes on income—the personal income tax, the payroll tax that pays for Social Security and much of Medicare, and the corporate income tax—have been the mainstay of paying for the costs of government.

The **personal income tax** applies to (1) all individuals, regardless of citizenship, age, or status, who earn income in America, and (2) all individual American citizens, regardless of age or status, who earn income anywhere.

The **payroll tax** applies to (1) all individuals, regardless of citizenship, age, or status, who earn wage income in America, (2) all individual American citizens, regardless of age or status, who earn wage income anywhere, and (3) all individuals and businesses who pay wages to employees.

The **corporate income tax** applies to (1) all corporations who earn income in America, and (2) all American corporations who earn income anywhere.

In addition to income taxes, two other categories of taxes pay for the remainder of the cost of government: **excise taxes** and other miscellaneous taxes.

Excise taxes apply to the sale of goods and services by American businesses anywhere and foreign businesses who sell goods and services in America.

Other taxes include the **estate and gift tax** which taxes the estates of all Americans and a grab bag of other miscellaneous taxes.

Table V-1 **Revenues by Source for FY 2014**		
	Amount	Percentage
Personal Income Tax	$1,394,568,000,000	46.16%
Corporate Income Tax	$320,731,000,000	10.62%
Social Insurance Taxes (the Payroll Tax)	$1,023,458,000,000	33.87%
Excise Taxes	$93,368,000,000	3.09%
Other	$189,362,000,000	6.27%
Total	$3,021,487,000,000	100.00%
Source: Data extracted from Fiscal Year 2016 Historical Tables, Table 1.3, Office of Management and Budget.		

As Table V-1 shows, two taxes—the personal income tax and the payroll tax–account for about 80% of total revenues. For at least the last 30 years or so, there has been little change in the relative percentages (as shown in Table V-1) of the mix of taxes that pay for the cost of government.

TAXING PERSONAL INCOME

After World War I, America switched from using regressive consumption taxes to pay for most of government, to using progressive taxes on personal income. Progressive taxation means taxing those with less income less, and taxing those with more income more. In the tax game, low-income taxpayers have an interest in increasing the progressivity of taxes, and high-income taxpayers have an interest in decreasing it. This conflict—whether taxes should be made more or less progressive—defines most of what the tax game is all about.

Two factors determine the progressivity of income taxes—the tax rate structure and tax preferences. A tax rate structure with graduated tax rates—in which marginal tax rates rise at least as fast as income increases the progressivity of taxes, and conversely, any tax rate structure in which marginal tax rates rise slower than income rises—decreases progressivity. Tax preferences result from special political deals in which certain types of income and expenditures get preferred treatment under the tax laws. Tax preferences enable certain preferred types of (a) income to be either excluded from taxation or taxed at reduced tax rates and (b) expenditures to be either deducted from or credited against taxes. Most types of income and expenditures that get special political treatment are attributable primarily to high-income taxpayers. Taken as a whole, tax preferences greatly reduce the progressivity of taxes.

Progressive taxation requires striking a balance between how much those with low income and those with high income should pay and doing it in a way that maximizes economic growth. Economic growth means more money for both consumption and investment—the types of expenditures that drive the economy and set the standard of living for most Americans. The economic fate of America's middle class depends on taxing in a way that both strikes the right balance in progressivity and simultaneously maximizes growth.

The Parameters of Progressivity

Taxing those with high income at higher rates than those with low-income leaves open the question of just how much more: progressivity without parameters offers little guidance for taxing. Two principles bracket how much those at the low end and the high end of the income scale should be taxed:

- No taxpayer who works full time should be taxed into or near poverty; and

- No taxpayer should be taxed so much that they have no reasonable incentive to earn the next dollar either through their own labor or through the investment of their capital.

Taxing full-time, low-wage workers at a level that draws them close to (or deeper into) poverty discourages them from working and invites both social and political unrest. If poverty is x, then how much after-tax income above x—10%, 15%, 20%, 25%, or higher—should a full-time worker be allowed to keep? This question gets answered in the tax game by politicians, not non-partisan tax experts. The less after-tax income those with low-income can keep, the more after-tax income those with high-income can keep.

Taxing high-income taxpayers' income at a level so high that it unreasonably discourages them from working or investing to make the next dollar results in slowing economic growth and also invites social and political unrest. At what level of taxation—30%, 35%, 40%, 45% or higher—would a taxpayer with $1 million or more income be unreasonably deterred from working or investing to make the next dollar? This question also gets answered in the tax game by politicians, not non-partisan tax experts. The less after-tax income those with high-income can keep, the more after-tax income those with low-income can keep.

Once these outer parameters are set, the politicians who preside over the tax game still must answer thousands of questions about who pays what, like the following examples:

- What rate should a family of four with an income of $90 thousand pay versus what rate a single 23-year old taxpayer with an income of $25 thousand pay?
- Should ordinary workers who have had no real wage increase in years get a break on their rates *versus* highly educated professionals who are on the fast track to success?
- Should the old get a tax break simply because they are old?
- Should homeowners get a tax break at the cost of increasing taxes on renters?
- Should a single mother of three who works full time and earns a poverty wage pay any taxes?
- If Tom Brady's taxes are increased by 5 percentage points would his game suffer because of a lack of financial incentive due to paying more taxes?
- Should high-income entertainers pay more so that ordinary workers can pay less?
- Should a billionaire's wastrel kid pay tax on the money he or she inherits?
- Should those who want to give to charity get a tax break paid for by those who do not want to give?

- Should those who get their income from their own labor pay more in taxes so that those who get their income from investing and saving can pay less?

- Should successful stock speculators get a tax break for successful speculation?

- Would a billionaire be less likely to invest his money if his effective tax rate increased from 22% to 42%?

Many of these questions go far beyond how much money a taxpayer makes and get into social matters like marriage and size of families, personal spending choices, and whether a taxpayer earns his money by the sweat of his brow or by investing his or someone else's capital.

At any point in time, the cost of government is a fixed amount set by law based on duly authorized appropriations and other legal commitments made by Congress and the President. Like it or not, the taxpayers are legally bound to pay for all cost that the government has legally incurred. Taxing, therefore, becomes a zero-sum game in that, if one taxpayer gets a break, some other current or future taxpayer must make up the difference. So, how the politicians answer these questions determines what each taxpayer's after-tax income will be and whether tax policy will help or hinder economic growth.

Progressivity and Types of Taxable Income

Of the two taxes on personal income, the personal income tax (despite the proliferation of tax preferences) is much more progressive than the payroll tax.

Unlike the payroll tax, which taxes only wage income from the first dollar earned, the personal income tax taxes many more (though not all) types of income and does not tax the first dollar earned. By taxing only wage income, the payroll tax hits those with low income (who depend on wages for all, or almost all, their income) much harder than those with high income (who oftentimes derive much of their income from non-wage sources). As shown on Table V-2, the percentage of non-wage income relative to wage income increases dramatically as taxpayers' income increases.

Table V-2 **Percentage of Salaries and Wages in Relation to Adjusted Gross Income for Taxpayers by Size of Adjusted Gross Income for 2013**			
Size of Adjusted Gross Income	Average Adjusted Gross Income	Salaries and Wages as % of Adjusted Gross Income	All Non-Wage Income as % of Adjusted Gross Income
$15,000 under $30,000	$21,982	80%	20%
$30,000 under $50,000	$39,164	81%	19%
$50,000 under $100,000	$71,524	77%	23%
$1,000,000 under $1,500,000	$1,202,164	47%	53%
$1,500,000 under $2,000,000	$1,718,216	42%	58%
$2,000,000 under $5,000,000	$2,975,787	37%	63%
$5,000,000 under $10,000,000	$6,810,392	32%	68%
$10,000,000 or more	$29,555,266	18%	82%
Top 400 Taxpayers	$264,034,000	8%	92%
Source: Data extracted from Table 2.1 Returns with Itemized Deductions: Sources of Income, Adjustments, Itemized Deductions by Type, Exemptions, and Tax Items, by Size of Adjusted Gross Income, Tax Year 2013.			

Table V-2 shows that for those with incomes over $1 million less than one half of their income is subject to the payroll tax, and, as their income increases, their percentages of income subject to the payroll tax falls. Also, Table V-2 shows that for those with incomes under $100,000 more than three-fourths of their income are subject to the payroll tax, and, as their income falls, their percentages of income subject to the payroll tax rises. If you are a high-income taxpayer, you like a tax that does not tax a big chunk of your income, but, if you are a low-income taxpayer, you do not like getting stuck with a bigger tax bill to make up for other taxpayers' income that was not taxed.

Progressivity and Income Tax Rates

The personal income tax is more progressive than the payroll tax because it has a progressive rate structure, as shown in Tables V-3, V-4, and V-5, while the payroll tax has a flat-rate structure, as shown in Table V-6. As an integral part of the rate structure, the personal income tax allows a "standard deduction" and "personal exemptions," each of which is deducted from the income to be taxed. In 2017, a change in the personal income tax eliminated the personal exemption by adjusting the standard deduction to reflect the number of dependents in a household.

Table V-3
Form of Tax Rate Schedule

2015 Tax Rate Schedules

Caution. *Do not use these Tax Rate Schedules to figure your 2014 taxes. Use only to figure your 2015 estimated taxes.*

Schedule X—Use if your **2015** filing status is **Single**

If line 5 is: Over—	But not over—	The tax is:			of the amount over—
$0	$9,225	----------	+	10%	$0
9,225	37,450	$922.50	+	15%	9,225
37,450	90,750	5,156.25	+	25%	37,450
90,750	189,300	18,481.25	+	28%	90,750
189,300	411,500	46,075.25	+	33%	189,300
411,500	413,200	119,401.25	+	35%	411,500
413,200	----------	119,996.25	+	39.6%	413,200

Schedule Z—Use if your **2015** filing status is **Head of household**

If line 5 is: Over—	But not over—	The tax is:			of the amount over—
$0	$13,150	----------	+	10%	$0
13,150	50,200	$1,315.00	+	15%	13,150
50,200	129,600	6,872.50	+	25%	50,200
129,600	209,850	26,722.50	+	28%	129,600
209,850	411,500	49,192.50	+	33%	209,850
411,500	439,000	115,737.00	+	35%	411,500
439,000	----------	125,362.00	+	39.6%	439,000

Schedule Y-1— Use if your **2015** filing status is **Married filing jointly or Qualifying widow(er)**

If line 5 is: Over—	But not over—	The tax is:			of the amount over—
$0	$18,450	----------	+	10%	$0
18,450	74,900	$1,845.00	+	15%	18,450
74,900	151,200	10,312.50	+	25%	74,900
151,200	230,450	29,387.50	+	28%	151,200
230,450	411,500	51,577.50	+	33%	230,450
411,500	464,850	111,324.00	+	35%	411,500
464,850	--------	129,996.50	+	39.6%	464,850

Schedule Y-2—Use if your **2015** filing status is **Married filing separately**

If line 5 is: Over—	But not over—	The tax is:			of the amount over—
$0	$9,225	--------	+	10%	$0
9,225	37,450	$922.50	+	15%	9,225
37,450	75,600	5,156.25	+	25%	37,450
75,600	115,225	14,693.75	+	28%	75,600
115,225	205,750	25,788.75	+	33%	115,225
205,750	232,425	55,662.00	+	35%	205,750
232,425	----------	64,998.25	+	39.6%	232,425

Source: IRS

Table V-3 shows that personal income tax rates for all categories of taxpayers—single, head of a household, married filing jointly or qualified widower, or married filing separately—increase as income rises and can easily be made more progressive by increasing rates on those with relatively more income and/or decreasing rates on those with relatively less income. Tax rates change each year, and in 2017 were revised to cut marginal rates.

The standard deduction, as shown in Table V-4, is available to all taxpayers who choose not to itemize their deductions. Within each category of taxpayers who chose the standard deduction, all are treated the same without any taxpayer being favored over any other. The standard deduction is changed each year to reflect inflation.

Table V-4
Standard Amounts

2015 Standard Deduction Amounts

There are two main types of tax deductions: the standard deduction and itemized deductions. You can claim one type of deduction on your tax return, but not both. For example, if you claim the standard deduction, you cannot itemize deductions – and vice versa (if you itemize deductions, you cannot claim the standard deduction). You are allowed to use whichever type of deduction results in the lowest tax.

The standard deduction is subtracted from your Adjusted Gross Income (AGI), thereby reducing your taxable income. For tax year 2015, the standard deduction amounts are as follows:

Filing Status	Standard Deduction
Single	$6,300
Married Filing Jointly	$12,600
Married Filing Separately	$6,300
Head of Household	$9,250
Qualifying Widow(er)	$12,600

Source: IRS

The personal income tax also can easily be made more progressive by increasing the standard deduction for taxpayers in one or more of the categories.

Personal exemptions, as shown in Table V-5, are available to all taxpayers except for those with very high income. Personal exemptions were eliminated in 2017, and the standard deduction was increased to reflect the number of dependents in each household.

Table V-5
Personal Exemptions

2015 Personal Exemption Amounts

You are allowed to claim one personal exemption for yourself and one for your spouse (if married). However, if somebody else can list you as a dependent on their tax return, you are not permitted to claim a personal exemption for yourself.

For tax year 2015, the personal exemption amount is $4,000 (up from $3,950 in 2014).

The personal exemption amount "phases out" for taxpayers with higher incomes. The Personal Exemption Phaseout (PEP) thresholds are as follows:

Filing Status	PEP Threshold Starts	PEP Threshold Ends
Single	$258,250	$380,750
Married Filing Jointly	$309,900	$432,400
Married Filing Separately	$154,950	$216,200
Head of Hosuehold	$284,050	$406,550

Source: IRS

Unlike the personal income tax which has higher rates for those with higher income, the payroll tax has only a single 7.65% rate for employees on their wage income and a single 15.65% rate for the self-employed on their net business income, as shown on Table V-6.

Table V-6
Payroll Tax Rate and Maximum Taxable Earnings.

	2014	2015
Tax Rate:		
Employee	7.65%	7.65%
Self-Employed	15.30%	15.30%

NOTE: The 7.65% tax rate is the combined rate for Social Security and Medicare. The Social Security portion (OASDI) is 6.20% on earnings up to the applicable taxable maximum amount (see below). The Medicare portion (HI) is 1.45% on all earnings. Also, as of January 2013, individuals with earned income of more than $200,000 ($250,000 for married couples filing jointly) pay an additional 0.9 percent in Medicare taxes. The tax rates shown above do not include the 0.9 percent.

	2014	2015
Maximum Taxable Earnings:		
Social Security (OASDI only)	$117,000	$118,500
Medicare (HI only)	No Limit	

Source: Social Security

In addition to the rates and caps shown in Table V-6, in 2013, the payroll tax was increased by .09% on all wage income above $200,000 for individuals and above $250,000 for married couples. Also, there is no cap on the amount of income that can be taxed under the personal income tax, but there is a $118,500 cap on the amount of wage income that can be taxed under the Social Security portion of the payroll tax. Each year the cap is increased to reflect inflation. Caps on the amount of income that can be taxed favor high-income taxpayers and make a tax less progressive.

For taxpayers who are employed, their employer pays a separate employer payroll tax equal to the employee tax. Even though employers pay a payroll tax for their employees, there is a broad consensus among tax experts that it is the employees who bear the burden of the tax in that the tax reduces the compensation that the employees would have received but for the tax.

Taxing only a capped amount of wage income from the first dollar earned at a single rate makes the payroll tax much less progressive than the personal income tax.

Progressivity of the Personal Income Tax vs. the Payroll Tax

Comparing how much a middle-income taxpayer pays under the personal income tax, and payroll tax with how much a high-income taxpayer pays under those taxes proves that the personal income tax is many times more progressive than the payroll tax.

A self-employed, married taxpayer with two minor children, whose total net self-employed income was $60,000, who qualified for a $28,600 standard deduction would have had taxable income of $31,400 ($60,000 – $28,600) and would have owed $3,787.50 in personal income tax in 2015. This same taxpayer would have owed $9,180 in payroll taxes. To most middle-income taxpayers, the personal income tax is small potatoes compared with the payroll tax.

A self-employed, married taxpayer with two minor children, whose total net self-employed income was $2,500,000 and whose non-wage income was $7,500,000, and who qualified for a $12,600 standard deduction would have had taxable income of $9,987,400 ($10,000,000 – $12,600) and would have owed $3,900,926.30 in personal income tax in 2015. This same taxpayer would have owed $72,905 of payroll taxes.

The middle-income taxpayer's payroll tax was 15.65% of his income, and his personal income tax was only 6.3% of his income, while the high-income taxpayer's payroll taxes were only .07% of his income, and his personal income tax was 39% of his income. To middle and low-income taxpayers, their payroll taxes are the primary taxes they pay, while to very high-income taxpayers, they are only a little more than an afterthought.

Progressivity and Tax Preferences

Tax preferences are the hundreds of special deals that the politicians stick in the tax code to do favors for politically preferred groups. Three government agencies, the OMB, and three in Congress (the JCT, the CBO, and the GAO), all track and report on the effects of tax preferences (also called "tax expenditures" by the tax professionals) on taxation, the budget, and the economy. The effects of tax preferences on taxes and the budget are tremendous. The CBO in its Budget Outlook for 2016-2026 estimated that "the more than 200 tax expenditures [tax preferences][…]will total almost $1.5 trillion in fiscal year 2016[…][which][…]equals nearly half of all federal revenues projected for 2016 and exceeds projected spending on Social Security, defense, or Medicare."

Tax preferences fall into four distinct categories, as follows:

- first, "income exclusions" that exclude certain politically favored types of income, such as employer contributions to employee health care and health care and long-term care insurance premiums, contributions to and earnings on pension funds, and the interest on certain types of municipal bonds from being taxed;

- second, "itemized deductions" that enable some taxpayers to deduct from their income subject to being taxed a percentage of various types of politically favored personal expenditures, such as home mortgage interest, state and local taxes, and charitable contributions;

- third, "preferred rates" that enable some high-income taxpayers to pay low rates on certain types of politically favored income, such as long-term capital gains and qualified dividends; and

- fourth, "tax credits" in two forms: (1) "non-refundable tax credits" that enable some taxpayers to credit against their taxes up to 100% of their tax liability for certain types of politically favored types of personal expenditures, such as renewable energy projects, miscellaneous housing expenditures, qualifying tuition expenses, and many others; and (2) "refundable tax credits" that enable some taxpayers to be refunded more than 100% of their tax liability to supplement their income through credits such as the earned income credit (aka EIC, earned income tax credit) and the child credit, and health insurance credits.

Almost all tax preferences other than refundable credits make the personal income tax less progressive in that they benefit those with higher income more than those with lower income.

The JCT's analysis of tax expenditures shows that each tax preference is a story in terms of who it helps, its effect on the economy, and its cost to other taxpayers who must pay higher taxes to make up for the revenue loss. Each year OMB, on behalf of the executive branch, prepares a federal budget and details the cost of tax preferences over a 10-year period, and shows their effect on the overall budget. Any politician who claims that they do not know what the effects of tax preferences are is admitting to laziness because all they need do is read the reports of OMB, JCT, and CBO.

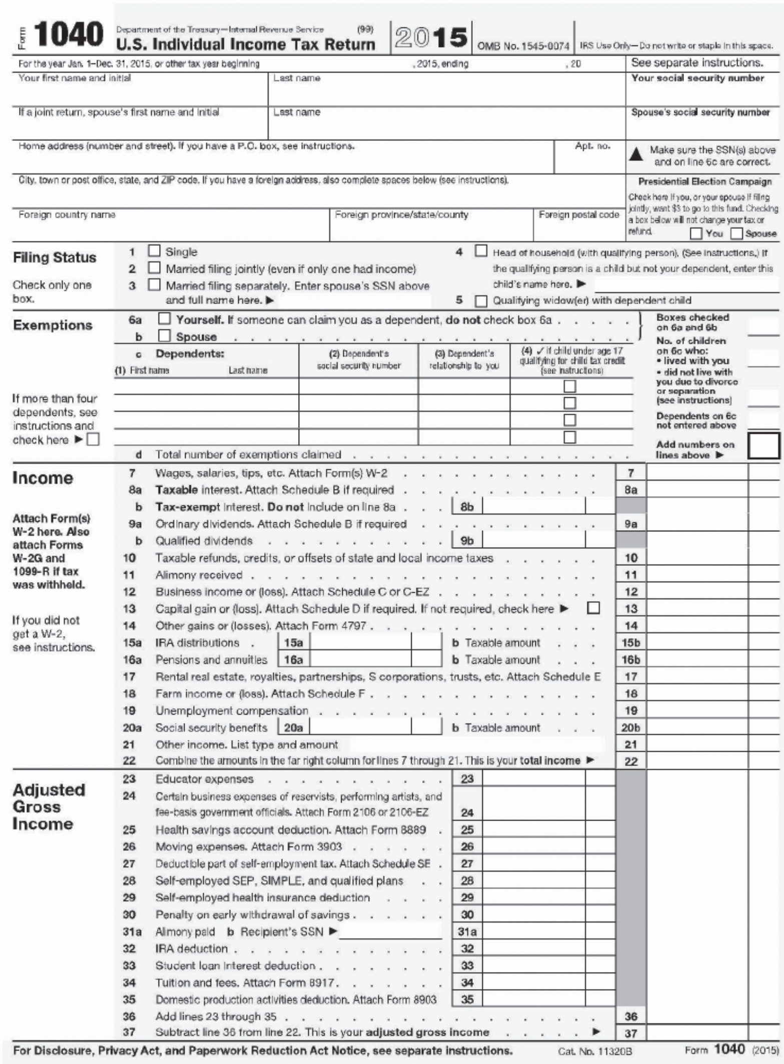
THE PERSONAL INCOME TAX

As the personal income tax has become cluttered with tax preferences, it has become so complex only very few tax professionals can understand it, and as the clutter continues, so too does complexity.

Form 1040, the Starting Point

Form 1040 (see figure 1), the form on which almost all individual taxpayers report their income and pay their income taxes, illustrates the complexity.

Figure 1
IRS Form 1040 – 2015


Form 1040 Department of the Treasury—Internal Revenue Service (99) U.S. Individual Income Tax Return 2015 OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

For the year Jan. 1–Dec. 31, 2015, or other tax year beginning , 2015, ending , 20 See separate instructions.

Your first name and initial | Last name | Your social security number

If a joint return, spouse's first name and initial | Last name | Spouse's social security number

Home address (number and street). If you have a P.O. box, see instructions. | Apt. no. | ▲ Make sure the SSN(s) above and on line 6c are correct.

City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions). | Presidential Election Campaign

Foreign country name | Foreign province/state/county | Foreign postal code | Check here if you, or your spouse if filing jointly, want $3 to go to this fund. Checking a box below will not change your tax or refund. ☐ You ☐ Spouse

Filing Status

Check only one box.

1 ☐ Single
2 ☐ Married filing jointly (even if only one had income)
3 ☐ Married filing separately. Enter spouse's SSN above and full name here. ▶
4 ☐ Head of household (with qualifying person). (See instructions.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶
5 ☐ Qualifying widow(er) with dependent child

Exemptions

6a ☐ **Yourself.** If someone can claim you as a dependent, **do not** check box 6a
b ☐ Spouse
c Dependents: (1) First name Last name | (2) Dependent's social security number | (3) Dependent's relationship to you | (4) ✓ if child under age 17 qualifying for child tax credit (see instructions)
d Total number of exemptions claimed

If more than four dependents, see instructions and check here ▶ ☐

Boxes checked on 6a and 6b
No. of children on 6c who:
• lived with you
• did not live with you due to divorce or separation (see instructions)
Dependents on 6c not entered above
Add numbers on lines above ▶

Income

Attach Form(s) W-2 here. Also attach Forms W-2G and 1099-R if tax was withheld.

If you did not get a W-2, see instructions.

7 Wages, salaries, tips, etc. Attach Form(s) W-2 — 7
8a **Taxable** interest. Attach Schedule B if required — 8a
b **Tax-exempt** interest. **Do not** include on line 8a — 8b
9a Ordinary dividends. Attach Schedule B if required — 9a
b Qualified dividends — 9b
10 Taxable refunds, credits, or offsets of state and local income taxes — 10
11 Alimony received — 11
12 Business income or (loss). Attach Schedule C or C-EZ — 12
13 Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ ☐ — 13
14 Other gains or (losses). Attach Form 4797 — 14
15a IRA distributions 15a — b Taxable amount — 15b
16a Pensions and annuities 16a — b Taxable amount — 16b
17 Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E — 17
18 Farm income or (loss). Attach Schedule F — 18
19 Unemployment compensation — 19
20a Social security benefits 20a — b Taxable amount — 20b
21 Other income. List type and amount — 21
22 Combine the amounts in the far right column for lines 7 through 21. This is your **total income** ▶ — 22

Adjusted Gross Income

23 Educator expenses — 23
24 Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ — 24
25 Health savings account deduction. Attach Form 8889 — 25
26 Moving expenses. Attach Form 3903 — 26
27 Deductible part of self-employment tax. Attach Schedule SE — 27
28 Self-employed SEP, SIMPLE, and qualified plans — 28
29 Self-employed health insurance deduction — 29
30 Penalty on early withdrawal of savings — 30
31a Alimony paid b Recipient's SSN ▶ — 31a
32 IRA deduction — 32
33 Student loan interest deduction — 33
34 Tuition and fees. Attach Form 8917 — 34
35 Domestic production activities deduction. Attach Form 8903 — 35
36 Add lines 23 through 35 — 36
37 Subtract line 36 from line 22. This is your **adjusted gross income** ▶ — 37

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11320B Form **1040** (2015)

Although form 1040 is only 2 pages, it is supplemented by numerous schedules and worksheets that add many, many pages for most taxpayers. Underlying form 1040 are many hundreds of pages of instructions, which in turn are distilled from many more hundreds of pages of laws and regulations. Even for individual taxpayers with the simplest taxes who have only wage income and claim the standard deduction, most will still need professional help to complete form 1040, and for those taxpayers with substantial income from sources other than wages, almost all will need very sophisticated tax accountants and lawyers to complete it.

Frequent changes are made to the tax laws which require updating the tax forms periodically. For most wage-earning taxpayers, changes in the tax forms are not significant, but for high-income taxpayers with significant non-wage income, changes in the tax forms are often quite significant and complex. Most wage-earning taxpayers can either complete their tax returns themselves or hire a non-professional tax preparer to do it, but almost all high-income taxpayers who have significant non-wage income must hire highly paid tax professionals to prepare their tax returns.

Completing Form 1040: A Mind-Bending Ordeal

For all but a very few taxpayers, filling out form 1040 is a mind-bending ordeal.

Step 1 is to fill out the taxpayer contact and demographic data on lines 1-6, which is the simplest part of the process.

Step 2 is to report all income, as shown on lines 7-22, to come up with the taxpayers "total income," which includes, among other things, compensation for services, such as wages, salaries, commissions, and fees, all income derived from business, gains from dealings in property (real, tangible, and intangible), interest, rents, royalties, dividends, alimony, pensions, and annuities. Tax preferences, however, exclude certain categories of income—income exclusions—from being included in total income, among which are the proceeds of life insurance paid to a beneficiary as a result of the death of the person who took out the policy, the proceeds of most inheritances or gifts, the interest on tax-exempt municipal bonds, employer-paid premiums for health insurance, contributions to employer-sponsored cafeteria health care plans, and the amount paid as benefits on health insurance.

Although all income is made up of fungible dollars, form 1040 breaks it down into 16 separate categories, one of which is a catchall, "other income." For wealthy taxpayers, two lines, 9^{b} and 13, are especially important because it is on these lines that "qualified dividends" and long term "capital gains" are reported. To qualify as a long-term capital gain, an investment must be held for more than one year, and to qualify as a qualified dividend, the corporate stock on which the dividend is paid also must be held for more than one year. Qualified dividends and capital gains are the subject of two leading tax preferences, both of which confer almost all their benefits on very high-income taxpayers, as shown on Table V-7.

Table V-7 Percentages of Qualified Dividends and Capital Gains Claimed by Taxpayers With an Adjusted Gross Income Over $100,000 in 2013	
Total Qualified Dividends	$158,069,115,000
Total Capital Gains	$504,322,768,000
Percentage of Qualified Dividends Claimed by Taxpayers with AGI > $100,0000	79%
Percentage of Capital Gains Claimed by Taxpayers with AGI > $100,0000	89%
Source: Data Extracted from IRS Table 1.4 All Returns: Sources of Income, Adjustments, and Tax Items, by Size of Adjusted Gross Income, Tax Year 2013	

Contrasted with all other forms of income, rates applicable to capital gains and qualified dividends—preferred rates—are capped at a maximum rate of 20%. From time-to-time capital gains are raised or lowered. These tax preferences add great complexity to the personal income tax, take up hundreds of pages of laws and regulations, and enable those with the greatest wealth to pay lower rates on qualified dividends and capital gains, aka "unearned income," than many wage earners pay on wage income, aka "earned income."

Each category of income that gets special treatment is the subject of a tax preference. If there were no tax preferences, there would be only one line for total income.

Step 3 is to specify all special deductions on lines 23-36, known by tax professionals as "above-the-line-deductions," which are deductible by all taxpayers. "Adjusted gross income," as shown on line 37, is total income less the sum of above-the-line-deductions. Above-the-line-deductions are so named because tax professionals draw a line at adjusted gross income in that all deductions on lines above line 37 apply to all taxpayers while all deductions below line 37 apply only to those who itemize their deductions.

Just as with income exclusions, each above-the-line-deduction gets special treatment because it is the subject of a tax preference. If there were no tax preferences, lines 23-37 would not be needed, and total income and adjusted gross income would be the same.

Step 4 is to determine the larger of "itemized deductions," or the standard deduction, and to do that, taxpayers must fill out schedule A (see Figure 2) to form 1040.

Figure 2 – IRS Form Schedule A, Itemized Deductions 2015

SCHEDULE A (Form 1040)
Department of the Treasury Internal Revenue Service (99)

Itemized Deductions

▶ Information about Schedule A and its separate instructions is at *www.irs.gov/schedulea*.
▶ Attach to Form 1040.

OMB No. 1545-0074 **2015** Attachment Sequence No. **07**

Name(s) shown on Form 1040 | Your social security number

Medical and Dental Expenses		**Caution:** Do not include expenses reimbursed or paid by others.	
	1	Medical and dental expenses (see instructions)	1
	2	Enter amount from Form 1040, line 38 [2]	
	3	Multiply line 2 by 10% (.10). But if either you or your spouse was born before January 2, 1951, multiply line 2 by 7.5% (.075) instead	3
	4	Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-	4
Taxes You Paid	5	State and local **(check only one box):** a ☐ Income taxes, **or** b ☐ General sales taxes	5
	6	Real estate taxes (see instructions)	6
	7	Personal property taxes	7
	8	Other taxes. List type and amount ▶	8
	9	Add lines 5 through 8	9
Interest You Paid Note: Your mortgage interest deduction may be limited (see instructions).	10	Home mortgage interest and points reported to you on Form 1098	10
	11	Home mortgage interest not reported to you on Form 1098. If paid to the person from whom you bought the home, see instructions and show that person's name, identifying no., and address ▶	11
	12	Points not reported to you on Form 1098. See instructions for special rules	12
	13	Mortgage insurance premiums (see instructions)	13
	14	Investment interest. Attach Form 4952 if required. (See instructions.)	14
	15	Add lines 10 through 14	15
Gifts to Charity If you made a gift and got a benefit for it, see instructions.	16	Gifts by cash or check. If you made any gift of $250 or more, see instructions	16
	17	Other than by cash or check. If any gift of $250 or more, see instructions. You **must** attach Form 8283 if over $500	17
	18	Carryover from prior year	18
	19	Add lines 16 through 18	19
Casualty and Theft Losses	20	Casualty or theft loss(es). Attach Form 4684. (See instructions.)	20
Job Expenses and Certain Miscellaneous Deductions	21	Unreimbursed employee expenses—job travel, union dues, job education, etc. Attach Form 2106 or 2106-EZ if required. (See instructions.) ▶	21
	22	Tax preparation fees	22
	23	Other expenses—investment, safe deposit box, etc. List type and amount ▶	23
	24	Add lines 21 through 23	24
	25	Enter amount from Form 1040, line 38 [25]	
	26	Multiply line 25 by 2% (.02)	26
	27	Subtract line 26 from line 24. If line 26 is more than line 24, enter -0-	27
Other Miscellaneous Deductions	28	Other—from list in instructions. List type and amount ▶	28
Total Itemized Deductions	29	Is Form 1040, line 38, over $154,950? ☐ **No.** Your deduction is not limited. Add the amounts in the far right column for lines 4 through 28. Also, enter this amount on Form 1040, line 40. ☐ **Yes.** Your deduction may be limited. See the Itemized Deductions Worksheet in the instructions to figure the amount to enter.	29
	30	If you elect to itemize deductions even though they are less than your standard deduction, check here ▶ ☐	

For Paperwork Reduction Act Notice, see Form 1040 instructions. Cat. No. 17145C **Schedule A (Form 1040) 2015**

Itemized deductions are also known as below-the-line-deductions because they appear on line 40 below adjusted gross income on line 37. Leading itemized deductions include, among others, interest paid on home mortgages, certain medical and dental expenses, charitable contributions, state and local taxes, certain unreimbursed job expenses, and a mishmash of miscellaneous deductions. As a taxpayer's income goes up, the value of itemized deductions is curtailed. Each itemized deduction is the subject of a tax preference. If there were no tax preferences, there would be no need for schedule A, and all taxpayers would take the standard deduction.

Step 5 is to take the larger of the standard deduction or itemized deductions, enter it on line 40, and deduct the sum on line 40 from adjusted gross income on line 38. Just as the tax preferences for qualified dividends and capital gains favor high-income taxpayers, so too do the tax preferences that relate to itemized deductions. Table V-8 shows by income group just how much more high-income taxpayers got out of itemized deductions than low-income taxpayers.

Table V-8
Statistics Relating to Itemized Deduction

Size of Adjusted Gross Income	Number of Returns	Number of Returns Itemizing	Percentage of Returns Itemizing	Average Amount of Itemized Deductions
All returns, total	147,351,299	44,330,496	30.08%	$26,812
No adjusted gross income	2,113,013	0	0.00%	$0
$1 under $5,000	10,608,111	352,950	3.33%	$16,389
$5,000 under $10,000	12,030,388	434,830	3.61%	$15,378
$10,000 under $15,000	12,503,345	742,962	5.94%	$14,711
$15,000 under $20,000	11,621,535	902,415	7.77%	$15,040
$20,000 under $25,000	10,125,285	988,360	9.76%	$15,611
$25,000 under $30,000	8,809,515	1,211,423	13.75%	$15,616
$30,000 under $40,000	14,473,606	2,886,977	19.95%	$15,710
$40,000 under $50,000	11,279,394	3,292,604	29.19%	$16,118
$50,000 under $75,000	19,229,309	8,015,510	41.68%	$17,780
$75,000 under $100,000	12,574,107	7,356,600	58.51%	$20,415
$100,000 under $200,000	16,425,446	12,950,515	78.84%	$25,771
$200,000 under $500,000	4,488,110	4,208,986	93.78%	$44,512
$500,000 under $1,000,000	724,251	668,727	92.33%	$89,623

$1,000,000 under $1,500,000	156,269	142,203	91.00%	$162,535
$1,500,000 under $2,000,000	64,235	58,573	91.19%	$221,717
$2,000,000 under $5,000,000	91,128	83,993	92.17%	$390,698
$5,000,000 under $10,000,000	21,412	20,375	95.16%	$865,587
$10,000,000 or more	12,839	12,493	97.31%	$4,688,125
Source: Data extracted from IRS Table 1.2 All Returns: Adjusted Gross Income, Exemptions, Deductions, and Tax Items, by Size of Adjusted Gross Income and by Marital Status, Tax Year 2013				

Table V-8 shows the following:

- only about 30% of all taxpayers benefit from itemized deductions,

- as taxpayers adjusted gross income rises, so too does their itemization,

- on average, most taxpayers whose adjusted gross income is less than $100,000, do not get much more out of itemized deductions than they would from the standard deduction,

- on average, middle to high-income taxpayers (*i.e.* married taxpayers filing jointly whose adjusted gross income is $75,000 to $100,000) get an itemized deduction worth 1.67 times more than their standard deduction, and

- on average very high-income taxpayers (*i*.e. married taxpayers filing jointly whose adjusted gross income is $10 million or more) get an itemized deduction worth 384 times more than from the standard deduction.

Itemized deductions add hundreds of pages to tax laws and regulations, tremendous complexity to taxpaying, do not do much for most middle-income taxpayers, and do a huge favor for very high-income taxpayers.

Step 6 is to list the number of personal exemptions for which the taxpayer qualifies.

Step 7 is to deduct the amount on line 42, the sum of personal exemptions, from the amount on line 41, the net of adjusted gross income less total deductions, to come up with the taxpayer's "taxable income."

Step 8 is to complete line 44, which opens a whole new world of complexity. Line 44 refers taxpayers to a page of detailed instructions referencing forms 8814, (relating to a child's interest or dividends), 4972 (relating to lump sum distributions), tax due to a section 962 election, form 8863 (relating to recapture of an education credit), form 8621 (relating to a section 1291 fund), form 8615 (relating to tax tables), the Foreign Earned Income Tax Worksheet, and the Qualified Dividends and Capital Gain Tax Worksheet. After reading these instructions, most taxpayers will turn to a tax professional to tell them "what the hell it all means."

Assuming a taxpayer (by hook or crook) figures out what these instructions mean, then he or she enters their tax on line 44 and girds up for the next step.

Step 9 is to complete line 45 relating to any tax due under the alternative minimum tax (the AMT), which applies only to certain high-income taxpayers. The AMT is a story in and of itself, more of which will be told later. Meanwhile, a brief perusal of the instructions for form 6251 shows how difficult it is to figure out how much AMT to pay for those high-income taxpayers who are fortunate to make enough money to have the privilege of paying it.

Step 10 is to complete lines 46-56 to report a few miscellaneous credits, each of which requires the completion of yet more forms, to determine if the taxpayer qualifies for each credit, and if so, how much the credit is.

Step 11 is to pay any additional taxes on lines 57-62 that may apply to some taxpayers such as the self-employment tax, unreported Social Security and Medicare taxes, additional tax on IRAs, the household employment tax (aka the "nanny tax"), and other miscellaneous taxes. Each of these taxes has its own form and set of instructions.

Step 12 is to complete line 63, which carries the promising (but somewhat misleading) label "total tax." Recapping, total tax is the sum of tax (on line 44), the AMT (on line 45), and an odd lot tax credit (on line 46) less applicable credits (on lines 48-54) plus the sum of other miscellaneous taxes (on lines 57-62). Even after coming up with total tax, there is still more to do.

Step 13 is to complete lines 64-74, which relate to administrative matters, including withholding and estimated payments (on lines 64-65), a few additional miscellaneous credits (on lines 69 and 72-73), and most importantly, several very important refundable credits targeted to benefit low-income taxpayers. These targeted refundable credits, more of which will be told later, include the EIC, the additional child credit, and the American opportunity credit (which aids low-income students to pay the cost of higher education). While the EIC is targeted to help those with low income, those with low income must first be able to read the instructions to see if they qualify. Line 74 is the total of all credits to which the taxpayer is entitled.

Step 14 is to complete line 75 by totaling up the amounts withheld or paid as estimated payments along with the credits (on lines 66[a]-73) to determine how much the taxpayer owes the IRS or how much the IRS owes the taxpayer. With the completion of line 75 the taxpayer completes the ordeal of figuring their taxes and is left with filling out the administrative details below line 75.

Although it is difficult to imagine, form 1040 is about as simple as it can be given the proliferation of tax preferences. If there were no tax preferences, form 1040 would still be about two pages, but it would have about half as many lines, very few if any schedules and worksheets, and accompanying instructions that could be understood by average taxpayers.

How the Normal Tax Became Abnormal

According to government tax professionals (most notably the JCT) the personal income tax is in reality two separate taxes—the "normal tax" and (for lack of a better term to describe the other tax) the "abnormal tax." Under the normal tax, taxpayers get no special favors, while under the abnormal tax, those taxpayers who can qualify, get the benefit of the many special favors conferred by tax preferences.

Congress has defined tax expenditures (tax preferences) as "revenue losses attributable to provisions of the federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability." Congress has gone on to point out that "Tax Expenditures include any reductions in income tax liabilities that result from special tax provisions or regulations that provide tax benefits to particular taxpayers. Special income tax provisions are referred to as Tax Expenditures because they may be considered to be analogous to direct outlay programs, and the two can be considered as alternative means of accomplishing similar budget alternatives."

Simply put, this means that Congress recognizes that reducing the amount of tax owed by a taxpayer because of a tax preference is the same as if an appropriation were made for the benefit of that taxpayer in the same amount as the tax reduction attributable to the tax preference.

Every time a group successfully lobbies Congress to create a new tax preference, the beneficiaries of the tax preference and the successful lobbying group wins, but everyone else loses. If the politicians wanted to cut taxes for everyone, as opposed to various politically favored groups, they could easily do so by lowering tax rates, increasing the standard deduction, and/or increasing the personal exemption—actions that would apply to all taxpayers.

In the tax experts' view, it should be the "normal" practice to take the standard deduction and personal exemption, and an abnormal practice to benefit from tax preferences, regardless of whether they take the form of income exclusions, itemized deductions, tax credits, and/or preferred rates. So, under the normal tax, there would be no tax preferences, but, under the abnormal tax, tax preferences would be available for those taxpayers who can successfully lobby Congress to get them.

The following examples compare the taxes paid by two typical families:

The Normal Tax Example

Consider a middle-class family, the Smiths, which includes John and Mary, in their late 30s, with two children, Mike, 7, and Jane, 6. John is employed at a local fast-food restaurant as a day manager and earns $24,000 a year as a full-time employee. Mary is employed at a local flower shop and earns

$20,000 a year as a full-time employee. Additionally, John moonlights at Home Depot and earns $6,000 a year as a part-time employee. The Smiths do not have health insurance because neither employer offers it. John and Mary own a house worth $105,000 with a home mortgage in the amount of $100,000. The annual property tax on the Smith home is $2,000 and the annual amount of mortgage interest is $4,900. Although Mary and John scraped together $850 to contribute to John's IRA, they have had to spend it, and a bunch more, on medical expenses for Mike's chronic asthma condition.

On these facts, it is easy to see what tax preferences do for the Smith family, as shown on Table V-9.

Table V-9
2015 Personal Income Tax Due for Smith Family

	Taxpayer Income from all Sources		$50,000
–	Income Exclusions		$0
=	Adjusted Gross Income		$50,000
–	Personal Exemptions		$16,000
	Itemized Deductions		
	Real Estate Taxes on Personal Residence	$2,000	
	Mortgage Interest on Personal Residence	$4,900	
	Medical Expenses (Above and Adjusted Gross Income Floor)	$850	
	Total Itemized Deductions	$7,750	
	Standard Deduction	$12,600	
–	Greater of Itemized Deductions and Standard Deduction		$12,600
=	Taxable Income		$21,400
	Tax on $0 to $18,450 @ 10%	$1,845	
	Tax on $18,450 to $21,400 @ 15%	$443	
	Total Personal Income Tax on Taxable Income		$2,288
+	Tax Credits	$0	
	Personal Income Tax Due		$2,288

In the case of the Smiths, a typical middle-class family, tax preferences did nothing for them because their standard deduction was larger than their itemized deductions. For the Smiths, as a middle-class family, the normal tax works just fine.

The Abnormal Tax Example

Consider the Jones family, which includes Robert and Jane, in their late 30s, with two children, Bobby, 7, and Amy, 6. Robert is employed by an investment-banking firm as a vice president and earns $140,000 a year as a full-time employee. Jane is employed as a schoolteacher and earns $30,000 a year as a full-time employee. Robert invested $30,000 of his non-retirement savings in a municipal bond fund and earned $1,800 in tax-exempt interest. The Jones family has employer-paid health insurance through Robert's employer whose value is $15,000 annually. Robert and Jane own a house worth $400,000 with a home mortgage in the amount of $320,000. The annual property tax on the Jones' home is $8,000 and the annual amount of mortgage interest is $17,000. Robert contributed $15,000 to an employer-sponsored 401(k) retirement plan.

On these facts, it is easy to see what tax preferences do for the Jones family, as shown on Table V-10.

Table V-10
2015 Personal Income Tax Due for Jones Family

	Taxpayer Income from all Sources(1)		$186,800
–	Income Exclusions(2)		$31,800
=	Adjusted Gross Income		$155,000
–	Personal Exemptions		$16,000
	Itemized Deductions		
	Real Estate Taxes on Personal Residence	$8,000	
	Mortgage Interest on Personal Residence	$17,000	
	Total Itemized Deductions	$25,000	
	Standard Deduction	$12,600	
–	Greater of Itemized Deductions and Standard Deduction		$25,000
=	Taxable Income		$114,000
	Tax on $0 to $18,450 @ 10%	$1,845	
	Tax on $18,450 to $74,900 @ 15%	$8,468	
	Tax on $74,900 to $114,000 @ 25%	$9,775	

	Total Tax on Taxable Income		$20,088
+	Tax Credits		
	Personal Income Tax Due		$20,088
Notes:			
(1) Includes Robert's salary of $140,000, Jane's salary of $30,000, employer-paid health insurance premiums of $15,000, and tax-exempt interest of $1,800.			
(2) Includes the $15,000 in employer-paid health insurance premiums, $1,800 in tax-exempt interest, and $15,000 contribution into Robert's 401K retirement plan.			

The Jones family took full advantage of all available tax preferences, and it worked out just fine.

However, had the Jones family taken the standard deduction as the Smith family did, its taxable income would have been $158,200, or $44,200 more than if it did not benefit from any tax preference, as shown on Table V-11.

Table V-11
2015 Personal Income Tax Due for the Jones Family without taking into account Tax Preferences

	Taxpayer Income from all Sources		$186,800
–	Income Exclusions		$0
=	Adjusted Gross Income		$186,800
–	Personal Exemptions		$16,000
–	Standard Deduction		$12,600
=	Taxable Income		$158,200
	Tax on $0 to $18,450 @ 10%	$1,845	
	Tax on $18,450 to $74,900 @ 15%	$8,468	
	Tax on $74,900 to $151,200 @ 25%	$19,075	
	Tax on $151,200 to $158,200 @ 28%	$1,960	
+	Tax Credits	$0	
	Personal Income Tax Due		$31,348

Taking advantage of tax preferences enabled the Jones family to cut what its taxes would have been under the normal tax from $31,348 to $20,088, resulting in a savings of $11,260. This tax savings for the Jones family would be fine but for the need to make up the $11,260 in lost revenue from some other taxpayer.

Lesson: Most tax preferences do nothing for a $50,000 a year income family like the Smiths but do a lot for a $186,000 a year income family like the Joneses.

Why Most Tax Preferences Benefit High-Income Taxpayers

A pristine personal income tax base would include (1) all income in all forms being counted, (2) no personal expenses being deducted from income, (3) all income in whatever form being taxed at the same tax rate applicable to each tax bracket, and (4) no tax offset especially benefitting any particular group of taxpayers—in short, the "normal tax." The personal income tax base, unfortunately, has become infected with an ever-growing list of viral tax preferences each of which benefits some politically favored group.

For those who like life simple, who do not like having the government tell them how to spend their money, and who do not like paying tax preparers, ending tax preferences would be welcome. But for most high-income taxpayers and others who have had their lifestyles blessed by the politicians in the form of beneficent tax preferences, cutting back on tax preferences would be unwelcome. For the most part, however, taxpayer ignorance and apathy, particularly among the least well-off, can be counted on to continue the practice of more rather than fewer tax preferences.

Table V-12 shows how much taxpayers in each tax bracket save in personal income taxes for each $1,000 of itemized deductions more than the standard deduction and how much more (in percentage terms) taxpayers in the higher brackets saved than taxpayers in lower brackets.

Table V-12
Value of Itemized Deductions in the Amount of $1,000 more than the Standard Deduction for Married Taxpayers Subject to Different Highest Marginal Personal Income Tax Rates

Taxpayers by Income Category	Highest Marginal Income Tax Rate Applicable to Taxpayer	Tax Savings Attributable to Excess of Itemized Deductions over the Standard Deduction and to Income Exclusions	Percentage Advantage of Best-off Taxpayer Relative to All Other Taxpayers
Income > $464,850	39.6%	$396	N/A
Income > $411,500 <$460,850	35%	$350	1.06%
Income > $230,450 <$411,500	33%	$330	1.25%
Income > $151,200 <$230,450	28%	$280	1.40%
Income > $79,900 <$151,200	25%	$250	2.33%
Income > $18,450 <$79,900	15%	$150	3.50%
Income > $0 <$18,450	10%	$100	3.96%

Table V-12 shows that the politicians have decided that the best-off taxpayers should save up to $396 in personal income taxes for each $1,000 of income exclusions and itemized deductions for which they qualify while the worst-off taxpayers should save only $100 in personal income taxes for each $1,000 in itemized deductions and income exclusions for which they qualify.

Putting the best spin on why the politicians create tax preferences—i.e. to promote taxpayer ownership of housing, expand the availability of health insurance, and encourage charitable donations—the politicians have decided that the better-off taxpayers should be rewarded a lot more for having tax preferences than the less well-off.

Tax Credits Targeted to Help those with Less Income

On very rare occasions, the politicians who control the tax game do something for those with low income, and so it is with the creation of a few tax credits. Breaking with tradition, the politicians (primarily the left, but more than a few of the right) granted tax preferences in the form of refundable tax credits for the working poor, most notably the EIC and the child tax credit, and a number of non-refundable tax credits for those who provide child and dependent care, for the disabled elderly, for those who adopt, and for certain educational purposes.

With few exceptions, tax credits targeted for those with low income are intended to benefit only those who are needy and unable to fend for themselves in today's economy. These types of tax credits should be considered to be a part of the social safety net. Although most tax credits targeted for those with low income are intended to help the needy, there are many esoteric ones that are designed to encourage the purchase of things that the politicians deem socially useful such as hybrid vehicles, solar power devices, and other environmentally friendly products. ***Tax credits intended to influence a taxpayer's purchasing decisions underscore the belief of many politicians that they know better than the taxpayer how the taxpayer should spend his or her money.***

Since income exclusions and/or itemized deductions only reduce a taxpayer's taxable income, tax credits are more valuable to a taxpayer, particularly refundable tax credits.

Tax credits have the tax effects as follows:

- A taxpayer who qualifies for a nonrefundable tax credit of $3,000 and whose taxes owed on taxable income is $2,000 will owe no tax.

- A taxpayer who qualifies for a refundable tax credit of $3,000 whose taxes owed on taxable income is $2,000 will be entitled to a $1,000 refund from the government.

- A taxpayer whose taxable income is reduced by $3,000 because of his income exclusions and itemized deductions will have his taxes reduced by as little as $400 if he is a low-income taxpayer whose marginal tax rate is 10% and by as much as $1,400 if he is a high-income taxpayer whose marginal tax rate is 35%.

Targeting

Spending public money on taxpayers who can take care of themselves and have no special needs both wastes scarce resources and makes it more difficult to help those who are in need. To avoid waste, most tax credits (especially refundable tax credits) are targeted in an effort to identify those taxpayers who are most in need. Targeting, however, comes at a cost. The more numerous and precise the conditions are for a taxpayer to qualify for a tax credit, the more complex the tax laws become. Complexity is the friend of the sophisticated, and the enemy of the unsophisticated. Most taxpayers who qualify for refundable tax credits are unsophisticated and need the help of tax advisors to qualify. Unfortunately, it is likely that many unsophisticated taxpayers who do not bother to try to qualify for refundable tax credits could qualify if they knew how to go about it.

Targeting begets an anomaly in that refundable tax credits are too complicated for the taxpayers for whom they are intended to help. But, if the qualifications for refundable tax credits were streamlined, the streamlining might result in some taxpayers who either had too much income or did not have sufficiently serious needs to warrant receiving a grant from the government jumping on board the gravy train. But if most taxpayers view refundable tax credits as a gravy train for the undeserving, it is likely they will die a quick political death. So, refundable tax credits must be complex, and someone must help qualifying taxpayers claim their due.

The Inspiration for Refundable Tax Credits

In 1962, Milton Friedman, the most prominent of all American economists of the right, proposed a negative income tax in his book, *Capitalism and*

Freedom. Since governmental welfare programs, laden with bureaucracy and notoriously ineffective, were anathema to Friedman, he proposed replacing welfare by using a negative income tax to provide an economic safety net for the working poor. Friedman urged, with respect to those among the working poor who did not earn enough to meet certain income thresholds, that the government should pay them an amount that would enable them to have a decent standard of living.

The mechanics of Friedman's plan were simple. Since everyone who works and earns any income (even if not enough to have to pay taxes) is required to file a personal income tax return, the tax system could be used to pay the working poor the difference between what they earned and the threshold. As an example, if the threshold for positive tax liability for a family of four was $10,000, a family with only $8,000 of annual income would, given a negative tax rate of 25 percent, receive a check from the government worth $500 (25% of the $2,000 difference between its $8,000 income and the $10,000 threshold). A family with zero income would receive $2,500. As with the personal income tax, the politicians would set the thresholds and the rates for the negative income tax.

Although the EIC and the child tax credit are pale imitations of the negative income tax, they are a step forward toward enabling certain of the working poor to have a decent standard of living. The EIC and the child tax credit are not predicated on replacing in-kind welfare programs but on encouraging the poor to work. Under the EIC, a taxpayer whose income falls below certain thresholds is given a refundable tax credit in the form of a cash payment, and under the child tax credit, a taxpayer with children is given a refundable tax credit of $1,000 per child, which phases out as the taxpayer's income reaches certain thresholds. The income thresholds vary depending on the size of the taxpayer's family.

In 2014, married couples with three or more minor children who had a combined income of $52,427 would be entitled to an EIC benefit of as much as $6,143. The amount of the EIC varies depending on family size and the amount of earned income in which large families with the least earned income getting the most relative to others. Also, in 2014, married couples with minor, dependent children with incomes of up to $130,000 were entitled to all or some portion of the per child $1,000 child tax credit. Both the EIC and the child tax credit represent efforts to redistribute after-tax income to low-income and middle-income families. As with other provisions of the tax laws, the terms of the EIC vary depending on the direction the political winds blow.

Some economists regard using tax credits targeted to benefit the working poor as an alternative to increasing the minimum wage. These economists regard the minimum wage as a deterrent to hiring inexperienced workers, but they also recognize, as did Friedman, that many low-skill, full-time workers will not be able to live on market income. Rather than let the workers subsist in poverty or impose a minimum wage on their employers that is high enough to take the workers out of poverty, these economists favor using targeted tax credits to supplement market wages as a means of keeping the working poor out of poverty.

While this approach has surface appeal, it comes at a cost. As with all tax preferences, targeted tax credits clutter and complicate the tax laws and rely on taxpayer funds to subsidize low wage businesses by paying a portion of their employees' after-tax wages. Using taxpayer funds to subsidize business results in (1) artificially increasing business profits and/or (2) keeping consumer prices below what the market would otherwise allow. Politically, targeted tax credits encourage both (1) many low wage businesses to keep wages low and (2) low wage workers to seek higher and higher tax credits, in each case with taxpayers footing the bill.

In coping with what to do about low wages, it is a fair question to ask why a viable business needs a subsidy to pay its workers a living wage. To suggest that taxpayers should subsidize any business to help pay its rent, utilities, insurance, or other expenses would be silly. So, a good case can be made that for a business to be viable, it should be able to pay its full-time workers a living wage, and if not, maybe the business is not viable.

Having businesses become dependent on government subsidies of any kind violates capitalistic principles and invites gaming the tax laws. It is likely that a well thought out combination of increases in the minimum wage, and increasing the progressivity of the personal income tax and payroll taxes that help pay for social insurance, could address the low wage challenge in ways that would not require making the tax laws more complex, and forcing taxpayers to pay for taking care of low-wage businesses and low-wage workers.

An Alternative to Refundable Tax Credits to Help the Working Poor

Replacing the payroll tax with the personal income tax would be a simpler way to help the working poor than using the EIC and child tax credits. A cruel fact of capitalism is that many Americans, perhaps a majority, will not be able to earn enough market income to enjoy an American style standard of living and be able to send their kids to college, pay their own medical bills, and retire on their own resources. Like it or not, for most Americans to live the American Dream, they will need government subsidies to a greater or lesser extent.

Before figuring out the subsidies, either through (1) expanding social insurance programs like Social Security, Medicare, and food stamps and/or (2) tinkering with the personal income tax to expand targeted tax credits like the EIC and the child tax credit, it would make sense to start with not taxing the working poor, either into or deeper into, poverty. The payroll tax can justly be named as the "poverty tax" because it taxes all low-wage earners—no matter how little they earn—at a rate of 15.3% on every dollar they earn and forces millions of low-wage working Americans into poverty.

Imagine a single mother of three who is working as a self-employed nanny for 2,000 hours a year at $9 an hour. On $18,000 of income, the single mom pays $2,754 in payroll taxes, which plunges her family deeper into poverty. To make up for the harm done by the payroll tax, the personal income tax grants the single mom access to the EIC and child tax credit, if she is aware of it and can figure out how to do her taxes. Rather than undoing the harm, it would be better to avoid the harm by not subjecting low-income Americans to a poverty tax.

Replacing the poverty tax (the payroll tax) with the personal income tax and taking the working mom off the tax rolls altogether would address the problems of the working poor far more simply and efficiently than using the personal income tax to undo the harm done by the payroll tax. Mandating a living wage and not taxing the nanny deeper into poverty would go a long way to eliminating the need for government anti-poverty programs and adding more refundable tax credits to the personal income tax. One would think that those who can afford a nanny should be able to pay their nanny a living wage so that the taxpayers do not have to come up with enough money through targeted tax credits to enable the nanny to get by.

Complexity, Hypocrisy, and the AMT

As tax preferences proliferated over the years, many of the best-off taxpayers and their tax professionals became so expert in exploiting them that they slashed their effective tax rates well below what most middle-income taxpayers were paying and in some instances zeroed-out their taxes altogether. Politically, tax breaks for the rich were one thing, but zeroing-out was quite another. In 1969, the politicians (including some on the right and more on the left) finally attempted to restrict the worst abuses of tax preferences by enacting the AMT (alternative minimum tax). The AMT, a product of the tax game, was and is no less awkward, inefficient, and feckless in achieving its goal of reining in the exploitation of tax preferences than if a person bothered by flies chose to swat them with a hammer.

Instead of either eliminating or at least narrowing the most inefficient tax preferences or cutting all of them across the board by a given percentage within the existing tax laws, the politicians added what some tax experts politely call a "parallel tax." This parallel tax has added exponentially to the complexity of the tax laws for many upper-income taxpayers without doing much to redress the worst abuses of tax preferences. **The two of the most effective tax savings devices that enable the highest income taxpayers to keep their tax rates lower than those for many taxpayers with much less income—(1) preferred rates on capital gains and qualified dividends, and (2) excluding from income the interest on certain types of municipal bonds—have been left largely unscathed by the AMT.**

Relying on complexity instead of simplicity, the AMT requires upper-income taxpayers to first compute their taxes under the abnormal tax (virtually all taxpayers who pay the AMT would otherwise pay the abnormal tax), second, compute their taxes under the AMT, and third, if their taxes under the AMT are higher than under the abnormal tax, add the amount by which their AMT tax exceeds their taxes under the abnormal tax to their tax due.

The following is the Tax Rate and Bracket Schedule for the AMT in 2013:

Table V-13 AMT Rate and Bracket Schedule for 2013		
Taxpayer Status	Single	Married Joint
Low Tax Rate	26%	26%

High Tax Rate	28%	28%
High Rate Mark	$179,500	$179,500
Exemption	$51,900	$80,800
Exemption Phase-out Mark	$115,400	$153,900
Exemption Ceiling	$323,000	$477,100
Capital Gain Rate*	20%**	20%**
Note:		
*The Capital Gain Rate also applies to Qualified Dividends.		
** The 20% rate only applies to those taxpayers in the 39.6% tax bracket.		

Determining the AMT requires that a taxpayer make a new computation of their taxable income for AMT purposes after having made a computation of their taxable income under the abnormal tax. Generally, AMT taxable income adds in certain tax preference items of income (both certain above-the-line-deductions and income exclusions) not included in adjusted gross income and cuts or eliminates many itemized deductions.

The following steps are required to determine each taxpayer's AMT taxable income:

Step 1:	Determine the taxpayer's taxable income under the abnormal tax before personal exemptions.
Step 2:	Re-compute the value of each of over 30 tax preferences (subject to the AMT) in accordance with AMT rules and determine the aggregate total of all such re-computed tax preferences [this re-computation is extremely complex and almost always requires a tax accountant to do it.]
Step 3:	Compute the sum of (a) the taxpayer's taxable income under the abnormal tax (as described in Step 1), (b) the aggregate total of all re-computed tax preferences (as described in Step 2), and (c) the taxpayer's AMT exemption.

The taxpayer's AMT taxable income is the sum described in Step 3.

Generally, except for taxpayers with substantial income from capital gains, qualified dividends, and tax-exempt municipal bonds, a high-income taxpayer's AMT taxable income will be only a little less than what their taxable income would be under the normal tax. While the AMT does chip away at a few tax preferences, it leaves many of the most important ones—preferred rates on capital gains and qualified dividends as well as tax-exempt bond interest—largely undisturbed. **No tax preferences are allowed under the normal tax.** After determining a taxpayer's AMT taxable income, a taxpayer must go on to determine their AMT tax by applying AMT taxable income to the AMT tax rate and bracket schedule, as follows:

No-Tax Scenario:	If a taxpayer's AMT taxable income is no greater than their exemption, $51,900 (for a single taxpayer) and $80,800 (for a married taxpayer filing jointly), then the taxpayer has no AMT tax.
Low Tax Scenario:	If a taxpayer's AMT taxable income is greater than their exemption but not greater than the high rate mark amount of $179,500, then their AMT tax is the amount that their AMT taxable income exceeds their exemption multiplied by (in the case of ordinary income) their low tax rate of 26%, and (in the case of capital gains) 15%.
Low/High Tax Scenario:	To the extent that a taxpayer's AMT taxable income is greater than the exemption phase-out mark of $115,400 (for a single taxpayer) and $153,900 (for a married taxpayer filing jointly) but not greater than the high rate mark of $179,500, then the taxpayer's exemption is reduced by $250 for every $1,000 in income above the exemption phase-out mark and their AMT tax is the amount that their AMT taxable income exceeds their exemption (as adjusted) multiplied by (in the case of ordinary income) the low tax rate of 26%, and (in the case of capital gains) 15%.
High Tax Scenario:	If a taxpayer's AMT taxable income is greater than their exemption ceiling of $323,000 (for a single taxpayer) and $477,100 (for a married taxpayer filing jointly), then their AMT tax is the amount that their AMT taxable income multiplied by (in the case of ordinary income) the high tax rate of 28%, and (in the case of capital gains) 15%.

If a taxpayer's AMT tax exceeds their abnormal tax, then the amount of the excess is added to the taxpayer's abnormal tax. If a taxpayer's AMT tax is no greater than the taxpayer's abnormal tax, then the taxpayer has no additional tax over and above the abnormal tax.

In 2013, under the normal tax, a married couple filing a joint return with two dependent children whose adjusted gross income was approximately $450,000 would have paid taxes at an effective tax rate of about 28%, and if that couple's adjusted gross income had been $10 million or more, it would have paid taxes at an effective tax rate of about 39%. The extent to which those taxpayers whose adjusted gross income is $450,000 and who pay taxes at an effective tax rate less than 28%, and those taxpayers whose adjusted gross income exceeds $10 million and who pay taxes at an effective tax rate less than 39%, shows the power of tax preferences in avoiding taxes and the fecklessness of the AMT in curtailing the use of tax preferences by very, very high-income taxpayers.

According to the IRS, in 2013, those taxpayers with an adjusted gross income of $500,000 paid an average effective tax rate of only about 16%, or at least 12 percentage points less than what their effective tax rate would have been under the normal tax, and those taxpayers with an adjusted gross income of $10,000,000 paid an average effective tax rate of only about 20%, or at least 19 percentage points less than what their effective tax rate would have been under the normal tax. So, notwithstanding the AMT, tax preferences were worth (in terms of reduced taxes) on average about (1) $60,000 to taxpayers with incomes of $500,000, and (2) $1,900,000 to taxpayers with income of $10,000,000.

Also, in 2013, the top 400 taxpayers (whose adjusted gross income is not less than $100 million and which averaged $265 million) paid an average effective tax rate of 23%, or 16 percentage points less than what their effective tax rate would have been under the normal tax. So, notwithstanding the AMT, tax preferences (in terms for reduced taxes) were worth on average $42.4 million to those in the top 400.

The effective tax rates for the top 400 taxpayers were as follows:

Table V-14
Average Effective Tax Rates for Top 400 Taxpayers in Terms of Adjusted Gross Income for 2013

0% > 10%	10% > 15%	15% > 20%	20% > 25%	25% > 30%	30% > 35%	> 35%
12	31	71	127	61	55	43

Source: IRS, Data extracted from Table 3, The 400 Individual Income Tax Returns Reporting the Largest Adjusted Gross Incomes Each Year, 1992-2013.

Many Americans would be astounded to know that there were even 12 taxpayers with incomes more than $100 million who paid personal income tax at an effective tax rate no greater than 10% and another 229 who paid tax at an effective tax rate no greater than 25%. For perspective, compare the effective tax rates paid by the top 400 taxpayers with the tax rate paid by the single mom who paid the payroll tax at a rate of 15.3% on every dollar of her income, and with each tax dollar she paid, falling deeper into poverty.

Market Income and the Personal Income Tax

Americans chose progressive income taxation over regressive consumption taxation as the primary source of funding government early in the 20th century because enough Americans decided that those with high incomes should pay more in taxes and those with low incomes should pay less. For over a generation, capitalism—driven by the inexorable forces of globalization and technology—simultaneously has driven down the wages of a majority of America's workers while driving up the income and wealth of America's top 1%, and there is not the slightest hint of this trend changing.

As long as the market income of most Americans at best remains static and at worse falls, the pressure will increase to make the personal income tax more, not less, progressive. While the politicians who oversee the playing of the tax game are more responsive to the best-off who pay and play, they cannot forever ignore the interests of the clear majority of Americans who feel the effects of static and falling wages. Until the market after-tax income of most American workers rises substantially, political pressure to use taxpayer subsidies to enable American workers to live the American Dream will grow.

THE PAYROLL TAX: PAYING FOR SOCIAL SECURITY & MEDICARE

Since the early 20th century, virtually all Americans have accepted that social insurance programs—most notably Social Security, Medicare, Medicaid, unemployment insurance, food stamps, and many more—are essential parts of American social, economic, and political life. Social insurance came to America in the form of Social Security in 1935 and in the form of Medicare in 1965, and neither was native to America.

Social Insurance

Social insurance was born in the late 19th century of conservative, not leftist, ideas, and was inspired by Bismarck, the archconservative Iron Chancellor of the German Empire. Bismarck realized that market income in an emerging industrial economy would not provide enough resources for German workers to pay for their own medical care and a decent retirement without government help. Mindful that Germany could not have political stability without social equity, Bismarck convinced most of his fellow conservatives to undertake an extensive program of government-sponsored social insurance. After taking hold in Germany, social insurance spread throughout most of Western Europe in the late 19th century and the early 20th century, and eventually, it came to America as a part of President Roosevelt's New Deal.

With millions of Americans out of work during the Great Depression, it became apparent to President Roosevelt and a majority of Congress that, unless the government provided some form of social insurance, millions of low-income Americans would spend their old age in dire poverty and millions more middle-class Americans would look to retirement with dread. What was true in the mid-1930s is also true today. Given the economic trends of at least the last 30-plus years, today only very few Americans earn enough market income to save for their own retirement, pay their own medical bills, and send their kids to college while enjoying an American style standard of living.

Social Insurance Contrasted with Private Insurance

Private insurance is where an insured individual or business pays a private insurer a premium to manage a particular economic risk as contrasted with social insurance where the government as insurer charges its citizens, the insured, a premium (usually in the form of taxes) to manage certain types of economic risks. Private insurance and social insurance each share in common the management of economic risks in exchange for a premium, but they differ in the type of risks they manage and the way premiums are charged.

With respect to the types of risks to be managed, the risks in private insurance are the subject of a contract between the insurer and the insured and, among others, include (1) the death of a breadwinner resulting in lost income, (2) damage to, or the theft of, property resulting in the diminished value of an asset, and (3) certain types of events that cause a business to suffer loss. The risks in social insurance to be managed are the subject of a social contract (memorialized in law) between the government (as insurer), its citizens (as the insured), and, among others, include the inability of workers to earn enough income to pay for (1) their own annuity in retirement, (2) their and their family's access to health care, (3) the post-secondary education of their children, and (4) their cost of living during periods of unemployment.

With respect to the price of premiums in private insurance, they are (1) based on what the insurer believes is sufficient to cover the cost of insuring the risk and return a profit and (2) have nothing to do with the insured's ability to pay. The price of premiums in social insurance (1) is set by the government (in the political process), (2) is not necessarily based on covering the cost of insuring the risk of returning a profit, and (3) almost always is related to the insured's ability to pay. Private insurance premiums are paid from private funds just as with other goods and services in the private marketplace while social insurance premiums are paid directly or indirectly as taxes.

Unlike the terms of private insurance which are defined in a contract between the insured and insurer, the terms of social insurance are a social contract between the government and its citizens memorialized in law. The terms of the social contract that prescribes which types of risk are to be covered, and the extent to which the taxes that pay for it will be based on a taxpayer's ability to pay, are determined in the political process in accordance with the voters' wishes.

Since the adoption of Social Security in 1935, the voters have decided that social insurance should be expanded to insure millions of Americans against the risk of, among other things, not being able to (1) retire in dignity, (2) pay for their own health care, (3) afford decent housing, and (4) pay for their children's post-secondary education. As the market income of millions of working Americans has remained stagnant or fallen and, as their jobs have increasingly become insecure, the political pressure to expand social insurance has increased.

Expanding social insurance means increasing taxes, and if taxes are to be increased, those who want to expand social insurance must get in the tax game and win it. For the millions of workers who worry about their wages remaining stagnant or falling, or losing their jobs and being unemployed for an extended period of time, imagine how the politicians who run the tax game would answer the following questions posed by a worried American worker:

- If I do not make enough money, or if I lose my job and can no longer afford it, should I have to forget about having a decent retirement?

- If I do not make enough money, or if I lose my job and can no longer afford it, should my family have to do without decent health care?

- If I do not make enough money, or if I lose my job and can no longer afford it, should my kids have to forget about college even if they are bright and hardworking?

- If I lose my job, cannot get another for six months, and run out of savings, should I lose my house and fall into bankruptcy?

Without social insurance, the answer to each of these questions will be "yes." If most voters are satisfied with "yes," then social insurance will be narrow, but if enough voters are not satisfied with "yes," then social insurance will have to be expanded.

The Existing Parameters of Social Security and Medicare

Social Security—Old-Age, Survivors, and Disability Insurance—provides retirement and disability benefits for the elderly who qualify and their dependent spouses and children. Eligibility depends on how many calendar quarters a worker pays a certain amount of payroll taxes into the program, as follows:

- Workers who earn a threshold amount in a calendar quarter (at least $1,220 in 2015 and indexed for future years) for a minimum of 40 quarters become fully insured and entitled to a retirement annuity for themselves and their spouses upon the taxpayer reaching 65 to 67, depending upon when they were born, and to disability payments for themselves and their dependents if the taxpayer becomes disabled.

- Workers who become disabled before becoming fully insured may also qualify to be insured depending on how many quarters they paid payroll taxes.

The amount of benefits payable to each beneficiary depends on the amount paid by the beneficiary in payroll taxes. Those who qualify for retirement benefits are given the option to start receiving benefits at 62 at a discounted amount.

At the end of 2014, 59 million Americans were covered by Social Security, 42 million of which were retired workers and their dependents, 6 million of which were survivors of deceased workers, and 11 million of which were disabled workers and their dependents.

Those who qualify for Social Security and meet certain other requirements are eligible for Medicare. Medicare provides insurance through (1) Part A, covering hospital, home health, skilled nursing facility, and hospice care, (2) Part B, covering physician, outpatient hospital, home health, and other services, (3) Part C, offered as an alternative to Part A and Part B in which beneficiaries choose to receive their care from private insurance companies which contract with Medicare, and (4) Part D, covering prescription drugs. Although participation in Part A is mandatory for all, participation in Parts B, C, and D are optional.

At the end of 2014, 53.8 million Americans were covered by Medicare, 44.9 million of which were over 65 and 8.9 million of which were disabled.

Since 1935, in the case of Social Security, and since 1965, in the case of Medicare, these social insurance programs have prevented millions of America's elders from falling into poverty and doing without medical care.

The Payroll Tax and the Need to Do More

The payroll tax, authorized by the Federal Insurance Contributions Act (FICA), pays for all of both (1) Social Security, and (2) Medicare Part A and is broken down into ten different components, each of which is dedicated to pay for specific programs, namely (1) under Social Security (a) old age and survivors insurance and (b) disability insurance and (2) under Medicare Part A hospital insurance, as shown on Table V-11.

Table V-15 Allocation of Payroll Tax		
Components of Payroll Tax	Rate	Purpose
Individual Social Security Tax	5.30%	Social Security- old-age and survivors' insurance
Individual Social Security Tax	0.90%	Social Security – disability insurance
Employer Social Security Tax	5.30%	Social Security- old-age and survivors' insurance
Employer Social Security Tax	0.90%	Social Security – disability insurance
Self-Employed Social Security Tax	10.6%	Social Security- old-age and survivors' insurance
Self-Employed Social Security Tax	1.80%	Social Security – disability insurance
Individual Hospital Insurance Tax	1.45%	Medicare – hospital insurance, Part A
Employer Hospital Insurance Tax	1.45%	Medicare – hospital insurance, Part A
Self-Employed Hospital Insurance Tax	2.9 %	Medicare – hospital insurance, Part A
Supplementary Medicare Tax*	0.09%	Medicare – hospital insurance, Part A
Total Tax Rate**	15.30%	
Notes: * Tax became effective in 2013 and applies to all wage income in excess of $200,000 for individuals and $250,000 for married couples. * Total Tax Rate for those who are subject to the 0.09% Supplementary Medicare Tax is 16.2%.		

Social Security and Medicare Part A are not payable from general revenues. Medicare Parts B and D are not payable from the payroll tax, instead they are paid from a combination of general revenues and individual premiums. Medicare Part C (as a comprehensive alternative program that covers the same expenses that are included in Medicare Parts A, B, and D) is payable proportionately from the same revenues that pay for Part A, on the one hand, and Parts B and D, on the other.

Since Medicare Parts B and D are payable from both general revenues and premiums, neither is at risk of becoming unable to pay full benefits. If there is a shortfall in general revenues, the Treasury makes up the difference by borrowing.

However, if the payroll tax fails to generate enough revenue to pay for benefits under Social Security and Medicare Part A then Congress and the President have three options, as follows:

- first, increase the payroll tax by increasing (1) the rate on some or all workers and/or (2) the wage cap to require those with high wages to pay more;

- second, cut benefits; and

- third, use general revenues to make up the shortfall.

The tax game is the arena in which the politicians would decide which of the three options (or any combination thereof) is to be chosen. It is quite likely that any increase in the payroll tax (other than raising the cap) or any cut in benefits (other than to those with high income) would fall harder on those with low income, and any use of general revenues to maintain benefits and avoid a payroll tax increase would fall harder on those with high income.

For over a generation, pressure has been building to do something about both Social Security and Medicare Part A because neither is adequately funded over the long term. Both of these programs are the victims of demographics—an inexorable force—in which the number of beneficiaries has grown and is growing faster than the number of workers who pay the payroll tax, as shown in Table V-12.

Table V-16 **Workers/Beneficiaries Ration to 1 for Years 1950, 2014, and 2090**			
Year	Workers	Beneficiaries	Worker/Beneficiary Ratio to 1
1950	48,280	2,930	16.5
2014	165,603	58,574	2.8
2090	246,472	1525,379	2.0
Data extracted from The 2015 Annual Report of The Board Of Trustees of The Federal Old-Age And Survivors Insurance And Federal Disability Insurance Trust Funds, Table IV.B3.—Covered Workers And Beneficiaries, Calendar Years 1945-2090.			

Table V-16 shows that the worker/beneficiary ratio has fallen from 16.5 to 1 in 1950 and from 2.8 to 1 in 2014, resulting in imposing intense pressure on the payroll tax.

Fewer payroll taxpayers being asked to pay for more beneficiaries is not a formula likely to please either workers or beneficiaries. The demographics of Social Security and Medicare Part A will force a *Hobson's Choice* on the politicians who set taxes in the tax game: **Either (1) require that the people who depend on Social Security for their income and Medicare Part A for their hospitalization take a cut in their benefits or (2) raise taxes.**

Social Security

The board of trustees for Social Security is required by law to report on the actuarial status of Social Security for the next 75 years. In its 2015 Annual Report, the report warned that if nothing is done to increase Social Security revenues or cut benefits before 2034, then benefits either will have to be cut or paid from general revenues. Given current finances, the report projected that for Social Security to continue to meet its obligations the following actions will have to be taken:

- revenues would have to be increased by an amount equivalent to an immediate and permanent payroll tax rate increase of 2.62 percentage points (from its current level of 12.40% to 15.02%); or

- scheduled benefits would have to be cut by an amount equal to an immediate and permanent reduction of 16.4% applied to all current and future beneficiaries; or

- some combination of the above alternatives would have to be adopted.

Every year that goes by without a permanent fix makes coming up with a fix that much harder meaning that when the time comes to either increase taxes or cut benefits, the tax increase would be steeper, or cut in benefits would be deeper.

Medicare

The board of trustees for Medicare is required by law, as with Social Security, to report on the actuarial status of Medicare for the next 75 years. In its 2015 Annual Report, the report warned that if nothing is done to increase Medicare Part A revenues or cut benefits before 2030, then its benefits either will have to be cut or paid from general revenues. Given current finances, the report projected that for Medicare Part A to be able to pay benefits at current levels over the next 75 years, revenues would have to be increased by an amount equal to a 1.70 percentage point increase in the Medicare Part A payroll tax.

Although Medicare Parts B and D are not in danger of running out of funds, the costs of these programs will increase substantially over the next 75 years. The 2015 Annual Report projects that the overall costs of Medicare will increase (as a percentage of GDP) from 3.5% in 2014 to somewhere between 6% and 9.1% by 2089. The rising cost of Medicare will place great strain on both beneficiaries and taxpayers, and it will be up to the politicians to decide whether beneficiaries or taxpayers should take the biggest hit.

Social Insurance: A Discounted Lunch

A stark (but rarely mentioned reality) underlies both Social Security and Medicare, the reality being that all beneficiaries get more out of these programs than they have contributed, and most beneficiaries get a lot more.

Table V-17 contains data extracted from an Urban Institute study, "Social Security and Medicare Taxes and Benefits Over a Lifetime," June 2011, authored by C. Eugene Steuerle and Stephanie Rename, which compares the lifetime contributions to the lifetime benefits of various categories of Social Security and Medicare beneficiaries.

Table V-17 Contribution/Benefit Ratios for Cohorts 1960, 1980, 2010, 2030, and 2011[1]					
1960 Cohort					
	Single Man – Average Wage[2]	Single Woman – Average Wage[3]	One Earner Couple – Average Wage[4]	Two Earner Couple – Average/Low Wages[5]	Two Earner Couple – High/Average Wages[6]
Lifetime Benefits	$128,000	$169,000	$248,000	$261,000	$310,000
Lifetime Contribution	$18,000	$18,000	$18,000	$26,000	$41,000
Contribution/Benefit Ratio	14%	11%	7%	10%	13%
1980 Cohort					
	Single Man – Average Wage	Single Woman – Average Wage	One Earner Couple – Average Wage	Two Earner Couple – Average/Low Wages	Two Earner Couple – High/Average Wages
Lifetime Benefits	$265,000	$330,000	$512,000	$529,000	$660,000
Lifetime Contribution	$104,000	$104,000	$104,000	$151,000	$246,000
Contribution/Benefit Ratio	39%	32%	20%	29%	37%
2010 Cohort					

	Single Man – Average Wage	Single Woman – Average Wage	One Earner Couple – Average Wage	Two Earner Couple – Average/Low Wages	Two Earner Couple – High/Average Wages
Lifetime Benefits	$432,000	$475,000	$798,000	$821,000	$1,016,000
Lifetime Contribution	$352,000	$352,000	$352,000	$510,000	$899,000
Contribution/Benefit Ratio	81%	74%	44%	62%	88%
2030 Cohort					
	Single Man – Average Wage	Single Woman – Average Wage	One Earner Couple – Average Wage	Two Earner Couple – Average/Low Wages	Two Earner Couple – High/Average Wages
Lifetime Benefits	$587,000	$638,000	$1,088,000	$1,117,000	$1,362,000
Lifetime Contribution	$485,000	$485,000	$485,000	$703,000	$1,261,000
Contribution/Benefit Ratio	83%	76%	45%	63%	93%
2011 Cohort					
	Single Man – Average Wage	Single Woman – Average Wage	One Earner Couple – Average Wage	Two Earner Couple – Average/Low Wages	Two Earner Couple – High/Average Wages
Lifetime Benefits	$436,000	$478,000	$805,000	$828,000	$1,023,000
Lifetime Contribution	$359,000	$359,000	$359,000	$520,000	$920,000

Contribution/Benefit Ratio	82%	75%	45%	63%	90%
Notes:					
(1) All amounts are in constant 2011 dollars as noted, adjusted to present value at age 65 using a 2 percent real interest rate. Each calculation assumes survival until age 65 and then adjusts for chance of death in all years after age 65. It also assumes that benefits scheduled in law will be paid even if trust funds are exhausted. Workers are assumed to work every year from age 22 to age 64 and retire at age 65. An average-wage worker earns the average wage in the economy every year, based on Social Security's measure of the "average wage." The low-wage worker earns 45 percent of the average wage, while the high-wage worker earns 160 percent of the average wage. The tax-max wage worker earns at the taxable maximum every year. Medicare numbers are net of premium, other than the new premium tax on some high earners.					
(2) Average Wage $43,500.					
(3) Average Wage $43,500.					
(4) Average Wage $43,500.					
(5) Average Wage $43,500, and Low Wage $19,575.					
(6) High Wage $69,600, and Average Wage $43,500.					

Table V-17 highlights how Social Security and Medicare skew the value of their benefits in favor of those who began receiving benefits the earliest and who are the least well-off. Even though the least well-off fare the best under social insurance, **NO** beneficiaries (regardless of when they began receiving their benefits or how well-off they are) pay full fare for their retirement—not a bad consolation prize for the well-off. Getting old in America is not all bad.

Paying for a Discounted Lunch

While social insurance is not a free lunch, it is a discounted lunch with those beneficiaries who got in early and contributed only pocket change paying as little as seven cents on the dollar for their lunch as other beneficiaries who got in late and contributed folding money paying as much as 93 cents on the dollar. Since no current beneficiaries are paying the full tab for their social insurance benefits, these benefits can continue at current levels only if the best-off future beneficiaries suck it up and agree to contribute more and continue to take no more than they are now getting.

Social Insurance Premiums

With the exception of social insurance taxes, all other significant taxes are applied to pay for the general cost of government or some specific activity that uniquely benefits certain classes of Americans—i.e. drivers benefit from highways and passengers benefit from airports and air traffic control. Social insurance taxes paid by and on behalf of individuals are dedicated by law to provide social insurance to those who pay it. In that sense, taxpayers are paying for specific insurance benefits for themselves and their dependents just as if they were paying insurance premiums to a private insurer.

All states mandate in some form that drivers obtain auto liability insurance. All mortgage lenders require homeowners who owe mortgages to maintain property and casualty insurance. There is nothing odd about individuals being required to carry and pay for various kinds of insurance. Social Security and Medicare are social insurance programs that the people acting through government have decided that everyone must have. For the most part, the programs have reduced poverty and the lack of any health care for the elderly.

THE CORPORATE INCOME TAX

Businessmen form corporations, partnerships, trusts, limited liability companies, and similar types of legal entities, to own businesses primarily for the purpose of shielding the owners from personal liability in connection with the financing and operation of their businesses. For example, if an individual owns a restaurant that serves contaminated food, the individual owner can be sued by customers who are harmed. However, if the individual owner arranges for the restaurant to be owned by a legal entity that in turn is owned by the same individual, then only the legal entity that owns the restaurant can be held liable.

The type of legal entity—corporation, partnership, limited liability company, or trust—that is appropriate to own a business depends on, among other things, the type and size of the business, the number of owners and whether the owners will actively manage the business, the ease of the organization under and ongoing compliance with state laws, and whether the owners wish to be taxed directly on the profits generated by the business or have the business taxed on its profits. While how business profits are taxed is important, other factors often dictate what type of legal entity is best suited to own a business.

C-corps and S-corps

Under federal tax law, all legal entities other than corporations that own businesses pass-thru their profits to the owners to be taxed as income under the personal income tax. By default, corporations are taxed under the corporate income tax unless they opt out by filing IRS form 2553 and choose to pass-thru their income to their owners to be taxed under the personal income tax. Corporations that pay federal taxes under the corporate income tax are designated as C-corps; and corporations that pass-thru their income to be taxed to their owners are designated as S-corps.

Double-Taxation of C-corp Income

Not only are C-corps the only business entities that pay the corporate income tax, but corporate income that is distributed to the owners as dividends is also subject to the personal income tax. This results in double-taxation—taxing first corporate profits under the corporate income tax, and second, the dividends (from which they are derived) under the personal income tax.

Taxation of Pass-Thru Business Entities

For years C-corps were the predominant entity through which business was done in terms of net income, but increasingly S-corps and other pass-thru entities are being used. A result of this trend is that a growing percentage of business net income is being taxed under the personal income tax instead of the corporate income tax. Given the burden of paying higher taxes, it is curious why any owner of a business would not choose to be taxed as an S-corp or some other type of pass-thru entity and avoid double taxation. The phantom income problem explains why submitting to double taxation makes sense in some instances.

The Phantom Income Problem

All business entities, other than C-corps, have to cope with the phantom income problem, and if not for the phantom income problem, all business entities (including C-corps) could be taxed on a pass-thru basis.

Phantom income is the income earned by a business in each tax year that is not distributed by the business to its owners. Many businesses (including almost all C-corps) routinely use some or all of their earnings as both working capital and investment capital.

It would be folly for a business to distribute all of its earnings while at the same time needing to either borrow back some of the distributed earnings or issue more stock or partnership interests to finance its needs for working capital and/or investment capital. It is essential for many businesses to be able to retain some of their earnings to finance their cash needs instead of distributing all of their earnings to their owners.

Among the worst things that can happen to many taxpayers, however, is for the taxpayer to have to pay personal income taxes on income that the taxpayer did not receive in cash. Suppose that a business earns $1 million in taxable income of which $100,000 is reported as income to a taxpayer who owns 1/10th of the business, but the business decides to use $50,000 of the taxable income as working capital and only distribute $50,000, or ½ of the $100,000, of income to the taxpayer. Here, the taxpayer has $50,000 in phantom income—the taxpayer's share of the income earned by the business that is retained as working capital—on which the taxpayer is required to pay personal income taxes.

From the taxpayer's point of view, the taxpayer should not be taxed on $50,000 of phantom income because the taxpayer received no cash. But from the government's point of view, someone must pay taxes on the $50,000 of phantom income. If no personal income tax is paid on the phantom income, then the business entity must pay tax on the phantom income—hence, the necessity for the corporate income tax. Since many taxpayers refuse to own an interest in a business in which phantom income is taxed, practicality dictates that a certain type of business entity (a C-corp) be permitted to pay taxes on business income so that the owners will not have to.

Given that many businesses do not want to organize as pass-thru entities, the corporate income tax exists as a means of taxing business income inside the business.

Solving One Problem and Creating Another

Businesses have a choice on how they cope with the phantom income problem—businesses can organize as either a pass-thru entity or a C-corp. Most businesses that are owned by only a few organize as pass-thru entities and almost all businesses that are owned by public shareholders organize as C-corps. Businesses that are owned by a few can control their own fate in terms of whether and how much phantom income the business will generate in any tax year while businesses that are publicly owned generally operate their businesses without regard to issues relating to phantom income.

Taxpayers who are worried about phantom income can invest exclusively in C-corps, and taxpayers who are not can invest in pass-thru business entities. As with many things, solving one problem frequently creates another. Investing in a C-corp avoids the taxpayer's phantom income problem at the cost of the taxpayer accepting the burden of double-taxation.

The Corporate Income Tax Base

A C-corp's taxable income is its receipts less its current expenses (including wages and interest), deductions for the cost of inventory when goods are sold, and depreciation of capital investments. American C-corps who do business in other countries pay tax on their worldwide profits, but tax on the profits of their foreign subsidiaries is deferred until those profits are paid as dividends to their parent. American C-corps are entitled to a tax credit, subject to various limitations, for foreign income taxes associated with their foreign-source income.

As with the personal income tax, the corporate income tax is riddled with tax preferences. In a 2013 study, "Corporate Tax Expenditures," the Government Accountability Office, the GAO, found that 80 corporate tax preferences deprived the government of approximately $181 billion in 2011. Each corporate tax preference favors some businesses (winners) over other businesses (losers) and causes overall corporate income tax rates to be substantially higher than they would be if there were no tax preferences.

Almost all economists agree that corporate tax preferences violate capitalistic principles in that they distort the return on capital and encourage investments that skew the market. From the winning businesses standpoint, corporate profits won in the tax game spend the same as profits won in the marketplace.

Corporate Income Tax Rates

For tax year 2015, corporate tax rates for most C-Corps are as shown on Table V-19.

Table V-19
Corporate Tax Rates for 2015

Over	Up to	Tax	Of the Amount Over
$0	$50,000	15%	$0
$50,000	$75,000	$7,500 + 25%	$50,000
$75,000	$100,000	$8,180 + 34%	$75,000
$100,000	$335,000	$22,250 + 39%	$100,000
$335,000	$10,000,000	$113,900 + 34%	$335,000
$10,000,000	$15,000,000	$3,400,000 + 35%	$10,000,000
$15,000,000	$18,333,333	$5,150,000 + 38%	$15,000,000
$18,333,333	N/A	35%	N/A

As with individual personal income tax rates, the nominal corporate rates are misleading in that the effective corporate rates are much lower. In a 2013 study, "Corporate Income Tax," the GAO found (using the most conservative assumptions) that the average effective corporate rate was only 22.7% or 12.3% less than the nominal rate. Tax preferences account for the difference between the corporate effective rate and the nominal corporate rate.

Who Bears the Burden of the Corporate Income Tax?

Unlike the personal income tax, which is a direct tax, the corporate income tax is an indirect tax. Although C-corps write the checks to the IRS for their corporate income taxes, the economic burden, or the incidence, of the tax falls upon someone other than the C-corps.

A C-corp is not a real person—it is a fictional person. As one lawyer with a wry sense of humor put it, "a corporation does not have a body to burn or soul to damn." The only embodiment that a C-corp has is a piece of paper, called a charter, issued by the government to document its existence as a fictional person. Fictional persons, unlike flesh and blood persons, do not bear the economic burden of taxes. Since C-corps do not pay taxes, who does? Well, there are several possibilities, and no one knows for sure.

If a C-corp has market power in that it can raise its prices without losing business, then its consumers bear the burden of the tax; if a C-corp can cut its employees' wages without losing its workforce, then its employees bear the burden; but if the C-corp cannot either raise its prices or cut its labor cost, then its shareholders bear the burden. Which group—consumers, workers, or owners—bears the economic burden of paying the corporate income tax most likely depends on the circumstances such as the size and market power of the C-corp and its accessibility to capital and labor.

After much analysis and argument, no one can state with certainty who actually bears the burden of the corporate income tax.

The Corporate Income Tax, the Darling of Most Politicians

One thing that most politicians secretly agree upon is that the corporate income tax is too important to lose. Pro-consumer politicians (who are skeptical of big business) raise campaign funds by telling their supporters that they will eliminate or curtail corporate tax preferences, and pro-big business politicians (who are friendly to big business) raise campaign funds by telling their supporters that they will protect and expand existing tax preferences and create more. As the tax game is played, both sets of politicians exploit the opportunity to scare or entice their supporters, as the case may be, into making generous contributions to protect their interest. No matter which businesses win or lose, almost always the politicians win.

As the tax game plays out, the pro-big business and the corporate lobbyists conspire to scare large corporate donors by telling them that **(if they do not get involved in the tax game)** they are going to be taxed into penury. Having been spurred to action, the money starts rolling in to both lobbyists and politicians. Not infrequently, a few otherwise uncommitted politicians who have a pet corporation in their bailiwick join the pro-big business politicians at the tax preference trough to support a tax preference for a home-town corporation—**all politicians revel in bringing home the bacon**.

EXCISE TAXES: TAXING USE, SIN, & LUXURY

Excise taxes are taxes payable with respect to the purchase of goods or services and are usually levied as a percentage of the price of the goods or services being sold. Although the amount of the excise tax is passed on to the consumer of the goods or services as a part of the price, it is almost always paid to the government by the manufacturer or service provider.

Excise taxes serve two purposes—first, they raise revenue, and second, they change consumer behavior. The oft quoted maxim, "the more something is taxed, the less of it there'll be," applies to excise taxes. At the margin, there will be less of all items that are subject to the excise tax than if there were no tax. Excise taxes are always regressive because, since the tax is the same on any given goods or services to all purchasers, it necessarily results in the less well-off paying a higher percentage of their income for whatever is being purchased than the better-off.

There are three major categories of excise taxes—use taxes, sin taxes, and luxury taxes. Beyond these categories, there is a mishmash of odd-lot taxes—none of which are particularly significant to most consumers and taxpayers. Every few years, the politicians toy with excise taxes by adding a few, deleting a few, and changing the rates on others.

Use Taxes

Gasoline and other motor fuels, tires, and airplane fuels, and related taxes, account for about 45% of all excise tax revenue. Of these taxes, the gasoline tax, which is 18.4 cents per gallon, is the most significant excise tax paid by individual consumers. For the past several years, the gasoline tax has been earmarked for use to construct and maintain interstate highways and mass transit facilities. There is a sort of rough justice in having motor fuel users pay for transportation facilities.

Another tax of interest to most consumers are taxes levied on flying, in particular an array of taxes for both domestic and international flights. In the past, excise taxes have been charged on telephone services and passenger autos, but since consumers, manufacturers, and auto unions rebelled against them, the politicians of both the left and right happily repealed many of these excise taxes.

Sin Taxes

Alcohol and tobacco taxes account for about 24% of all excise tax revenue, and wagering taxes account for a small amount of revenue. When looking for a few extra dollars to close a revenue gap, the politicians (particularly the sanctimonious kind) frequently turn to taxing the sins of drinking and smoking. Many of the poor, if they thought about it, might complain that drinking and smoking are sins that are more costly to them than to those who consume expensive cigars and fine wines. Taxing a beer by a few cents and a pack of cigarettes by over $0.50 is more burdensome to the poor than the well-off.

The sin taxes operate at cross-purposes by raising revenue on the one hand, and discouraging sin (drinking and smoking) on the other hand. It is difficult to know the extent to which fewer revenues are being collected because these sin taxes have increased the price of smoking and drinking and thereby reduced consumption of tobacco and alcohol.

Luxury Taxes

Luxury taxes are older than Solon's time. When the politicians of the Roman Republic wanted to chastise the well-off for conspicuous consumption in the face of economic hard times, the Roman politicians of the left routinely passed Sumptuary Laws (the old name for laws prohibiting ostentation), and when times get better, the politicians of the right repealed them. Taxing the ostentation of the wealthy almost always proves futile in terms of either raising revenue or changing behavior.

Anyone who wants to know why laws against ostentation are futile should read the 1st century A. D. letter of the Emperor Tiberius to the Roman Senate, as reported in *The Annals, Book III, Chapters 53–55,* by Tacitus. Tiberius argued that, despite good intentions, government has no practical ability to ban ostentation by law.

The rationale regarding luxury taxes in America has not progressed beyond the wisdom of Tiberius. When economic times are tough, the politicians of the left frequently turn to luxury taxes as old standbys for political pandering to their base to rant against the ostentation of the rich, and conversely, in better economic times, the politicians of the right pander to their base by preaching that luxury taxes are examples of class warfare.

In the past when politicians of the left were on top, excise taxes were levied against yachts, expensive autos, jewelry, furs, and other similar types of luxuries, and later, when the worm turned and politicians of the right gained control, most luxury taxes were repealed.

One lesson learned the hard way regarding luxury taxes was that the yacht tax, enacted in 1986 as a part of that year's tax reform effort, resulted in devastating the domestic yacht industry. The rich did not abandon ostentation—they just indulged themselves by buying their yachts from foreign manufacturers or buying other trinkets. It was the less well-off workers toiling away in the yacht industry who, joined by the well-off yachtsmen and manufacturers, had the tax repealed.

One additional luxury tax of note is the tax on gas guzzlers. This tax requires those who want to buy autos that guzzle gas to pay an excise tax that increases with the quantity of gas guzzled. At one end of the spectrum, an excise tax of $1,000 is levied on autos whose mileage rating is less than 22.5 miles per gallon, and at the other end of the spectrum, an excise tax of $7,700 is levied against autos whose mileage rating is less than 12.5 miles per gallon.

Excise Taxes as Tools

Excise taxes offer an opportunity to have the users of certain governmentally provided facilities and services and governmentally controlled products pay all or a portion of the cost of such facilities, services, and products. Having the users pay for what they use makes more sense than having income taxpayers pay these costs. Also, having the users pay such costs will awaken them to an understanding that these facilities, services, and products are not free.

As any parent of an adult child leaving home can testify, knowing what things cost and paying for them yourself changes behavior. As long as someone else (parents in the case of an adult child and the government in the case of users) pays for things, everyone is happy to have all that is provided free, but when users themselves have to pay, they tend to question if what they are getting is worth what they are paying.

These three examples show how excise taxes can allocate the costs of government more fairly and impose spending discipline upon the politicians.

Excise taxes generally require that users pay for transportation facilities, sinners pay for consuming alcohol and tobacco, and the wealthy pay for ostentation. Complaints about regressivity, particularly pertaining to the gasoline tax, ignore the fact that the poor use the highways too, and all users should pay some share for their use. Taxing sin works at cross-purposes in that the more sin is discouraged through high taxes the less likely it is that substantial revenues will be raised. However, because taxing sin is usually a political winner, sin taxes are not likely to go out of fashion. Luxury taxes come and go depending on economic conditions and whether the politics of the time are dominated by the right or the left. Right now, luxury taxes have gone and show no sign of returning soon.

Making the Gasoline Users Pay for Highways

Since the 1950s, the federal government has assumed responsibility for the interstate highway system. There is no fairer way of paying for all or a portion of the cost of this system than having those who use it pay for it. Consumption of motor fuels fairly measures use of interstate highways and the amount of income taxes paid by a taxpayer does not. The excise tax on motor fuels practically and equitably allocates among users the burden of paying for the costs of interstate highways.

In a rare act of political wisdom, the politicians have dedicated motor fuel taxes to a trust fund restricted to the payment of transportation facilities. Anytime those who pay motor fuel excise taxes conclude that these taxes are too high relative to what they are getting in return, this is as good an indication as the politicians will ever have that too much is being spent on highways.

Making Sinners Pay for Their Sins

Smoking and drinking are commonly known to increase health risk, particularly for Medicare recipients. Dedicating the excise taxes on tobacco and alcohol, amounting in 2013 to about $40 billion, could help make up a portion of the Medicare deficit. Under Medicare, it is possible to track with precision the costs of treating patients suffering from the effects of smoking and alcohol. Requiring the sinners to pay for medical costs attributable to smoking and drinking would more fairly allocate the Medicare burden than increasing the payroll tax for those who are not guilty of those particular sins.

If preaching does not seriously discourage drinking and smoking, increasing the sin taxes might. **So, what if the price of driving, drinking, and smoking increases and harms the poor more than the rich?** Making drivers, drinkers, and smokers pay for the cost of their behavior most likely would be opposed by politicians of the right and left.

Many politicians of the right will object to any taxes for any reason even if it means requiring drivers to pay the cost of interstate highways. Many politicians of the left will object to the regressive effect of an increase in excise taxes.

All politicians should remember that there is nothing in the Declaration of Independence or the Constitution guaranteeing drivers the right to have highways and cheap gasoline, and smokers and drinkers the right to have cheap medical care, in each instance, without paying for it. If these things are not paid by excise taxes, they most likely will have to be paid from the income tax. Many types of governmental services should be paid for by use taxes as a means of allocating the tax burden fairly and forcing users to tell politicians anytime the taxes outweigh the benefits.

THE ESTATE AND GIFT TAX: DEATH AND TAXES

Under the category of other revenues and taxes, the estate and gift tax is the only tax of consequence from the standpoint of raising revenue. For 2014, the estate and gift tax generated approximately $19.3 billion in revenues, down from an all-time high of $29.1 billion in 2000 before the Great Recession. Put in perspective, taken together with other tax revenues, the estate and gift tax accounts for about 3% of the personal income tax revenues, about 5% of the social insurance tax revenues, and accounts for a little more revenue than either the gasoline tax or the alcohol and tobacco tax. The gift tax is a necessary accompaniment to the estate tax to prevent a decedent from giving away his or her estate prior to death as a means of escaping paying the estate tax. As a result, the two taxes are treated for most purposes as a single tax.

Paying the Estate Tax

Upon death, a decedent's gross estate becomes subject to the estate tax. The gross estate includes all property in which the decedent had an interest (including real property outside the United States), and it also includes the following:

- Certain transfers made during the decedent's life without adequate and full consideration of money or money's worth,
- Annuities,
- The includible portion of joint estates with right of survivorship,
- The includible portion of tenancies by the entirety,
- Certain life insurance proceeds (even though payable to beneficiaries other than the estate),
- Property over which the decedent possessed a general power of appointment,
- Dower or curtsy (or statutory estate) of the surviving spouse, and
- Community property to the extent of the decedent's interest as defined by applicable law.

The estate tax is payable on Form 706, which is longer and even more complex than Form 1040 for the personal income tax. And, like Form 1040, it comes with a detailed set of instructions that can only be understood by tax professionals.

Similar to the personal income tax starting with total income and working its way through a maze of tax preferences to get down to taxable income, the estate tax starts with the gross estate and also works its way through its own maze of deductions and credits to get down to the net taxable estate. Among others, the types of deductions from the gross estate include the decedent's funeral expenses, the expenses incurred in administering and distributing the estate, the debts that have claims against the estate, all unpaid mortgages secured by property comprising the estate, the decedent's bequest to the decedent's spouse, the amount paid as taxes under state laws to the decedent's beneficiaries, and most importantly, the decedent's bequests to charities.

In addition to all of the deductions and credits that are applied, the gross estate is further reduced by the amount of what the tax code calls the unified credit and by the sum of all individual credits given from amounts paid by the decedent under the gift tax regarding gifts made during the decedent's lifetime. For 2015, the uniform credit is $5,430,000, and for subsequent years, it is indexed for inflation. As an analogy, the uniform credit for the estate and gift tax is similar to the standard deduction under the personal income tax.

Estate Tax Rates

Once all deductions and credits are applied to reduce the gross estate to the net taxable estate, the following rates, as shown on Table V-15, determines the amount of estate tax owed.

Table V-20
Estate Tax Rates for 2015

Taxable Estate		Estate Tax Rate	
Over	Up to		Of the Amount Over
$0	$10,000	18%	$0
$10,000	$20,000	$1,800 + 20%	$10,000
$20,000	$40,000	$3,800 + 22%	$20,000
$40,000	$60,000	$8,200 + 24%	$40,000
$60,000	$80,000	$13,000 + 26%	$60,000
$80,000	$100,000	$18,200 + 28%	$80,000
$100,000	$150,000	$23,800 + 30%	$100,000

$150,000	$250,000	$38,800 + 32%	$150,000
$250,000	$500,000	$70,800 + 34%	$250,000
$500,000	$750,000	$155,800 + 37%	$500,000
$750,000	$1.000,000	$248,00 + 39%	$750,000
$1,000,000	N/A	$345,800 + 40%	$1,000,000
Source: IRS			

The Gift Tax

Similar to the personal exemption under the personal income tax, the gift tax has an annual gift tax exclusion which enables a person to give a certain amount to any number of individuals each year without incurring any gift tax liability. Gifts made in any year in excess of the gift tax exclusion are subject to the gift tax. For 2015, the gift tax exclusion is $14,000 per person and is indexed for inflation. Upon the death of the donor, all gift taxes paid in connection with gifts given from what would have been the donor's estate are credited against the estate tax. For statistical purposes, revenues attributable to the estate tax and gift tax are treated as a single item.

Avoiding Paying the Estate Tax and the Gift Tax

Avoiding the estate tax can be done but it is complicated and expensive. If and to the extent that a decedent is willing to donate the assets in his or her gross estate to a qualified charity, then the donor will not have estate tax liability for an amount equal to the donation. Unlike the personal income tax where there are limits on the amount of charitable donations certain high-income taxpayers can use to reduce their taxable income, there are no limits under the estate and gift tax on the amount of charitable donations that can be used to avoid taxes.

No matter how wealthy, a decedent so inclined can zero-out estate and gift tax liability by arranging to donate to a charity all remaining assets in his or her gross estate after paying all the deductible expenses and making a bequest to his or her spouse. For those who want to zero-out, they have to decide how much to bequeath to their spouse and how much to give to charity.

Estate planning—a pleasant term that translates in many instances to tax avoidance—costs money and lots of it. In 2014, 6,925 estates paid over $548 million in legal fees, averaging almost $80 thousand per estate, and for those estates whose gross estate was $20 million or more, their legal fees averaged about $139 thousand. These fees do not take into account tax accounting fees and other administrative costs. Instead of being merely a business, estate planning has become an industry.

For the largest estates that are willing to pay the most, there are ways for those among the very wealthy who are so disposed to donate their money to a charity while at the same time letting their families and friends control it and benefit from it: Eating one's cake and having it too.

Donating to Charity, Eating One's Cake and Having it Too

A decedent who wants to donate to charity and qualify for a charitable deduction has a choice: donate to a public charity or donate to a private foundation.

Generally, a public charity is a non-profit corporation organized to carry out a charitable purpose, such as churches, private schools, hospitals, homeless and battered-wives shelters, animal shelters, helping the disabled and disadvantaged, and numerous other such activities. To qualify for tax purposes as a public charity, an organization must raise most of its funds from the public, be governed by a diversified board, and not be under the control of any group of interested directors. Public charities are required to meet a number of tax requirements and file annual forms reporting on their income and activities. The IRS maintains a list of all public charities which meet the tax requirements for their contributions to be deductible. According to the IRS, as of April 2016, about one million charities qualified.

Private foundations are also usually non-profit corporations organized to carry out a charitable purpose, which is, subject to certain tax requirements, limited to making grants to various types of public charities. If certain tax requirements can be satisfied, private foundations may also make grants to individuals and to charities other than public charities. Unlike public charities, private foundations can be under the control of anyone chosen by the donor and hire family members and friends as employees as long as they are paid reasonable compensation. To deter self-dealing and other abuses, private foundations are subject to a number of restrictions regarding governance, fundraising, investing, and mandatory grant-making as well as being required to file a number of annual reports regarding their ongoing operations, grant-making, and expenditures. In 2012, there were 93,542 private foundations with assets aggregating about $698.6 billion and which made about $42.6 billion in grants.

Prominent examples of private foundations include the Bill and Melinda Gates Foundation and a foundation established by Warren Buffet, each worth billions. Private foundations offer the wealthy the ability to set up a non-profit corporation under the control of their immediate family and/or friends and enable them to control, subject to tax requirements, how the foundation's money is spent, and receive reasonable compensation for their services. Reasonable compensation depends on the facts and circumstances of each case and can be an elastic concept. The foundation may also hire (as consultants) anyone the board determines will assist it in carrying out its mission and pay them reasonable compensation and reimburse them for their expenses. For some foundations, travel includes first-class accommodations.

The full deductibility of charitable contributions to private foundations enables the wealthy to avoid millions in taxes, assure well-compensated employment (and oftentimes first-class travel on official business) for their children and friends, and make donations to any types of public charities that catch their fancy, regardless of any objective test as to need. What the wealthy do with their money is their business, but what they do with taxpayer-subsidized funds should be the business of all taxpayers.

A Choice: Pay Down the National Debt and/or Cut Taxes or Fund Charities

But for the charitable deduction (a product of the tax game) as much as 40%—the top rate applicable to both the personal income tax and the estate and gift tax—of deductible charitable contributions would have been taxed and the revenues attributable to them could have been used to pay down the national debt and/or lower taxes. The charitable deduction, however, diverts what would have been tax revenue to public charities and private foundations. Taxpayers (other than those who take advantage of the charitable deduction) should ask those who control the tax game if it would be better for America if the diverted revenues were used to either (1) pay down the national debt and/or (2) lower taxes instead of funding charities. With America's national debt at the highest level in three generations and headed upward to even more dangerous levels, diverting revenues to fund charities instead of using them to pay down the national debt or cut everyone's taxes seems dubious.

Farming out to the Wealthy the Right to Say Who Gets Diverted Revenues

The charitable deduction has the effect of substituting the whims of the very wealthy for that of the American people in deciding what to do with diverted revenues. If there were no diversion, Congress and the President would set the priorities regarding how these revenues should be spent, but because of the diversion, those who run charities set such priorities. In the case of private foundations, a small group of individuals (almost always chosen by the very wealthy who create them) decide who should benefit from these diverted revenues. While philanthropy is good, it can be unfocused and even wasteful.

The most sound philanthropy is that which is done by philanthropists with their own after-tax dollars with no involvement from the government.

Included among the approximately one million public charities (as reported by the IRS on its list of public charities) are the following: the Middlesex Barbarians R F C Inc., the Hanover Soccer Club Inc., the Agamenticus Yacht Club of York| Harbor, the Healing and Deliverance Ministry Inc., the Church of Cosmic Consciousness Gospel of Awareness, and the Liberty County Historical Society Inc. No doubt each of these charities serves a good purpose, but most taxpayers might find it doubtful that funding these charities with diverted revenues is better for America than paying down its national debt and/or lowering taxes. If most taxpayers thought about it, they might well doubt the wisdom of using diverted revenues to support many organizations, merely because they qualify as public charities.

The Charitable Deduction, Charity, or a Tax Dodge?

No one doubts that the charitable deduction encourages some to make donations to charity and that donations to charity are good, but the charitable deduction comes at a steep price. Not only does the charitable deduction divert substantial revenue from paying down the national debt and/or lowering taxes, but it also channels most of these revenues to charities favored by the very wealthy. So, imagine what the effect on charities would be if the charitable deduction were eliminated.

The total elimination of the charitable deduction would not affect the charitable giving of an overwhelming majority of Americans. Most Americans who give to charity get no tax benefit from their donations because only a few thousand taxpayers who die each year have estates large enough to have estate and gift tax liability and the overwhelming majority of taxpayers do not qualify for a deduction under the personal income tax. With respect to the personal income tax, only about 25% of all taxpayers qualified in 2015 for the charitable deduction. Subsequent changes in the tax laws have reduced the number of taxpayers who qualify for the charitable deduction to an estimated 10%. So, given that only a small number of taxpayers, primarily those with high incomes, benefit from the charitable deduction, it affects the charitable giving of only a relatively few taxpayers, overwhelmingly those with high incomes.

No group benefits more from the charitable deduction than the very well-off, and, among the very well-off, no group benefits more than the wealthiest of the wealthy. Eliminating the charitable deduction would leave the very wealthy in the same position as most other Americans who get no tax benefit from donating to charity. Eliminating the charitable deduction also would put all taxpayers on the same footing in that all taxpayers could donate as much as they want to whom they want without any government involvement. As an added benefit, the lawyers, accountants, and lobbyists who populate the estate planning industry could get into another line of business that adds to the productivity of the American economy.

Although no one knows for sure, it is likely that the very wealthy would still give a lot to charity even if the charitable deduction was ended. Once the very wealthy have left unimaginable fortunes to their spouses and families, they have to decide what to do with the rest of their money. During the *Gilded Age*, when there was no such thing as the personal income tax and either no or inconsequential federal taxing of estates, the robber barons, men like John D. Rockefeller, Andrew Carnegie, J. Pierpont Morgan, and Andrew Mellon, accumulated vast amounts of wealth, and then they or their families donated many millions to charities and their charitable foundations, most notably, the Rockefeller Foundation established in 1913 and the Carnegie Foundation established in 1911. Prior to 1913, there was no personal income tax and there was no federal estate tax between 1902 and 1916. Whether the robber baron donations were made from a belief in altruism, religious conviction, or as penance for misdeeds in business, only they knew, but whatever it was, it was not due to the personal income tax or federal estate tax.

Today, there is no reason to believe that the wealthiest of the wealthy, billionaires like Bill Gates and Warren Buffet, would not still give billions to charity even if there was no tax incentive to do so. Like most ordinary taxpayers, the very wealthy should pay their taxes and donate what they want afterward.

Who Bears the Burden of the Estate Tax and the Gift Tax?

Although the estate and gift tax are a direct tax against the decedent's estate, the burden of the tax falls upon the decedent's beneficiaries. Legacies are taxed differently. Many states tax the amount of bequests to each beneficiary through inheritance taxes instead of taxing the decedent's estate, and such tax laws vary. Since personal income taxpayers are not required to report bequests as income, it is not possible to track the income level of taxpayers who receive bequests.

The number of estates subject to any meaningful estate taxes is infinitesimal. In 2014 only 11,931 estate and gift tax returns were filed listing gross estates totaling $169.5 million of which only 5,158 estates whose gross estates totaled $90.1 million paid any tax. Table V-21 shows how the $16.39 billion in estate taxes was distributed.

Table V-21
Size of Gross Estates, Number of Returns, Amount of Gross Estates, and Net Tax for 2014
[Money Amounts in Millions]

Size of Gross Estate	Returns	Amount in Gross Estate	Net Tax
Total	5,158	$90,139,044	$16,390,024
Under $5.0 million	796	$2,541,219	$408,884

$5.0 million under $10 million	2,429	$17,290,434	$2,021,626
$10.0 million under $20.0 million	1,132	$15,500,585	$3,261,539
$20.0 million under $50.0 million	578	$17,295,913	$4,022,406
$50.0 million or more	223	$37,510,894	6,675,569
Source: IRS			

In 2013, there were 2.56 million deaths (presumably the deaths in 2014 were about the same), and only 5,158 (or about .20% of all decedents) paid any estate tax in 2014. The estate tax only affects the wealthiest of the wealthy, and then only slightly in that the average effective tax rate for gross estates of $50 million or more was about 18%. The middle class need not worry about the estate tax. For those who are concerned about the decedent's families losing their family owned farms and small businesses, there are a number of tax provisions that, among other things, provide both for the special valuation of these assets and, if there is any tax liability, the right to pay the tax over an extended period of time at favorable interest rates.

Replacement of the Estate and Gift Tax

Politicians who rant about repealing the estate tax and gift tax never mention how the lost revenues are to be replaced. Any reduction in estate tax revenues will almost certainly have to be made up by increasing the personal income tax.

Some tax experts, in fact, have suggested substituting a progressive inheritance tax—in effect the personal income tax—for the estate and gift tax. The tax and economic effects of the death of a wealthy decedent should focus on who inherits the estate rather than on the decedent—the decedent is dead and the inheritors are alive.

THE TAX GAP, THE CHILD OF COMPLEXITY

Every year over a third of a trillion dollars of tax revenue is lost to the tax gap, the amount of taxes owed under law less the amount of taxes collected. As some taxpayers avoid or evade paying their taxes, the burden of replacing the lost revenue falls on those taxpayers who voluntarily pay what they lawfully owe.

Almost all tax preferences invite differing interpretations which can result in billions of tax dollars being lost if an improper interpretation is asserted by taxpayers and the improper interpretation goes unchallenged by the IRS. For example, suppose a billionaire improperly claims that he or she is entitled to the benefits of a tax preference which saves them millions in taxes. Unless the IRS audits and disallows the improper claim then the billionaire will save millions in taxes and all other taxpayers must make up the difference. Making sure that millions of taxpayers comply with intensely complex tax laws is a gargantuan task that requires huge resources. Since the IRS is not the most popular agency, the politicians of both parties are not interested in providing it with the resources necessary to enforce proper compliance.

Complex tax laws favor those with the highest income the most because, unlike middle and low-income taxpayers, they can much more easily afford to hire expensive lobbyists to get them favorable tax preferences and professionals who can help them exploit them.

THE TASK AHEAD

The purpose of taxing is to pay for the cost of government, and if done well, it should not discourage economic growth, create social discord, or distort the operation of markets.

Unfortunately for taxpayers (but necessarily for America), the cost of government is going up and up substantially. Since the end of World War II, the cost of government has trended up, ranging from a low of 14.1% of GDP in 1950 to a high of 24.4% in 2009 at the height of the Great Recession. Government costs more now because (1) America is (and will continue to be) the world's leading power and with that comes having to pay for an ever-growing national security establishment, and (2) economic changes have compelled America to expand social insurance, most notably Social Security and Medicare, but also including programs to assist those with middle and low-income gain access to health care and post-secondary education.

From the end of World War II through about 1980, income disparities were relatively narrow, college was important but not necessary, health care was not as sophisticated or as expensive as it is today, wages were not under nearly as much pressure from technology and globalization as they are today, people did not live so long in retirement, and jobs were much more secure than now. The economic and social changes that began in the 1980s are accelerating at an ever-faster pace and have created an environment which is leading to more (not less) social insurance. With the need to maintain a strong military and expand social insurance, the cost of government for the foreseeable future can be expected in the next few years to approach, and thereafter exceed, 25% of GDP.

From about 1980 to the present, with only a few exceptions, America taxed much less than it spent, which has resulted in its having its largest national debt (as a % of GDP) in over a half century. All of this means that America must increase taxes from about a range of 17% to 19% of GDP to a range of about 22% to 24% of GDP in the next few years if it is to pay for the current cost of government and pay down the national debt to a manageable level. A tax increase of 5% to 6% of GDP (even if it is phased in over a few years) will intensify the tax game. It will be much harder to be a winner and much easier to be a loser.

Early in the 20th century, America switched from consumption taxation (excise taxes and tariffs) to taxing income (the personal income tax, the payroll tax, and the corporate income tax) because income taxes were much more progressive. The same political pressures—too many low and middle-income taxpayers being unwilling and/or unable to pay for the bulk of government—that led to progressive taxation a century ago are no less potent today. For several generations, progressive income taxes have paid for about 90% of the cost of government, and with more and more Americans suffering from job anxiety and stagnant income syndrome, it is likely that more (not less) of the cost of government will be paid from progressive income taxes.

Putting aside individual winners and losers in the tax game, it is worthwhile to ask what would be the best way for the America of the 21st century to tax at a level of about 24% of GDP. So, here are a few suggestions:

- **Ways to Promote Economic Growth:** Tax rates should be as low as possible for everyone by including **ALL** income as taxable income; taxation should be simplified by ending **ALL** significant tax preferences; **ALL** business income (including C-corp income) should be taxed under the personal income tax as such income is distributed to the business owners and shareholders: and taxes on **ALL** of a decedent's assets should be paid by those who inherit such assets.

- **Ways to Reduce Social Discord: NO** taxpayer (regardless of their wealth) should be taxed at a rate so high that it unreasonably discourages them from making the next dollar; **NO** taxpayer should be taxed into or near poverty; **NO** taxpayer who has the same income as another should pay significantly more taxes than the other; and, as income concentrates in a few, taxation should be made **MORE** progressive.

- **Ways to Reduce Distortion in Markets:** Ending all significant tax preferences, the corporate income tax, the estate and gift tax, and the payroll tax and replacing them with a single progressive personal income tax would eliminate almost all incentives for investors to invest in tax-driven investments and consumers to spend their money on tax-deductible consumption.

While these suggestions would deprive the tax establishment that rules over and benefits from the tax game of the largess resulting from picking winners and losers, it would be good for America.

As a former card-carrying, deal-doing member of the tax establishment that has foisted the existing system of taxation on America, I cannot think of a single legitimate reason not to implement my suggestions. To me, tax reform boils down to a question of which is to prevail: greed or patriotism.

CHAPTER 6

THE TAX GAME

"An income tax form is like a laundry list – either way you lose your shirt."
-Fred Allen

What is the Tax Game? • What the Tax Game Should Produce for America • Who Plays the Game? • Getting in the Game and Staying in the Game • Rules of the Game • President Donald Trump and What it Has Meant for Taxes • Changing the Game

WHAT IS THE TAX GAME?

Only a minuscule percentage of American citizens understand tax law, tax policy and how elections for public office are conducted. As a result, the way tax laws are passed and tax policy is implemented is a "game" played by politicians, lobbyists, businesses, and the wealthy. This "game" is opaque to the ordinary citizen, and therefore it is a game played by a select few which ends up being in the interests of a select few. So, it is essential that American citizens acquire a basic understanding of the tax game, who plays it and how it is played so they can learn to protect their own interests and ensure that they become winners in the game.

WHAT THE TAX GAME SHOULD PRODUCE FOR AMERICA

Who pays what in taxes results from an ongoing high stakes game played under loosely defined and elastic rules that favor those who are wealthy, avaricious, ruthless, and clever, and in which the dearest skill is the ability to create false myths that convince the many to believe that it is in their interest to benefit the few. Creating false and convincing myths is a pleasant way to describe sophisticated and skillful lying.

If the tax game were to be played honestly and in the national interest, it would produce a system of taxation based on the following principles:

- Taxes must raise enough revenue to both pay the ongoing cost of government and keep the national debt at a financially responsible level.

- At the low-income end no person should be taxed into poverty, and at the high-income end no person should be taxed so high that they lack a reasonable incentive to earn the next dollar.

- Taxes should be allocated among those in between the worst-off and the best-off based on ability to pay.

- Taxpayers who have roughly the same income should pay roughly the same taxes.

- Taxes should promote economic growth.

- Taxes should not distort the allocation of investment capital.

- Taxes should be friendly toward families—for America's workforce to be large enough to meet the needs of a growing economy and to generate sufficient revenues to pay for America's social insurance programs, tax policy must encourage America's families to grow larger.

- The tax laws should be as simple as possible.

Instead, America's tax laws are infested with hundreds of tax preferences most of which (1) make it more difficult to raise the necessary revenue, (2) cause many taxpayers who make about the same income to pay dramatically different amounts of taxes, (3) divert investment capital from market favored purposes to politically favored purposes, and (4) add undue complexity to taxation. Aside from the economic harm done by tax preferences, they corrupt politics in general and the tax game in particular. Explaining how the tax game is played explains the proliferation of tax preferences.

Politics and the Tax Game

Politicians can stomach overhauling the structure of the tax laws only about once a generation. Major structural changes were made to the tax laws in 1939, 1954, and 1986, and in between, the politicians have only nibbled at the edges. Nibbling, however, can have significant revenue implications if tax rates are cut substantially and tax preferences are made more generous. In 1981, the Reagan Administration enacted a significant tax cut as did the Bush Administration in 2001 and 2003, but none of these cuts involved major structural change. In each case, the politicians cut tax rates and expanded tax preferences. ***Each time the politicians cut taxes, the national debt grew.***

Two reasons explain why the politicians timidly approach structural change in the tax laws—one is a reluctance to create economic uncertainty, and the other is fear of taxpayer retribution.

First, the economy abhors confusion and uncertainty. Significant structural changes in the tax laws affect individual financial decisions for millions of taxpayers that determine how they live their lives and prompt many taxpayers, both individuals and businesses, to ask questions such as: Should I buy or rent? Can I afford to retire? How can I send my kids to college? Should I carry life insurance and health insurance? What will my after-tax income be? How much can I plan to spend? Should our company purchase new equipment this year or wait until next year? Should our company increase its dividend this year or wait until next year? I've got a capital gain in some stock I own, should I take it this year or wait? These questions and many more can lead to taxpayer confusion and uncertainty that risk disrupting the economy.

Getting into anything that confuses millions of taxpayers and potentially disrupts the economy terrorizes most politicians, even the bravest and most noble (an oxymoron?). For virtually all politicians, changing the structure of the tax laws should not occur any more frequently than Halley's Comet comes–once every 76 years. So, to save taxpayers the burden of informing themselves about changes in the tax laws and to avoid harming the economy, politicians happily steer clear of major structural changes in the tax law. Structural changes in tax laws only occur when the politicians are certain that an overwhelming majority of taxpayers are so disgusted with the existing tax laws that they are ready for a change—a generational event.

Second, structural changes in the tax laws inescapably create winners and losers among taxpayers. Even if the changes do not increase the overall tax burden, each tax law change upends the status quo for millions of taxpayers. Over time, taxpayers learn to live with the status quo, even if they know that it is unfair. Changing the status quo means some taxpayers will be better off (the winners) and others will be worse off (the losers). Taking away a tax preference that a taxpayer has become accustomed to can traumatize the taxpayer more than if he or she were to lose a cherished pet.

In deciding when and what to change in the tax laws, politicians calculate whether a change will advance their careers, and if they do not believe that it will, then there is little chance of a change being made. For a politician to believe that a change will help them, he or she must believe that their key supporters believe that the change will benefit them. Supporters include not only the voters whose vote determines the politician's fate, but more importantly, supporters include those who provide campaign contributions.

Politicians know that campaign contributions can be used to convince voters of things that are not so—it is the value of myth-making. Even though a tax preference may only benefit a small group, advocates of the tax preference can tilt a politician's calculation in their favor if they are willing to raise enough campaign contributions to convince the public that the tax preference is in the public interest. Successful politicians make it their business to know what tax preferences are dear to their supporters, and knowing this, they make sure that they do not do anything to upset them. Structural reform of the tax laws means changing or eliminating hundreds of tax preferences that are held dear by many supporters of most politicians. Out of fear of stirring up a hornets' nest among their supporters, most politicians shy away from structural reform.

In almost all sessions of Congress, the politicians decide that they can hype some segment of the economy by adding one or more tax preferences and/or that they can end some abuse by eliminating a few. Generally, what hypes the economy and what is an abuse are both matters of party doctrine—in other words, faith-based economics depending on which party the politician belongs to. Politicians of the right and left each have their own pet tax preferences that they like to either expand or curtail. Most changes that nibble at the edges result in an overall loss of revenues on the theory that a spoonful of sugar makes the medicine go down. Cutting taxes also cuts the risk of riling too many taxpayers—creating winners without obvious losers is the safest way for politicians to play the tax game. Those who are harmed the most by cutting current taxes without replacing the revenue—future taxpayers—do not vote. Knowing who you can hurt without fear of retribution is one of the keys to success in politics.

There are certain politicians who have politicked themselves into unique positions so that they have the power to make or break tax legislation as each biennial tax game plays out. These are: the House leadership, the Chairman and the members of the House Ways & Means Committee, the Senate leadership, the Chairman and the members of the Senate Finance Committee, and the President of the United States. What influences how these politicians ply their power determines the outcome of the tax game.

A taxpayer can easily figure out what influences a politician on tax matters by asking what would influence the taxpayer if he were in the politician's place—a walk in the other guy's shoes. Politicians, as humans, suffer from the same foibles as taxpayers and act accordingly. Like non-politicians, occasionally some politicians put the interests of others ahead of themselves, but usually most politicians, like non-politicians, put their own interests ahead of others—nothing new here.

Generally, nobility inspires a politician to protect the interest of ordinary taxpayers, and ambition inspires a politician to cater to special interests. Unfortunately for the ordinary taxpayer, nobility all too frequently leads to martyrdom, and ambition leads to success. Since survival of the fittest rules in politics, nobility is a weak reed on which the ordinary taxpayer can lean.

The tax game plays out in the arena of politics, and politics is a business much like selling stocks and bonds, insurance, or real estate. Instead of selling stocks and bonds to investors who the salesman convinces will make them money, a politician sells his constituents on his ability to promote their interest in politics. Just as salesmen sometime sell bum stocks and bonds to investors, politicians sometime bum out on their promise to promote the interests of their constituents.

Unlike investors who know whether the stocks and bonds they bought made them money, a politician's constituents rarely have a clue whether the politician has advocated their interest or not. Since tax matters mystify most taxpayers, most taxpayers live in the land of ignorance regarding whether politicians are advocating their interest in the tax game. Taxpayer ignorance leaves politicians free to do what is in their interest rather than the interests of ordinary taxpayers. As salesmen, not educators, few politicians feel any need to teach tax policy to their constituents, including in particular not telling them that they are getting a raw deal under proposed tax legislation. Most politicians reason that if their constituents are not clamoring for any change in the tax laws, why stir up trouble.

As in business, where a crack salesman can get rich selling a bad stock to an ignorant investor, a politician can make it in the political world by advocating tax policies that are contrary to the interests of most of his constituents as long as they naively believe that he is shooting straight with them—a gifted salesman can sell a refrigerator to an Eskimo. P. T. Barnum summed up how most politicians approach selling when he said, "If you want to make a living, sell the people what they need, but if you want to get rich, sell the people what they want." Catering to wants, instead of needs, explains why the national debt has grown over the last two generations. Although tax matters affect how much money most taxpayers will have to spend, and social issues like gay marriage, abortion, gun control, and flag burning do not, most taxpayers fixate on social issues and ignore tax issues. In a world of wants and needs, social issues are more like wants and tax issues are more like needs.

Other than a few millionaires who can afford to indulge themselves, most politicians are work-a-day stiffs, just like their constituents, trying to claw their way up the ladder of success in politics as their chosen field. Almost all of today's politicians get into the business of politics as a full-time career. The example of the legendary Cincinnatus, a simple farmer in 5th century B. C. Rome, who the Romans put in charge of saving Rome from barbarian invaders and who, after defeating the invaders, laid down his powers and returned to the farm, long ago faded into antiquity. Leaving the plow to help out in government for a while and then going back to the farm may have been good enough for Cincinnatus, but today's politicians see Cincinnatus's decision to return to the farm as a bad business decision. Today, not only does politics pay better than pushing a plow, politics is inside work.

The day of the part-time citizen legislator who served in Congress for a few terms and then went back home to resume a private life and a real job or profession ended for almost all elected politicians over a half-century ago. The current Congress, unlike the Congress of a century ago, now meets all year every year, and new campaigns for Congress and President begin as soon as old ones end. As a selling business, politicians have to be mindful of how to advance their careers. A politician can reasonably ask, if I do not look out for my career, who will. With few exceptions, what a politician believes will advance his career drives what he will do about taxes and other legislative matters—careerism beats out ideology almost every time in the hierarchy of the factors that make a politician tick.

Elections preoccupy all politicians, even those not running, because elections determine which party will control Congress and the presidency, and which party controls Congress and the presidency determines how much political stroke each politician will have. Getting elected costs in the millions for a seat in the House, tens of millions for a seat in the Senate, and many hundreds of millions for a shot at being President. The cost of climbing the ladder continues to grow with no sign of a change in the trend. Paying the cost of surviving and rising in politics preoccupies almost every moment of a politician's consciousness. Extracting millions from favor-seeking donors, as a fundraiser, and avoiding disappointing them, as a lawmaker, challenges all politicians—disappointed donors cannot be counted on to keep pouring money in an unprofitable venture.

Almost all of today's politicians obsess with clinging to the rung on the ladder they currently occupy, climbing to the next rung, or, if they fall off the ladder, getting a job either as a lobbyist or in the executive branch. Since success in politics cannot be guaranteed, prudent politicians constantly watch for career alternatives if the public tires of them. For many politicians who either do not seek to climb higher up the ladder in elective politics or who lose and fall off, lobbying is the most attractive and lucrative career alternative, and for other politicians who lose or become bored with dealing with constituents, a job in the executive branch can be just the right tonic.

Regarding lobbying, the bucks in lobbying (particularly for those who are successful) often far exceed the bucks a politician gets for serving in elected office. How strange that in the business of importuning, the importuner makes much more than the importuned—in most other businesses, the reverse applies. For those politicians who resent years of underpayment and lack of appreciation for their service as an elected politician, becoming a lobbyist at an exponential jump in salary can be just the thing. For many representatives and senators who are anxious to escape from the boredom and stress of dealing with lobbyists and constituents, an executive job, particularly a prestigious cabinet position or an ambassadorship, can be appealing to them. For example, it should not be too much to ask for a two-term Senator who has delivered time and again for the President to be awarded a European ambassadorship if the senator pleads his case well enough. If a politician wants an executive job, however, he had best keep the President happy.

Rare is the politician who decides to leave politics and go home to live out the rest of his life like most Americans. Politicians make thousands of legislative decisions, including quite a number that relate to tax matters that affect their careers. Many career advancing decisions come at the cost of favoring the few over the many—the omnipresent contest in the character of each politician between nobility and ambition. How politicians balance advancing their career against promoting the interest of ordinary Americans determines how the many will fare against the few in the tax game.

WHO PLAYS THE GAME?

The Gauntlet

For a tax provision to be adopted, repealed, or modified, the proponents of the provision must persuade a majority of the House and Senate and the President each to approve it. Winning these approvals requires surviving a legislative gauntlet by side-stepping pitfalls, hurdling obstacles, and avoiding traps that would intimidate Indiana Jones, and by persuading many politicians along the way to go along. Persuading is a pleasant word that encompasses every behavior from enticing to bludgeoning.

Imagine the gauntlet as two lines that each zigzag through the standing committees of each of the House and Senate, then each respective line runs to the floor of the House and the Senate, then the House line and the Senate line each runs to a joint House/Senate conference committee, and then the House line runs back to the floor of the House and the Senate line runs back to the floor of the Senate, and, assuming that the full House and Senate each approve the same tax provisions, then the two lines merge into a single line that runs from the Congress to the President. Any tax provision that falls prey to any trap along the gauntlet perishes.

Process and personality meld to rule the tax game. Congressional rules and the rules of the Republican and Democratic parties' respective caucuses in Congress dominate the process, and individuals who have access to money and knowledge and who have the moxie to grab and exploit power dominate as personalities. As a warning, those who possess a generous quantum of moxie do not always possess an equal quantum of concern for treating ordinary taxpayers fairly. At each point along the gauntlet, each ordinary taxpayer should (but does not) ask who is looking out for them.

Divided Government

Divided government, the control by different parties of the presidency and one or both of the Senate or the House, compels the two parties to compromise in playing the tax game. When a state of divided government exists, no tax legislation will make it through the gauntlet unless each party agrees, and the price for agreement is compromise. Divided government can protect those Americans who are not ideologically inclined from the faith-based tax doctrines of each of the parties. In this respect, Republicans and Democrats each reason that if I cannot get my pet tax provision then you cannot get yours, and so each party decides to work things out independently of any ideological agenda.

Unfortunately, divided government on occasion can also create the worst of all worlds in the tax game. In this respect, Republicans and Democrats may decide to split the baby in half by agreeing that each party can include their ideological favorite tax provisions—an unholy deal in which each party agrees to take a few of their pet provisions. Sometimes divided government protects the interest of the ordinary taxpayer in the tax game, but sometimes it makes things worse. As with most things in life, nothing is perfect.

Congress

Each November in each even numbered year, the voters elect all members of the House and one-third of the members of the Senate. Because only one-third of the Senate changes with each election, experts refer to the Senate as a continuing body whose rules and organization remain in place regardless of each election. But, because the entire House is elected every other year, the House is not a continuing body, and therefore, it must adopt rules and organize afresh after each biennial election.

When each Congress convenes, the House by majority vote adopts its governing rules, but, as a continuing body, Senate rules continue in effect. At the beginning of each congressional session, each party's caucus meets to organize and determine which members will sit on each congressional committee and which members will chair each committee.

The existing personal income tax has been in the making for over the last half century. Although there have been few changes in House and Senate rules that govern the process, the practices under which the Democratic and Republican party caucuses operate have changed, and those changes have affected how tax legislation becomes law. Congressional rules and party practices are made for dealing with nibbling changes to the tax laws but not structural changes—Congress excels at the tactic of legislating favors for select groups and often fails at strategically addressing major problems confronting all of America.

The House

House rules prescribe each decision point (better described as a potential trap) in the House phase of the gauntlet, and party practices determine which House members line up at each point in the gauntlet. The Speaker of the House, based on the advice of the House Parliamentarian, interprets House rules. A majority of the House elects the Speaker, and the Speaker appoints the House Parliamentarian. Custom and precedent count in interpreting and applying the House rules, but not so much as to prevent politics rising above principle when the occasion invites it.

Under the Constitution, Article I, Section 7, all revenue bills must originate in the House, and under House Rules, formal tax action begins in the Ways

& Means Committee—the primary playpen in the House for personalities to work their will on tax legislation. The Ways & Means Committee has exclusive jurisdiction over all tax matters and is the most prestigious committee in the House.

As an example of how the system works, for the 114th Congress that convened in 2015, there were 39 members of the Ways & Means Committee, 24 of which were Republicans and 15 of which were Democrats. The majority party in the House (regardless of whether it is the Republicans or Democrats) always insists on having a healthy majority on the committee—the ratio of Republicans to Democrats in the entire House was only about 1.15 : 1, but in the Ways & Means Committee it jumps up to about 1.41 : 1. Whichever party is in control of the House always maintains a wide majority on Ways & Means to insure that one or two mavericks on their own side of the aisle will not have the power to frustrate the party's will.

In each session of Congress, the majority party in the House prescribes the rules which determine how the House is to be organized in terms of, among other things, what the committees and their jurisdiction are to be, the membership of the committees, and the House's administrative budget that controls staffing. The majority party sets the legislative agenda, has more staff than the minority party, has many more perks, and, therefore, can raise political contributions much more easily than the minority—it is better than good to be the controlling party, and it is horrible to be the minority party. Because being in the minority in today's House admits impotence, the leadership of both parties obsess with, in the case of the majority, clinging to control, and in the case of the minority, grabbing control. After all, how can a politician do the Lord's work if he or she is not there to do it? The means used by each party to win control might make the Lord blush and frequently require that the Lord's work wait.

Inside the Ways & Means Committee, committee rules vest vast powers in the chairman. The chairman decrees if and when there will be tax legislation in each congressional session. And, if the chairman decides there is to be tax legislation, he chooses what provisions are to be included in the first draft for consideration by the full committee and when to bring the legislation to the committee for consideration. For taxpayers seeking a change in the tax laws, no one is more important to get on their side than the chairman of Ways & Means, and no one knows this more than the chairman. Like the old adage about children, new members of the committee are expected to be seen and not heard. Given the partisanship between Republicans and Democrats in the House for the last generation or so, the members of the minority party are barely tolerated, but, if they are good, they are sometimes thrown a bone, albeit one with little flesh on it. After the chairman unveils his draft, the full committee has a crack at offering amendments in what Belt-Way insiders call the chairman's mark. Once Ways & Means completes the amendment process, the committee by majority vote reports the legislation to the full House.

The full House cannot consider proposed legislation reported from any committee, including Ways & Means, unless the Rules Committee by a majority vote clears it for consideration under a special rule. Each special rule prescribes, among other things, when the full House will consider proposed legislation, how much time will be scheduled for debate, and whether amendments may be offered on the floor of the House. With respect to tax legislation, the Rules Committee almost always adopts a special rule, aka closed rule, which forbids floor amendments. As a result, the full House has the choice of taking or leaving the proposed legislation as reported out of Ways & Means. Forbidding the full House from changing tax legislation on the floor makes Ways & Means the primary arena for the tax game to play out in the House. If a taxpayer cannot get his or her provision in the tax legislation reported out of Ways & Means, then the taxpayer has probably lost the tax game for that session. But, getting a provision in the Ways & Means version of proposed tax legislation by no means assures ultimate success.

Once the full House adopts proposed tax legislation, it must be reconciled with any proposed legislation approved by the Senate that differs from that approved by the House. Rarely do the House and Senate agree on proposed tax legislation. All differences between bills approved by the House and the Senate, respectively, must be reconciled in a conference committee composed of representatives of the House and Senate. House members of the joint conference committee are appointed by the Speaker upon the recommendation of the chairman of Ways & Means. The chairman of Ways & Means always serves on conference committees and has a big say in who else does. Rarely in today's House do members of the minority party serve on a joint conference committee.

House Leadership

Tax legislation depends more on the interplay of personalities in interpreting and manipulating the rules than on the rules themselves—generally, rules yield to the clever, particularly when the stakes are as tempting as the tax laws. The top leaders of the majority party in the House are the Speaker, the Majority Leader, and the Majority Whip, and for the minority party, the Minority Leader and the Minority Whip. Over the last generation or so, party politics has been working to transform the types of personalities who play the tax game in the House from those who are relatively independent, secure, and non-ideological to those who are relatively dependent, insecure, and ideological.

Until the latter part of the last century, seniority ruled the House. Since the 1970s, each party, to a greater or lesser extent, diluted the power of the seniority system, made its members more or less toadies of their party's caucus, and almost completely cleansed itself of those who lack their party's ideological purity. These actions have taken place in each party's caucus acting through the party's elected leadership.

A generation ago, seniority was a leading factor for a member getting on a powerful committee such as Ways & Means; parties rarely removed a member from a committee even if he frequently bucked his party's leadership on important issues; the chairmanship of committees almost automatically went to the most senior member of the party in control of the House who served on a committee; and there was a generous sprinkling of left leaning politicians in the Republican party and right leaning politicians in the Democratic party. Neither party's caucus exercised much discipline over their members.

In today's House, each party's caucus, acting through its leadership:

- **screens members to make sure that if a member is put on a committee the member will stick to the party line,**

- **will yank a member off a committee if the member strays too far from the party line,**

- **selects the chairmen of committees (largely independently of seniority) based on whom the leadership believes will raise the most campaign funds for the party, and**

- **makes life uncomfortable for those members who are not sufficiently ideologically attuned.**

On top of these evolutions for some and devolutions for others, both the Republican and Democratic leaderships in the House have set up "leadership PACs" (short for political action committees) in an effort both to raise campaign contributions and control which members advance in the House. Party leaders organize PACs under the campaign finance laws for the purposes of soliciting, accepting, and dispensing political contributions in an effort to elect as many Republicans to the House as possible. For the most part, Republican leadership PACs have raised considerably more money than Democratic Leadership PACs. Leadership PAC money fuels the election of like-minded candidates that are intended to strengthen the party's position in the House.

A great way to ascend to a leadership position or committee chairmanship is for a member to raise big money for a leadership PAC. Big money for Congressional elections, most notably for members of the Ways & Means committee, inevitably comes from lobbyists and special interests, not the little guy. The message for those who aspire to become the chairman of a committee in a Republican controlled House: forget about learning Robert's Rules of Order and reading policy papers and instead learn how to shake the money tree.

No member of any Congressional committee is better equipped to shake the money tree from taxpayers all over America than the chairman of Ways & Means. Political contributors cannot justify wasting precious campaign funds on a junior committee member. Contributors get the most bang for their buck by funneling money to those who can get something done, and no one gets things done better on tax matters than the chairman.

In the previous generation, a typical chairman of Ways & Means or the Rules Committee was a member who was elected from a safe district, had been around for a long time, knew where all the bodies were buried, had seen Speakers and other party leaders come and go, became chairman by hanging around the House longer than his fellow members on the committee, knew that the seniority system would protect him from losing his chairmanship, frequently worked with members across the aisle to get bipartisan legislation enacted, paid little attention to his party's leadership or caucus in fashioning legislation, and spent little if any time raising funds for his party. No chairmanship better epitomized how the old seniority system worked on Ways & Means than that of Wilbur Mills who dominated the committee for the better part of a generation.

As left-leaning members left the Republican party and right-leaning members left the Democratic party, each party's caucus has become more ideological and intolerant of a bunch of old gaffers running their committees much like feudal baronies. Over the last 20 years or so, the party caucuses have purged the old gaffers from committee chairmanships and replaced them with younger members who readily adhere to their party's line, support their party leadership's legislative agenda, pay at least as much attention to political fund-raising as to legislating, know that, if they oppose the party's leadership on any matter of consequence, they can lose their chairmanship, and rarely work with members across the aisle on a bipartisan basis.

The House and Committee rules grant broad powers to the chairmen of Ways & Means and the Rules Committee, but in today's House, it is the party's caucus and leadership (for those interested in history they should read about Joe Cannon's House in the early 20th century) that, in large measure, determine how these committees will be run and what legislation they produce. Before the chairman of Ways & Means decides to initiate tax legislation, he is much more likely than his predecessor of 30 years ago to touch base with his party's leadership on when and what to bring up in a tax bill. If the chairman gets the go ahead from his leadership, it is likely that the majority members on Ways & Means will go along. If they do not, some may be invited by the leadership to serve on another committee.

Swapping a seniority model for a party loyalty model has resulted in young adventurers, who can be relied on by their party's leadership to adhere to party policy and soil their hands in party sponsored fundraising, replacing the old gaffers, who believed that they could legislate pretty much any way and with whom that they wanted and who did not bother themselves much with party politics. The Republicans, much more than the Democrats, have moved away from the seniority model by term-limiting the chairmen of their committees in both the House and the Senate. As with most things, some think this is good; some do not; and some see it just as different. Term-limiting a chairman, however, eats into his or her power to persuade and/or intimidate the members of their committees and the interest groups who deal with them. While term-limiting a chairman is a loss for the chairman, it is a gain for the party's leadership who gets to appoint chairmen.

Tax preferences have thrived under both the seniority model and the party loyalty model, and, under both models, almost all tax preferences have been crafted to benefit the well-heeled. Neither model promotes the national interest over narrow interest. The seniority model has resulted in a modicum of bipartisanship between the political parties, and the party loyalty model has resulted in all but eliminating the prospect for bipartisanship.

Neither the House leadership nor the chairman of Ways & Means can represent America as a whole. A single district elects the Ways & Means chairman, and, therefore, the chairman cannot credibly pretend to represent the national interest. The party leadership, moreover, is responsible only to a majority of the members in their party, not the majority of Americans. Given the social, cultural, ethnic, political, and economic diversity of America, neither the Republican nor the Democratic party leadership nor any Ways & Means chairman can be expected to fairly balance the interest of all Americans.

Inevitably, tax provisions that make it through the House phase of the gauntlet will cater to those with special economic and tax-related interests over the national interest and the interests of the ordinary taxpayer.

The Senate

As with House rules, Senate rules prescribe each decision point in the Senate phase of the gauntlet. With respect to who will fill leadership posts in the Senate, who will serve as the chairmen of Senate committees, and who will serve on Senate committees, the Democratic caucus in the Senate determines for Democrats and independents who participates in the Democratic caucus, and the Republican conference in the Senate determines for Republicans and independents who participates in the Republican conference. Any Senator in either party who wanders too far off their party's reservation in terms of policy risks losing their committee membership or chairmanship any time a majority of their fellow caucus or conference members wish it.

The Presiding Officer of the Senate (the Vice President) interprets Senate rules based on the advice of the Senate Parliamentarian who is appointed by a majority of the Senate. Traditionally, the Senate Parliamentarian renders non-partisan advice. Although a majority vote of the Senate may overrule any ruling of the Presiding Officer, it rarely does. Generally, custom and precedent seem to count a bit more to the Senate in interpreting and applying its rules than they do in the House. Unlike the House rules which provide few opportunities for individual members to affect legislation, Senate rules make it possible for individual senators, even junior senators, to significantly affect legislation.

Formal tax action in the Senate begins in the Finance Committee—the Senate analogue of the House Ways & Means Committee. The Finance Committee has exclusive jurisdiction over all tax matters and is the most prestigious committee in the Senate. For the 114th Congress that convened in 2015, there were 26 members on the Finance Committee, 12 of which were Democrats and 14 of which were Republicans. Unlike the Ways & Means Committee which always maintains a wide margin of members of the majority party, the majority party maintains a margin in the Finance Committee roughly comparable to membership in the entire Senate. As a result, one or two mavericks, among the majority party membership on the Finance Committee, can force a change in the legislation that is reported out of the committee.

The controlling party in the Senate lacks the power of its counterpart in the House to set arbitrarily the legislative agenda. A maze of arcane parliamentary procedures empowers individual senators to hold Senate action hostage to compromise. Two big reasons account for why the minority can prevent the majority from running roughshod—first, each senator has the right to talk legislation to death unless cut off by the full Senate, and second, each senator may offer floor amendments to majority-backed legislation that can slow the legislative process and divert the majority from its legislative goal.

Most Senate parliamentary procedures that make delay an effective tactic for members of the minority party stem from the right of each senator to take the Senate floor and talk until, in some instances, a majority, and in other instances, 60 senators, vote to close debate—in the trade, talking is known as "filibustering", and closing debate is known as "cloture." Since each Senator prizes the right to throw a monkey wrench in the works by filibustering, fear of losing that right discourages each senator from invoking cloture too easily. The result: a small minority of senators can slow Senate action to the point that the majority can be forced into either compromising or getting nothing done.

The right to offer floor amendments arms each senator with a dual-use weapon that can both slow down a majority of senators bent on forcing legislation through and drive a wedge among members of the majority. Every time an amendment is offered by a member of the minority and debated, the process steals time away from the majority's legislative agenda. And, if a minority member offers an amendment to majority-backed legislation that is supported by some in the majority, but opposed by others, the amendment may split the majority and torpedo the majority-backed legislation.

The Senate, because of its rules, differs from the House in that a minority (even a small minority) can thwart the majority's attempt to ram through its legislative program. In the Senate, unlike the House, compromise between the majority and minority rules in most instances. Even though being in the minority is not as bad for members of the Senate as it is for members of the House, it is still a bummer, and minority Senators nevertheless obsess with gaining the majority.

Inside the Finance Committee, its rules vest great powers in the chairman, but not quite as much as the chairman rules in Ways & Means. As with the chairman of Ways & Means, the Finance Committee chairman pretty much has the power to decide if and when there will be tax legislation in each congressional session. However, unlike the Ways & Means chairman, the chairman of the Finance Committee usually consults, not only with his Majority Leader but also with the ranking member of the minority party, before taking action. Since the chairman of the Finance Committee knows that his party probably cannot impose its will on the minority, the chairman usually attempts to make a deal with enough members of the minority to be assured of getting committee approval. Almost always, getting the ranking member of the Finance Committee on the same page as the chairman will assure that the chairman's proposals will make it through the committee, and if the chairman cannot get the ranking member on board, there is likely to be blood on the floor, first in committee, and later, on the floor of the Senate. Gaining the approval of the ranking member requires that the chairman compromise. Unless the bone thrown by the chairman to the ranking member has some meat on it for the minority members, the minority will resort to its parliamentary bag of tricks to stymie the majority-backed proposal.

Even though the chairman of the Finance Committee lacks the power of the chairman of Ways & Means to shape tax legislation to suit himself and his party, the chairman of Finance still possesses significant latitude that enables him to include many significant tax provisions in any tax legislation reported out of the Finance Committee. As with Way & Means, if a provision fails to make it out of the Finance Committee, it falls prey to the gauntlet. Once the Finance Committee approves draft legislation, it goes to the floor of the Senate and is considered when the leadership of the controlling party, most notably the Majority Leader, schedules it. The Majority Leader usually consults with top Senators in his own party before picking an opportune time to submit it for floor consideration.

Contrary to the House, it is not unusual for major amendments to tax legislation to succeed on the Senate floor. While Ways & Means shapes tax legislation in the House, with little input from the full House, the full Senate plays a major role, relative to the Finance Committee, in shaping tax legislation in the Senate. More than occasionally, a few Senators, who do not serve on the Finance Committee, will muster enough support on the floor to amend the legislation reported out of committee.

Once the full Senate adopts proposed tax legislation, it must be reconciled with House approved legislation that differs from that approved by the House. Rarely do the House and Senate agree on proposed tax legislation. All differences between legislation approved by the House and the Senate, respectively, must be reconciled in a joint House/Senate conference committee. Senate members of the joint conference committee are appointed by the Majority Leader upon the recommendation of the Finance Committee chairman who always serves on conference committees. Rarely in today's Senate do members of the minority party serve on a joint conference committee.

Senate Leadership

The top leaders of the majority party in the Senate are the Majority Leader and the Majority Whip, and for the minority party, the Minority Leader and the Minority Whip—all of whom are elected by a majority in their party's caucus or conference. It is not unusual for second term Senators, who are relatively junior to the majority of senators in their parties, to become leaders. The seniority system that once dominated the Senate, as well as the House, has faded in importance over the last generation, but not quite as much as in the House.

All things being equal, a senior senator can still get a committee assignment or chairmanship over a junior senator, and except in unusual circumstances, a committee chairman will not be removed from a chairmanship because of getting crossways with some members of the Senate caucus or conference and leadership. Each senator tends to be respectful of other senators' rights in the hope that other senators will be respectful of their rights—put another way, you scratch my back, and I will scratch yours. Notwithstanding all of this mutual respect, if a senior senator wanders too far off the reservation, the caucus may decide that enough is enough and deny the senior senator a chairmanship in favor of a junior senator. Unlike the House, the Senate leadership, particularly for the Democrats, does not insist (to the extent that the House does) that would-be chairmen of committees join leadership PACs and shake the money tree for the party. Seniority, as the test for chairmanship, relieves a would-be chairman from having to do as much fund raising as would be required if the chairmanship were determined by the party leadership. As far as old gaffers are concerned, they get a better deal in the Senate than the House. Many old gaffers in the Senate still retain lots of power.

As with surviving the House phase of the gauntlet, tax provisions that make it through the Senate gauntlet almost always favor those with special economic and tax-related interest over the national interest and the interest of the ordinary taxpayer. The Senate participants in the gauntlet, as with the House participants, inevitably represent narrow parochial economic interest. America as a whole does not elect either senators or representatives. Voters in individual states and congressional districts elect senators and representatives, and these senators and representatives reflect the views of their voting constituents.

The cultural, educational, and economic background of the voters in each state and congressional district vary considerably as do the types of businesses engaged in commerce, industry, and agriculture. The interests of economically prosperous and highly educated voters who are employed by successful high-tech companies often clash with the interests of voters who are poor, not well educated, and employed by aging industries just hanging on to survive. The few senators who participate in the gauntlet cannot possibly fairly represent the interests of all Americans. Inevitably, the interests of many Americans will not be represented as tax legislation works its way through the gauntlet.

The House/Senate Conference Committee

The House/Senate Conference Committee wields great power because, in resolving differences between House and Senate versions of tax legislation, the conference committee can junk much of what is in each version and start all over if it wants. The chairmen of Ways & Means and the Finance Committee, in consultation with the leadership in the House and Senate, take the lead in conjuring a compromise. The conjuring plays out behind closed doors and is not subject to public scrutiny. Brokering interest for interest among the members of the conference committee, with a view to what will pass on the floor of the Senate and House, continues until a deal is struck. If no compromise can be conjured, tax legislation will languish indefinitely in the conference, and there will be no tax legislation that session.

At each point in the congressional gauntlet in which a politician has to decide what to do about tax legislation, the politician asks himself what do the people I care about think I should do. To almost all politicians, the people they care about are the people who determine their political futures. Since each congressional politician is elected in a state or district that comprises only a small part of America, tax legislation coming out of Congress cannot possibly represent the national interest—tax legislation can only reflect the views of those who determine it.

In tax matters, encouraging as many ordinary Americans who are willing to work to become as prosperous as possible and not shifting the tax burden from one generation to the next are the national interest. Instead of addressing the national interest, each biennial tax game involves narrow groups of self-interested taxpayers jockeying with each other to avoid paying taxes. Permitting some select groups of taxpayers to shed their tax burden usually comes at the cost of making ordinary Americans pay more than is necessary and/or shifting the tax burden from the current generation to the next. Regardless of whether the seniority model or the party loyalty model controls, or whether politicians of the right or left control in Congress, what is good for those who influence the politicians who staff out the congressional gauntlet beats out what is good for America in all but the rarest of instances.

The President

If tax legislation makes it through the congressional gauntlet, the President must approve it for it to become law. A presidential veto of tax legislation kills it. As stewards of the national economy, presidents develop and pursue their own agenda for tax legislation. The veto power coupled with the President's power to persuade makes the President the dominant player in the tax game.

The President can inject himself into any phase of the tax game that he or she thinks will increase their chance of getting what they want. Sometimes the President may want a provision added to the agenda, and sometimes the President may want a provision taken off the agenda. By letting Congress know early in the process that its agenda is unacceptable and will result in a veto, the President can force Congress to revamp its tax agenda. Conversely, if the President wants something included in tax legislation, he can use his powers of persuasion to induce Congress to enact his agenda.

If the President wants to play the tax game, the President becomes the 500-pound gorilla in the arena. Mindful that many tax provisions can anger taxpayers, presidents not too infrequently conclude that to play the tax game is to lose, and so they leave it to Congress to do unpleasant things. Presidents find that taking bad provisions out of a tax bill is less fun than pulling weeds and, on top of that, no one appreciates that the weeds are gone.

The President has unique tools available to him or her to persuade the public and Congress to his point of view.

First, regarding the public, the President can command media attention to assure that he or she gets their message out the way they want to on their own terms. No other politician can match the power of the President to dominate public debate on a tax issue.

Second, regarding Congress, presidents control a vast arsenal of weapons that are effective in influencing and, if necessary, bludgeoning senators and representatives into seeing tax matters their way. Just a few of these weapons include the power to appoint a congressman's ne'er do-well son-in-law to a good federal job, include or exclude a congressman's pet local project in his budget, appoint a congressman's longtime chief fundraiser to an ambassadorship, invite a congressman having a hard time getting reelected for a photo op, raise campaign funds for a congressman's reelection campaign, and discourage or encourage an opponent in a party primary from running against a congressman.

Given the President's powers to persuade, most presidents can entice or intimidate enough senators and representatives, particularly members of their party, to see things their way. Presidents rarely lose a vote in Congress by one or two votes.

America elects the President to watch out for the interests of all Americans, as opposed to congressmen, who are elected by states and districts to look after the interest of their constituents. For the most part, ordinary Americans can expect to get a better break from the President than the Congress. In politics, ordinary Americans pay more attention and have more to say in electing the President than in electing their Representatives and Senators. Most ordinary Americans cannot name their representatives and senators but can name the President. Given the limited attention span of most ordinary Americans when it comes to politics, presidential elections attract the interest of more ordinary Americans than do congressional elections.

Among politicians, the President has the best claim to representing the national interest. But, a series of razor thin presidential elections, where the winner usually gets around 50% and sometimes less, tarnishes presidential claims to representing the interest of all Americans. America has two electorates, a presidential electorate and a congressional electorate, and the presidential electorate comes much closer to reflecting the views of most Americans than the congressional electorate. In the 2012 presidential election, 56.5% of all voting-age Americans voted with only 38.0% of 18-24 year olds voting while 71.1% of 65-74 year olds voted. In the 2014 congressional election, 38.5% of all voting-age Americans voted with only 15.9% of 18-24 voting while 59.1% of 65-74 year olds voted. With a vastly larger electorate voting for the President than for senators and representatives, the President has a compelling argument that he or she better represents the national interest than Congress.

Presidential politics frequently demand that the President prefer the interests of some Americans over others, and in this world, other than in exceptional times, the interests of ordinary Americans often yield to the interests of extraordinary Americans. Extraordinary Americans are those who, in the mind of the President, command enough money and power to make a difference in an election and are willing to do so. In calm and prosperous times, ordinary Americans tend not to bother themselves with tax matters. Only in tumultuous and precarious times do many ordinary Americans take the trouble to pay attention to how tax laws put a penny in or take a penny out of their pockets.

GETTING IN THE GAME AND STAYING IN THE GAME
Election & Re-Election

Nothing affects a politician's career more than his relationships—who are his supporters and what they are willing and able to do for him. Without supporters who fork over enough bucks to bankroll a winning campaign, only very few politicians will have any chance to climb the political ladder. In theory, politicians should be most responsive to advice from their constituents who vote because voters can end a politician's career. But, theory and reality part ways in that more often than not it is the politician who advises the voters instead of the voters advising the politicians. A politician may have done a lousy job in representing most of his constituents, but if the constituents do not know it, the politician escapes voter wrath—many politicians depend on voter ignorance.

If voters had perfect knowledge about what a politician does to promote or frustrate their interest, voters would know whether to further or terminate the politician's career. Since there is no such thing as perfect knowledge in politics, much of what voters know about their politicians stems from what they learn in campaigns. From the standpoint of an incumbent politician (left and right), campaigns should re-elect the incumbent, and from the standpoint of the challenger (left and right), campaigns should elect the challenger. Incumbents and challengers do not look at campaigns as opportunities to educate voters on matters of high public policy—they look at campaigns as an exercise in winning. In campaigning at its best, politicians exchange vacuous slogans about what each thinks will turn on their voters, and in campaigning at its worst, politicians lie about each other on any matter that they think will work. As a rule of thumb, voters listening to campaign propaganda would be well-advised to believe 95% of what politicians say about their opponents and 5% of what they say about themselves.

Politicians spend vast sums in fabricating and circulating their campaign message, an exercise in myth-making. Highly paid hired guns, political marketing experts, concoct the message and oversee circulating it to the right markets. If a politician has a record contrary to the interests of a majority of his voting constituents, a carefully devised campaign can divert voters from bad news to good news and discredit the opponent. What the hired guns think will sell at any moment drives what the campaign message will be. If a politician challenges special interest tax laws, his opponent would likely charge him with being soft on crime, terrorism, gay marriage, flag burning, and who knows what else, and, if everything else fails, character assassination almost always turns the trick. Every consultant knows that voters will not vote for a naïve, unpatriotic, heathen with bad character.

Political experience bears out that, if a campaign throws enough mud against the wall, enough will stick to do the job. Since mud is a limitless commodity, the trick is to amass enough resources to be able to hurl it at the velocity and in the quantities as required. Mud-hurling capacity, then, often decides campaigns—he who hurls the greatest volume of the stickiest mud almost always wins. With respect to political campaigns, few voters question anything said in the media if it is said simply enough, frequently enough, and not denied. As an excuse for lack of attention, most ordinary Americans are too busy eking out a living in a dog-eat-dog global economy to pay much attention to political palaver.

Financing Campaigns

Mud-hurling capacity depends on money to buy propagandists and the media to distribute propaganda. Politicians quickly learn how to increase their mud hurling capacity or they get in a different business. Campaign funds flow from two sources—one a trickling stream and the other a raging torrent. Contributions of less than $200 made by ordinary individuals account for the trickling stream, and contribution of over $200–ranging from just over $200 made by better off individuals into millions of dollars made by the super-rich—account for the raging torrent. For perspective, in the 2014 congressional elections, the total cost of the congressional races was approximately $3.8 billion of which about one third came from the trickling stream (contributions of less than $200) and about two thirds of which came from the raging torrent (contributions in excess of $200). Of the contributions in excess of $200, a huge amount came from those in the top 1 tenth of the top 1 percent.

Given who contributes to campaigns, it is easy to understand why the after-tax income of the top 1% has grown faster than their pre-tax income.

The stream trickles because only ordinary Americans contribute to it, and most ordinary Americans spend little on politics either in time or money. What a shock to think that most ordinary Americans had rather live their lives—work, have some family time, go to the movies, watch a football game, take a vacation, fix up their homes, and pursue a hobby—than listen to politicians or study tax policy. While it is understandable that ordinary Americans spend their time and money on things other than politics, there is a price to pay.

Ordinary taxpayers, the less well-off, should walk a few miles in the politician's shoes and then ask themselves, as if they were the politician, a few questions and imagine the answers, as follows:

Q. Why should I pay much attention to the ordinary taxpayer?

A. Hard to figure.

Q. What has he done for me lately?

A. Nothing.

Q. What is he likely to do for me in the future?

A. No money, and not even a vote.

Q. In the last session of Congress, I sent the ordinary taxpayers a mail-out explaining why they should get involved in a tax bill that was shafting them, and what did they do?

A. They all blew it off.

Q. When is the last time an ordinary constituent took me to lunch at the Palm and told me what a great job I am doing?

A. Never.

Q. What is the chance the ordinary jokers are going to vote for me next time?

A. Most only vote about half the time if that much. Suppose it snows next November, I will bet most stay home.

Q. Last time us Congressmen sucked it up and voted ourselves a pay raise, what did ordinary folks say?

A. They squawked for months, and the ingrates cut my victory margin to less than two points in the last election.

Q. How can I go home and explain to my wife, who constantly complains about not having enough money to send young Johnny to Princeton, that I have to look out for the ordinary taxpayers when it means getting crossways with the lobby and maybe drawing a big money-backed opponent in my next election?

A. I cannot.

Given ordinary taxpayer's insensitivity to the politician's problems, it is a wonder that the politician does anything for them. Not only do ordinary taxpayers not play the tax game, ordinary taxpayers do not even know there is a tax game.

While a trickling stream will not generate much power, a raging torrent will. What fool would build Hoover Dam on a creek instead of an overflowing river? For a politician in the chase for the big bucks necessary for a winning campaign, he or she need look no further than the raging torrent, the flood of campaign money largely controlled by lobbyists and extremely wealthy individuals. Before evaluating the effects of raising campaign funds, it is important to understand how lobbyists fit into the tax game and who they are. Politicians and lobbyists understand each other because lobbyists, just like politicians, sell for a living, and on top of that many lobbyists are former politicians. Lobbyists sell their clients' interests to politicians, and if they believe a politician is effective, they sell the politician to their clients who contribute to political campaigns.

In today's politics, lobbying now requires framing messages that will change minds both with the voters and legislators, an exercise more in public relations than in influence peddling. Lobbyists either work for or are hired to represent businesses and trade associations that are big and rich enough to afford them. Businesses (in all phases of commerce, industry, and agriculture and the professions) band together to create trade associations for the purpose of sharing information and pursuing common goals. Because getting and keeping tax preferences is a primary common goal, trade associations play the tax game big time. Dues paying businesses support trade associations. Since the personal and corporate income taxes pervasively affect all businesses of any consequence, naturally these businesses and their trade associations play the tax game. What a shock that a business will fight to get or keep a tax preference—businesses are in business to make money, and saving taxes makes money. Not only do the owners of businesses profit from saving taxes but the jobs of ordinary Americans employed by these businesses are made more secure. This is a blatant example of businesses increasing their profits by winning in the world of politics instead of markets.

Although lobbyists come from all backgrounds, law, business, public relations, advertising, and politics kick in the most. Like political consultants, lobbyists hire out as hired guns for those who can pay. Unlike the hired guns in the Old West who packed heat for firepower, lobbyists frequently get their firepower from trading on relationships, like former congressmen who know how the legislative process works, who the key lawmakers are, and how to influence them. Effective lobbyists can raise substantial campaign funds by going to their clients and businesses allied to their clients for money to contribute to a politician that they believe can and will deliver. Lobbyists regard a politician who cannot or will not deliver as a bad investment. In the lobbying business, a lobbyist who makes a bad investment sins against his clients. Regardless of some attempts to demonize lobbyists, all should realize that most lobbyists are like the rest of us, and if we were in their place, we too would most probably act like them. Capitalism dictates that business be profitable, and lobbying is just another business subject to the dictates of the profit motive.

Like in other businesses, some lobbyists make a few bucks, and some make an awful lot of bucks—inevitably some businesses make more money than others. Since the stakes are particularly high in the tax game, generally only high-end, highly paid lobbyists are hired to play. Not only is there nothing wrong with being a hired gun for business, but businesses depend on hired guns to promote their interests on important matters, and taxes are an important matter. In the world's leading capitalist economy, any business that fails to do what it takes to succeed, including playing the tax game to win by rounding up the best hired gun available, should be fired.

What criminal defendant, particularly one who is guilty and rich, would skimp on hiring the most effective criminal defense attorney he can afford? So why would businesses or trade associations hire a cheap, ineffective lobbyist? More than a little truth can be found in Calvin Coolidge's 1920s aphorism that "business is the business of America" and, in an aphorism often attributed to "Engine" Charlie Wilson, that "What's good for General Motors is good for America." For those few who did not know, Engine Charlie Wilson was the CEO of General Motors who resigned to become President Eisenhower's Secretary of Defense. These aphorisms, however, omit another truth, namely that American business can prosper while the living standard of millions of ordinary taxpayers stagnates or declines. As proof, for quite a while GDP has grown at a healthy rate, but median income has not—a rising tide may lift all boats, but a rising GDP does not necessarily raise the median income for Americans.

If the gulf between the profitability of business and the well-being of ordinary taxpayers widens too far, social friction will grow to the point that it will threaten almost everyone's economic, social, and political well-being (remember the 6th century B. C. Athenian Social War). The preoccupation of most ordinary taxpayers with social issues, rather than tax issues, proves that most taxpayers are not yet sufficiently alarmed about their economic well-being to follow what is going on in the tax game. If the tax game were played for the benefit of everyone, business and ordinary taxpayers would both be better off in the long run. If a frog had wings, he would not bump his butt.

Business should not be faulted for playing the tax game to win even if it means ordinary taxpayers lose. It is not businesses' responsibility to look out for the interests of ordinary taxpayers; businesses' responsibility is to look out for their own interest. It is the job of politicians to look out for the ordinary taxpayer, but it is hard for them to find a reason to do so much of the time. Since lobbyists work for businesses, any lobbyist who lets his or her concern over the fate of the ordinary taxpayer get in the way of getting his or her client the best deal he or she can from the politicians, sins against his or her client. Although many ordinary taxpayers work for businesses that play and win at the tax game, most do not. Those ordinary taxpayers who work for businesses that either do not play the tax game or lose also lose.

Each lobbyist is keenly aware of what goes through a politician's mind as the politician assesses whether to support a yummy tax preference being pushed by the lobbyist that uniquely prefers the lobbyist's client, or oppose it because the tax preference shifts more of the tax burden onto the ordinary taxpayer without helping any business except the lobbyist's client. Unlike the ordinary taxpayer who does not bother to imagine what it is like to walk in the politician's shoes, lobbyists do. An effective lobbyist has the imagination to put himself in the politician's place and anticipate the questions a politician might ask himself about his relationship with the lobbyist and what the answers should be if the lobbyist is to succeed, as follows:

Q. Why should I pay much attention to the lobbyist pitching his deal to me?

A. He got his client to contribute $50K in my last campaign.

Q. What has he done for me lately?

A. He told me that he heard there is a leadership position opening and told me that I should run for it; it was also thoughtful of him to arrange that outing for me and my wife to San Francisco last spring; the fact that it coincided with my anniversary killed two birds with one stone.

Q. What is he likely to do for me in the future?

A. He told me that he thinks he can raise $100K in my next campaign, particularly if his client has good luck in the next congressional session.

Q. When is the last time he took me to lunch at the Palm and told me what a great job I am doing?

A. Yesterday; and he's invited me to Duke Ziebert's (the steaks are better than those at the Palm!!!) next Wednesday. So far, he is the only guy that appreciates that it was my parliamentary tactic that helped his tax provision squeak through committee last July.

Q. Last time us congressmen sucked it up and voted ourselves a pay raise, what did he do?

A. He and his clients told civic groups that Congressmen were woefully underpaid and deserved a raise; they even paid for a few media spots explaining to the public why the pay raise was long overdue.

Nobility often asks too much of a politician. Most ordinary taxpayers, were they in the politician's shoes, would have as much trouble justifying to their wives, as the politicians do, why they should side with the oblivious ordinary taxpayers over the understanding lobbyists. In fact, given the callous disregard by ordinary taxpayers of the problems faced by politicians, it is a wonder that any politician ever watches out for their interest. For the politician out to increase this mud-hurling capacity and who likes to be comforted, lobbyists are a much better bet than ordinary taxpayers.

RULES OF THE GAME

Special Interest vs. National Interest

Each biennial tax game begins with various supplicants—those seeking tax preferences that uniquely benefit them—buzzing around the chairmen of Ways & Means and the Finance Committee and whispering in their ears that if their pet tax preference is not enacted, the American economy will crash. No politician occupying any perch along the legislative gauntlet has any significant incentive, other than nobility, to make sure that each piece of proposed tax legislation serves the national interest as opposed to merely dishing out a special benefit to its supplicants. Usually it is easier for a politician to support an intensely lobbied tax preference than to oppose it in the national interest.

The supplications could come from lobbyists representing the insurance industry telling the politicians that the insurance industry will be devastated unless the "special alternative tax on small property and casualty insurance companies" is not made more generous; or lobbyists representing the agriculture industry telling the politicians that the fate of the family farm depends on expanding the "treatment of loans forgiven for solvent farmers"; or lobbyists representing the coal industry telling the politicians that energy independence will be threatened and coal mining jobs will be lost if something is not done to expand the "capital gains treatment of royalties on coal"; or lobbyists representing the transportation industry pleading that the shipping industry will grind to a halt if the "deferral of tax on shipping companies" is not increased; or umpteen lobbyists representing any number of businesses telling the politicians that if their clients do not get a tax break, the economy will falter and unemployment will skyrocket.

Amidst this swarm of lobbyists, no one pleads the case of the ordinary taxpayer to the chairmen of Ways & Means and the Finance Committee that the standard deduction—something that would benefit the ordinary taxpayer—should be increased. If the addition or expansion of a tax preference survives Ways & Means and the Finance Committee, it has a fighting chance to make it all the way across the goal line; but if it does not, it will most likely have to wait for the next biennial tax game. There is no chance of a provision not included in the Ways & Means reported legislation winning inclusion on the House floor. Although floor amendments to the legislation reported out of the Finance Committee sometimes succeed, rarely do these amendments help ordinary taxpayers. Usually, the types of tax preferences that make it on the floor benefit a select group for businesses that have enough clout to attract a number of senators.

Once tax legislation arrives at the joint conference committee, the serious deal-making begins. The representatives from the House and Senate, respectively, are forced to balance keeping their pet provisions in the package while having to sacrifice those provisions that are expendable—the process of separating the seemingly sacred cows from the truly holy cows. The bargaining centers around what each of the players believes will produce a package that will pass on the floor of the two houses and escape a presidential veto.

If the President fails to speak up for the ordinary taxpayer in conference, it is a good bet than no one else will. All the congressional players are so fully invested in satisfying the supplicants whose tax preferences have made it to the joint conference committee that they have little time to think about the ordinary taxpayer. All congressional politicians, senators as well as representatives, represent bits and pieces of America, but none represent America's national interest. Even presidents, especially those who are concerned about maintaining the support of their ideological political base, rarely rush to the aid of the ordinary taxpayer.

Strange as it may be, despite the fact that the ordinary taxpayer has the potential to wield far more political power in terms of voting strength than any interest group supplicating for tax preferences, the ordinary taxpayer has no one to champion his cause as the tax game plays out. Lesson: potential coupled with ignorance and indifference results in impotence. In the tax game, democracy notwithstanding, a small, disciplined, informed, well-financed, purposeful swarm of lobbyists will prevail over a herd of oblivious taxpayers every time.

Regular Order vs. National Interest

Regular order is congressional speak for the process by which a party's congressional leadership, committee chairmen, and individual representatives and senators play the tax game (under House and Senate rules of procedure) from the moment a tax bill is introduced until it becomes law.

To understand regular order, imagine a circuit board populated with a few hundred circuits and, at each juncture, a switch. While a circuit board and regular order each operate based on hundreds of switches, the switches differ as night and day. The switches for a circuit board operate as programmed by electrical engineers, but the switches for regular order are operated by politicians whose decisions are based on perceived self-interest. Just as a signal (in the case of a circuit board) cannot make it through the system unless all of the switches are turned on, so too a tax bill (in the case of regular order) cannot make it through the tax game unless all of the switches are turned on. To be successful in playing the tax game, players must master the art of coaxing and/or compelling politicians to turn on their switches. Programming the switches on a circuit board is easy, but convincing the players in the tax game to turn on their switches is excruciatingly hard work.

Under regular order, one or more switches control every phase of the tax game from the introduction of a bill, to its referral to committee, to the amendment process in committee, to its passage out of committee, to its consideration by leadership to be placed before the full House or Senate for a vote, to the amendment process before the full House or Senate, to dodging a filibuster on its way out of the Senate, to its referral to a House-Senate conference committee, to the amendment process inside the conference committee, to a final vote by each house, and to the President for final approval. At each of these major junctures, and a bunch more minor ones, either a single member or (in some instances) the party's leadership controls if a switch is to be turned on or left off. Unless all switches are turned on, a tax bill fails.

Individual Prerogatives and Party Leadership

House and Senate rules protect the prerogatives of individual members while simultaneously enabling their party's leadership to discipline these prerogatives when necessary to protect the interest of the party. Nothing underscores the importance of individual prerogative more than for a member of the House or Senate to have the power to either get or keep a juicy tax preference for a preferred donor or constituent. And, nothing underscores the importance of protecting a party's interest more than its leadership's ability to discipline an individual's prerogative, particularly its committee chairmen.

Generally, the agenda of an individual member is first to get re-elected, second to become a committee chairman or member of leadership, and third, do what they think will be good for America. And, generally, the agenda of the members of a party's leadership in both the House and Senate is first to get re-elected, second, to maintain or enhance their status in leadership, third, to maintain or obtain a majority in its house for their party, and fourth, to do what they think will best help America.

Getting reelected for almost all members of Congress requires both money to woo the voters and support from party activists, and what a member of Congress has to do to get money and attract activists rarely reflects the national interest. Most campaign money comes from special interests that have an interest in one or more tax preferences, and most campaign workers come from party activists who have strong ideological bents. For politicians on the prowl for money, getting, expanding, and keeping tax preferences for special interests is where the money is. There is no money in getting rid of tax preferences. Most party activists will man the ramparts over explosive ideological issues but cannot get worked up about getting rid of tax preferences, particularly if they get something out of them.

Local Interest vs. National Interest

All members represent states or districts with distinct electorates that have special economic, social, and ideological attributes that differ not only from each other but from America as a whole. Even though a majority of states and districts may be prosperous and growing, the national interest suffers if a substantial and growing minority falls behind. Not only are local interests often at variance with the national interest, but more often than not, they are in direct conflict.

Tax preferences that benefit certain industries concentrated in particular states and districts may mean more jobs there, but for other states and districts with industries not so benefitted, they may suffer job loss. Since tax preferences are the product of a game in which the spoils go to the victors, states and districts with politicians skilled at playing the game fare best. Doling out tax preferences to industries located in states and districts whose senators and representatives just happen to play the tax game best does not necessarily lead to economic growth that promotes the national interest.

Allocating the tax burden among different income groups affects both America's economy and its political and social health. In deciding how much the rich and poor and those in between should pay in taxes, some states and districts have high-income electorates and others have low-income electorates. The differing interests of diverse electorates play out in the tax game. Raising or lowering the relative tax burden of certain income groups at the expense of others because the senators and representatives who represent those groups just happen to play the tax game best does not necessarily promote America's economic growth and political and social well-being.

For politicians seeking election from a particular state or district, they had better be in sync with the perceived self-interest of that state's or district's electorate or be prepared to go into a different line of business. In the ongoing contest between the interest of a state or district versus the national interest, local interest almost always wins.

Individual Member Interest vs. Party Interest

While the interests of a political party are broader than those of its individual members, neither party can represent the national interest. Both parties have core ideological, geographic, income, and geographic constituencies that comprise important parts, but not the whole, of the national interest. To mollify their constituencies, political parties almost always advocate their interests rather than sacrificing them to the national interest. Political parties are not in the nobility business.

Defining America's national interest requires reconciling the interests of (1) many diverse ethnic and social groups, (2) a population with huge income and wealth disparities, and (3) all types of businesses, many of which compete with each other. Defining the national interest begins with first understanding the interest of each group, and second balancing the interests of each of these groups against the others. Politicians elected locally and affiliated with a political party cannot be expected to devote the same energy to understanding the national interest as they do for their local interest and their party interest, particularly when the two are in conflict.

Even though a party's interest is broader than an individual member's interest, each party's interest must reflect its activists and those of economic groups and businesses aligned with it. Otherwise, the party will be unable to mobilize its forces to do battle in the tax game. Sometimes, but not too frequently, the interest of an individual member of a party conflict with the party. If the party's leadership has to have the individual member's vote to win, then the individual member is put to an unpleasant choice—vote against a local interest and risk losing an election, or vote against the party leadership and risk losing a valuable committee assignment and/or its financial support. Although a party's leadership can usually depend on getting an individual's vote in a crunch, it is not a certainty.

Divided Congress

Working a controversial tax bill is hard enough when dealing with a single party, but working a controversial tax bill with two parties is more than twice as hard. Tampering with almost any tax preference stirs up controversy because it involves lots of money going in and out of the pockets of influential groups. Each party is aligned to influential groups who believe that their interest and the national interest are the same and that their party's job is to guarantee that their interest prevails. Influential interest groups who contribute millions to campaigns are not interested in being lectured on compromise and the national interest. In most times, asking a party to compromise asks a lot, but in times when parties are polarized, asking a party to compromise asks too much. So, if one party controls one house of Congress and the other controls the other house, compromise becomes all but impossible except in extreme cases of need.

Regular Order's Legacy

A growing array of tax preferences with no indication of a slowdown is the legacy of regular order. Regular order with its many switches offers special interests almost unlimited opportunities to sabotage legislation that would restrict tax preferences. All a special interest need do to kill a bill is get to one politician who controls a single switch to refuse to throw it. Since many special interests have invested heavily in many politicians, special interests almost always have little trouble in finding at least one politician who is willing to do their bidding.

Oftentimes a single politician aligned with a single special interest who controls a single switch can kill proposed legislation that could easily gain overwhelming majorities on the floor of both houses. Such is the power of regular order. While the national interest begs for a personal income tax cleansed of almost all tax preferences, regular order all but guarantees their proliferation. Just like you do not have to be a weatherman to know which way the wind is blowing, you do not have to be a political scientist to know how regular order works and does not work.

PRESIDENT DONALD TRUMP AND WHAT IT HAS MEANT FOR TAXES

In modern politics, nothing happens in taxation without the personal approval of the President, and so it is a big deal that Donald Trump, America's most notorious billionaire/personality, got himself elected President. Experts have attributed President Trump's victory to his having persuaded millions of disaffected middle-class voters to believe that if elected he would make their lives better. During the 2016 presidential campaign, many of these voters convinced themselves that he would get back many of the jobs that they had lost, make the jobs they still have more secure, and raise their wages. It is easy to understand why millions of middle-class voters were looking for a better economic deal, because for the last 40-plus years the economy has left their incomes flat or falling and deprived them of job security. America's future depends on a healthy and growing middle class and what happens to families like the Middletons will determine in large part the fate of the middle class. For the Middletons and families like them, their test of tax policy is whether it provides them with more after-tax income and makes their jobs more secure.

In addition to after-tax income and job security, social insurance (that includes programs for retirement, health care, post-secondary education, and a safety net in case of job loss) is critical to making life better for the middle class. While the effect of taxes on after-tax income is clear, its effect on jobs and social insurance is far from clear. What makes jobs more secure depends more on educational and economic factors than on taxes. As will be shown later, social insurance is paid for with taxes and cutting taxes can mean cutting social insurance.

So, what President Trump did about taxes affected all Americans and none more than middle-class families.

Enacting tax policies that advance the national interest would require that President Trump make significant personal sacrifices. President Trump's billions in wealth (as reported to the Office of Government Ethics) is concentrated in commercial real estate holdings, and his success in business stems primarily from his being a real estate developer and owning interests in real estate. Since Trump has chosen not to divest himself of his real estate holdings or real estate development business, both his wealth and income are significantly affected by any changes in taxes. More than other major industries, the real estate industry benefits from tax loopholes, which have been described as follows:

"A deliberate or accidental provision in tax law that allows an individual or corporation to be exempt from some provision. Most loopholes are deliberate and are created to ensure that the law is not draconian, to please a lobbyist, or for some other reason. For example, a country may pass a law requiring most companies to pay taxes on their net assets each year. However, it may contain a loophole allowing the exemption of companies that would find this tax too difficult or expensive. Occasionally, the government may close a loophole, which means that it takes away the exemption."

Tax loopholes (special deals in the tax laws by which the politicians prefer a certain group of taxpayers over others by taxing their income at lower rates and making their deductions and exemptions more generous) are just another name for tax preferences. Tax preferences are the mortal enemy of both progressive taxation that favor middle-class taxpayers and free-market principles that assure that capital will be employed in its highest and best use independent of government involvement. As will be shown later, the overall effect of tax preferences has been to tax capital income at lower rates than labor income, which helps explain why the 400 highest income taxpayers pay effective tax rates lower than many wage-earning taxpayers.

President Trump's skills as one of America's preeminent real estate developers provided a few clues as to how he dealt with taxes. Among President Trump's real estate developer skills are the following:

First, he has dreamed great dreams and then worked successfully with architects and designers to make them so.

Second, he has both created and satisfied demand in commercial developments, such as office, retail, and travel and leisure projects, and residential developments, such as apartments and condominiums. Without demand, no development is possible, but with imagination and audacity, exceptional developers, like President Trump, can create demand.

Third, he has financed his developments by raising capital at the cheapest cost by working with tax lawyers and accountants to exploit the use of the many tax preferences that favor the real estate industry.

Fourth, he has convinced private investors, commercial banks, and investment banks to provide the capital to get his deals done.

Fifth, he has obtained from politicians of all stripes (by hook or by crook) special tax provisions as well as the zoning and building permits necessary to get his deals done.

Sixth, he has negotiated deals with property owners, contractors, vendors, property managers, and unions to make his developments work.

Seventh, he has marketed (1) commercial developments to sophisticated tenants such as hotel chains, leading business tenants including law and accounting firms and major corporations and (2) the residential developments to upscale tenants and purchasers.

No developer skill is more important than raising money because without it there will not be a development. Unlike investor money which must be repaid with a return, tax preference money that substitutes for investor money is free and does not have to be repaid. Since the cheapest capital is money saved by avoiding taxes, President Trump became an expert in making sure that his tax lawyers and accountants did not miss a trick in taking full advantage of every tax gimmick available. Personally, President Trump has bragged about not paying taxes.

President Trump's record as a developer proves conclusively that (1) he knows what tax preferences are and how to exploit them, (2) he is a skilled and ruthless negotiator, and (3) he deals effectively with politicians of all stripes. These skills make President Trump a great player in tax game politics that determines winners and losers, but having these skills does not foretell for whose benefit he will employ them. While it is in the Middleton family's interest that taxes raise enough revenue to pay for the social insurance on which the middle class depends and that the after-tax income of the middle class be increased, neither of these things is in President Trump's personal financial interest. Most super-extraordinary and capitalist taxpayers believe that it is in their interest to cut social insurance to keep taxes down and to reduce their share of the tax burden even if it means increasing that of the middle class. As the Trump tax plan shows, President Trump used his skills to favor his personal financial interests and that of the super-extraordinary and capitalists over that of the middle class.

The Trump Tax Plan

On December 22, 2017, President Trump signed the Tax Cuts and Jobs Act into law which made major changes in the taxation of both individuals and businesses. In doing so, President Trump removed all doubt about whose interest he would advocate in tax policy, either those of the middle class like the Middletons or those among the very, very best-off like himself, his family, and his friends. Those like Trump, his family, and friends won hands-down. The Trump tax plan cut taxes so deeply that it will add at least another $1 trillion over the next decade to an already historically high national debt and used the tax cuts to favor the very, very best-off over the middle class, recipients of capital income over wage earners, and current taxpayers over future taxpayers. While President Trump's tax plan included many specific provisions cutting various types of taxes, it only tinkered with the hundreds of tax preferences, as shown by the JCT in its "Estimated Budget Effects of the Conference Agreement for H.R.1, The "Tax Cuts and Jobs Act, Fiscal Years 2017-2027." Regarding tax preferences, the Trump tax plan eliminated a few, trimmed a few, but left most in place and created many new ones. President Trump justified his debt-financed tax cuts by claiming that they would increase average household incomes anywhere from $4,000 to $9,000 a year.

The leading changes to the personal income tax included the following: (1) an across-the-board rate reduction with the top rate cut from 39.6% to 37%, (2) lowering the income levels associated with each bracket, (3) changing the measure for adjusting brackets for inflation from the consumer price index to the less generous chained consumer price index, (4) doubling the standard deduction, (5) eliminating the personal exemption, (6) increasing the child tax credit, (7) reducing the alternative minimum tax on those with high incomes, and (8) eliminating some and reducing other itemized deductions, such as employer-provided moving expenses, state and local taxes, home mortgage interest, medical expenses, preparation of individual tax returns, and certain other miscellaneous expense items. Individual taxes were also lowered by doubling the exemption under the Estate and Gift Tax and eliminating the penalty under the Affordable Care Act for not having health insurance. Almost all changes to individual taxation expire after December 31, 2025.

The leading changes to the taxation of business income included the following: (1) individuals who receive business income from most partnerships, trusts, and limited liability companies (S-Corps) will be allowed a 20% deduction under the personal income tax for such income; (2) for corporations, (a) the corporate tax rate has been cut from 35% to 21%, (b) the rate of certain types of depreciation has been accelerated, and (c) the deductions for a number of business expenses (the most significant of which are a 30% limit on interest deductibility and the denial of carry-back treatment of the net operating loss deduction) have been modified; and (3) domestic corporations doing business internationally, (a) may receive dividends from their foreign subsidiaries without incurring tax liability, (b) will have high return income from foreign sales (whether earned through a foreign corporation or a domestic corporation) equalized in order to reduce the erosion of the corporate income tax base, and (c) will be subject to a new minimum tax for certain related party transactions. The deduction of business income from S-Corps expires at the end of 2025, and the acceleration of depreciation is phased out by 2026.

Before the enactment of the Trump tax plan, the national debt had grown to almost $20 trillion, 107% of GDP, the highest debt level since 1947, and, as shown on Table II-11, it was projected to rise at an increasingly accelerating rate over the next decade by an additional $10 trillion.

Table II-11
Estimate of Revenues, Outlays, and Deficits before Enactment of Trump Tax Plan

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Revenues	17.3%	17.7%	17.8%	18.0%	18.1%	18.1%	18.2%	18.3%	18.3%	18.4%	18.4%
Outlays	21.0%	20.5%	21.2%	21.6%	22.1%	22.6%	22.6%	22.6%	23.0%	23.4%	23.6%
Deficit	-3.6%	-2.8%	-3.3%	-3.6%	-4.0%	-4.5%	-4.4%	-4.3%	-4.7%	-5.0%	-5.2%

Source: Data extracted from Table 1 of CBO's June 2017 report An Update to the Budget and Economic Outlook: 2017 to 2027 contains tables detailing the agency's budget projections for fiscal years 2017 to 2027.

Confronted with an out-of-control national debt, the Trump tax plan is estimated to add an additional $1 trillion to it. Many non-partisan national security leaders, most notably the Coalition for Fiscal and National Security, have sounded the alarm that the national debt threatens America's national security. Before the enactment of the Trump tax plan, the Coalition warned:

"Over the next 25 years, the federal debt is projected to climb to 131 percent of GDP under current law—three times the average since World War II—or to a staggering 175 percent of GDP under alternative assumptions. This debt burden would slow economic growth, reduce income levels, and harm our national security posture. It would inevitably constrain funding for a strong military and effective diplomacy and draw resources away from the investments that are essential for our economic strength and leading role among nations. Putting our budget onto a sustainable path is thus a fundamental precondition for future prosperity and security."

To the extent to which the national debt threatens America's national security, the Trump tax plan compounds the threat.

Table II-12 shows who, in terms of income groups, gets what in terms of the Trump tax cuts.

Table II-12
Average Change in Federal Taxes for Taxpaying Units
(Negative Numbers Mean Tax Cuts and Positive Numbers Mean Tax Increases)

Income Category	2019	2021	2023	2025	2027
Less than $10,000	-$20.56	-$3.11	$14.59	$16.50	$20.17
$10000 to $20,000	-$87.13	$92.51	$146.87	$137.66	$318.33
$20,000 to $30,000	-$138.63	$89.77	$109.99	$134.34	$371.53
$30,000 to $40,000	-$338.27	-$122.86	-$12.70	$6.58	$299.08
$40,000 to $50,000	-$523.95	-$266.03	-$155.18	-$121.47	$300.52
$50,000 to $75,000	-$841.31	-$682.47	-$533.98	-$505.32	$141.71
$75,000 to $100,000	-$1,258.03	-$1,131.56	-$886.88	-$874.90	-$53.21
$100,000 to $200,000	-$2,294.71	-$2,080.11	-$1,554.33	-$1,484.86	-$179.80
$200,000 to $500,000	-$7,155.27	-$6,522.11	-$4,887.86	-$4,860.22	-$593.57
$500,000 to $1,000,000	-$20,877.94	-$18,356.78	-$11,817.03	-$11,296.02	-$2,550.62
$1,000,000 and over	-$64,428.32	-$51,104.45	-$16,553.87	-$15,711.95	-$13,505.56

Source: Data extracted from report prepared by the Joint Committee on Taxation, December 18, 2017, JCX-68-17.

For most high-income, wage-earning taxpayers, they will get a middling tax cut (in the range of $1,200 to $2,300) from 2019 through 2023, but afterward, their tax cuts will be substantially reduced. For most middle- and low-income wage earners, they will get modest to paltry tax cuts (in the range of $850 to $20) in 2019, but afterward, their tax cuts will be substantially reduced with some of the lower-income wage earners getting a tax increase as early as 2021. For those with substantial business and/or investment income, almost exclusively taxpayers with incomes over $100,000, they will get healthy and enduring tax cuts with those with the highest income getting by far the most. Most of the benefit of the tax cuts went to those with S-Corp and C-Corp income which is highly concentrated in those with income of $100,000 or more. As Table II-13 shows, 94% of taxpaying units (those with income less than $100,000) received only 24% of the benefit of the tax cuts in 2019 with it shrinking to 4% in 2027 while 6% of tax paying units (those with income of $100,000 or more) received 76% of the benefits of the tax cuts in 2019 with it swelling to 96% in 2027.

Table II-13 Percentage Share of Tax Cuts Under Trump Tax Plan						
Income Category	Percentage of Taxpaying Units	2019	2021	2023	2025	2027
$0 to $100,000	94%	24%	20%	22%	22%	4%
$100,000 and over	6%	76%	80%	78%	78%	96%
Source: Data extracted from report prepared by the Joint Committee on Taxation, December 18, 2017, JCX-68-17.						

In the ongoing contest between simplicity and complexity in taxation, the Trump tax plan made taxes simpler for almost all wage-earning taxpayers but more complex for those with business income. By rolling the personal exemption into the standard deduction and curtailing a few itemized deductions, the Trump tax plan made it in the interest of all but a very, very few wage-earning itemizers to abandon itemization. Eliminating itemization will greatly simplify taxation for most individual taxpayers. By creating a deduction for 20% of certain types of pass-thru income from S-Corps and modifying many corporate tax preferences, the Trump tax plan made the taxation of business income more complicated. Most owners of S-Corps, however, will find the added complexity a tolerable nuisance because they will get lower taxes. Highly paid tax professionals will enthusiastically welcome the Trump tax plan because it means higher fees. So, the Trump tax plan simplifies taxation for most wage earners but increases complexity for those with business income.

Comparing the Trump Tax Plan with Prior Law

Compared to prior law, the Trump tax plan not only favors the very, very best-off over the middle class, but it both threatens America's national security and invites political strife among various groups of taxpayers.

The revenue loss due to Trump's tax cuts and the ongoing needs of more resources for national security, social insurance, and infrastructure all but guarantee growing political strife on the one hand, among various groups of taxpayers with each seeking to shift the burden from themselves to others, and, on the other hand, among those groups who are competing for scare-tax revenues to preserve America's national security, to fund the social insurance on which the middle class depends for its standard of living, and to pay for improving America's infrastructure. As the pressure for increasing taxes intensifies due to dwindling revenues, and the need for social insurance and infrastructure grow, so too will political strife.

President Trump's Rationale for His Tax Plan

As justification for his tax plan, President Trump's Council of Economic Advisors (the CEA) predicted (in its 2017 publication, "Corporate Tax Reform and Wages: Theory and Evidence") that reducing the corporate tax rate from 35% to 20% would have the following effect:

Conservative estimates from the literature imply an increase in average household income of $4,000 and more moderate estimates show increases of $9,000. Put simply, capital deepening, which brings additional returns to the owners of capital, brings substantial returns to workers as well.

"Capital deepening," in plain language, means putting more money in the pockets of the owners of S-Corps in the expectation that they will invest the tax cuts in new "factories" and "equipment" that will create more and better-paying jobs for the middle class. If this prediction proves true, it will go a long way to justifying the Trump tax plan, but if not, a lot of tax revenues will have been wasted and the disparities in income and wealth between the middle class and the very, very best-off will worsen. As a cautionary note, investments in new factories and equipment—given advances in technology that have accelerated automation—might also result in job loss if the new factories and equipment displace workers. Over time, the facts will either prove or disprove President Trump's prediction, but in the meantime, there are plenty of reasons to doubt it. With the passage of a couple of years, there is no evidence that the Trump tax plan has led to new additional jobs or an improvement in job security for the middle class.

Tax cuts are not an economic reward, like increased profits, for skill in the world of business. Instead, they are a windfall, much like a gambler's winnings in a crap game. While a gambler's winnings are the product of luck, tax cuts are the product of some groups of taxpayers, to the exclusion of others, influencing the right politicians for their own advantage. In the case of the Trump tax cuts that go to the owners of S-Corps and, the owners, like a gambler, can do with their winnings as they please. Generally, the owners of S-Corps can dispose of their winnings in any of the following ways:

- They can keep the money themselves and increase their personal consumption; and/or

- They can keep the money themselves and increase their personal savings; and/or

- They can cause their businesses to reduce the prices of their goods and services for the benefit of their customers; and/or

- They can cause their businesses to increase the wages of their employees; and/or

- They can cause their businesses to add new jobs, and/or

- They can cause their businesses to expand by purchasing new factories and equipment to make their businesses more competitive and/or meet new demand.

It is bad business to (1) pay employees more than necessary, (2) employ unneeded employees, (3) fail to charge the highest prices possible to maximize profits, or (4) fail to expand whenever it will add to a businesses' bottom line. The purpose of any business is to make money for its owners, not to engage in philanthropy by paying employees more than necessary, hiring unneeded employees, or unnecessarily cutting prices. If a business owner has charitable impulses (and thankfully many do), they can best satisfy their impulses by donating, as individuals, their share of the business profits that have been distributed to them.

For tax-cut money to create new and better paying jobs, it must be invested (as stated by President Trump's CEA) in new factories or equipment. Saved tax-cut money that goes to add to a business owner's personal portfolio of stocks or other investments, purchase fine art or vacation homes, or pad their personal bank account makes them wealthier but does not mean more and better jobs in their businesses. Since nothing in the Trump tax plan requires business owners to invest their tax cut money in new factories and equipment, many business owners may choose to either save it or use it for a trip to Paris, for redecoration, for yet another private club membership, or for some other indulgence. If business owners believed that adding a new factory or equipment to their business would have added to its bottom line, presumably they would have done so without the tax cut.

Only if the economy is starved for the investment capital needed for business expansion can tax cuts be justified, particularly debt-financed tax cuts given to well-off business owners. There are two major sources of investment capital—existing wealth and business profits. In pre-pandemic 2016, business profits accounted for a 9-percentage point higher share of national income than the 40-year average (as shown on Table II-14) resulting in their having more capital to finance their expansion.

Table II-14
Percentage Shares of Gross Domestic Income

	40-year Average	2016	2016 Compared to 40 Year Average
Gross domestic income	100.00%	100.00%	100.00%
Compensation of employees paid	55.42%	53.20%	95.99%
Private enterprises	22.81%	24.80%	108.74%
Corporate profits with inventory valuation and capital consumption adjustments, domestic industries	7.73%	8.90%	115.18%

Source: Data Extracted from Bureau of Economic Analysis, Table 1.11. Percentage Shares of Gross Domestic Income
A1, [Percent], Last Revised on: August 3, 2017.

With those in the top 1 percent enjoying an historically large share of wealth available for business investment and business profits grabbing an above average share of national income, there is no apparent need for a government-paid windfall—in the form of a debt-financed tax cut—to meet the investment needs of business.

While granting tax cuts to business owners for them to invest in their businesses is a dicey way to create more jobs, a far more certain way of creating more jobs would be to grant tax cuts directly to the employees of these businesses so that they can increase their consumption. In 2016, wage income, as a share of national income, had fallen about 4 percentage points below the 40-year average compared with total business income (in general) rising about 9 percentage points and corporate profits (in particular) rising about 15 percentage points above the average. With wages shrinking, as a share, and business profits swelling, as a share, a boost to consumption would likely do more to encourage job growth than a boost to investment. Tax-cut money put in the pockets of middle-class wage earners (who have gone for more than a generation without an increase in their standard of living) would most likely result in their spending their tax cut money on goods and services. This increased spending on goods and services would force businesses to expand to meet the new demand.

Since nothing in the Trump tax cut requires that tax-cut money be invested in jobs creating factories and equipment, there is a danger that the tax cut will do nothing more than add to the national debt and exacerbate wealth disparities. If the purpose of the tax cuts were to add jobs and improve the living standard of the middle class, a better way to do it would have been to grant the tax cuts directly to the middle class. Adding a $1 trillion or two to the purchasing power of the middle class would most certainly lead to more jobs from those businesses competing to satisfy the new demand. In an economic environment with ample investment capital, *a demand-driven tax cut offers a better prospect for job creation than an investment-driven tax cut.*

CHANGING THE GAME

The Key to Tax Reform: Short-Circuiting Regular Order

A personal income tax that maximizes economic growth and allocates the tax burden in a way that fosters a healthy and growing middle class depends on eliminating or sharply curtailing almost all tax preferences. Getting such a tax cannot happen unless regular order is short-circuited. The best chance for short-circuiting regular order is for the President to create a presidential commission on tax reform that proposes a politically compelling comprehensive plan that Congress dare not reject. To do this, a President can create a commission pursuant to an executive order modeled after the one that established the "National Commission on Fiscal Responsibility and Reform," better known as Simpson-Bowles. Constitutionally, the President has the inherent authority to appoint presidential commissions to study and recommend to Congress policies that promote the national interest, but a commission's recommendations can only become law if approved by both houses of Congress.

In the real world of politics, Congress will never enact the recommendations of a presidential commission unless it suspends regular order. Under regular order, congressional procedure would peck to death any comprehensive tax proposal made by almost anyone of either party. Suspending regular order means Congress (1) putting aside the procedural traps enshrined in the rules of the House and Senate and (2) guaranteeing within a limited time-frame an up or down vote by both the House and Senate on commission recommendations as written and without amendment. Putting aside the procedural traps translates to individual members of both the House and Senate and the leadership of both parties giving up their prerogatives, something no one can be expected to do willingly.

Congress will not give up regular order unless it is motivated to do so. Since reason, fairness, and patriotism rarely motivate Congress, fear offers the best prospect of turning the trick. Few fears register with both individual members and party leaderships more than the fear of losing their offices. Congress will give up regular order only if both its individual members and party leaderships are made to believe that they could lose their jobs if they refuse to give it up. Unless Congress believes that it would face dire consequences if it uses regular order to bottle up a commission's recommendations, it will never give up on regular order. Seeing mass support from a roused public that includes a majority of voters from both parties and independents as well as a consensus among major non-partisan and bi-partisan social, economic, and public policy organizations is the sort of proof that moves Congress.

Even with broad public support for a commission's recommendations, no proof would be more convincing than if Congress sees tens of millions of middle and low-income voters (who hardly ever pay any attention to politics) suddenly clamoring for tax policies that benefit them. What these millions of voters lack in money and influence, they make up for in numbers. Their numbers count, however, only if Congress believes that they will vote in the next election. Since most middle and low-income Americans are too busy living their lives and scratching out a living to think much about politics or tax policy, mobilizing them as active voters is the challenge.

Most Representatives and Senators who have been around for a while have watched a mass of voters get exercised over the headline *du jour* for a week or so and then when the next and more enticing headline *du jour* pops up, voter interest in the first headline evaporates. Seasoned politicians will not take voter disgust seriously unless voters express it vigorously and continuously for an extended period of time. No doubt the potential political power of middle and low-income Americans is the sleeping giant of politics, and if that potential can be realized, it will be decisive. But in a contest between a giant who will not wake up, and a wide-awake, clever, and rich dwarf, put your money on the dwarf.

As to awakening the giant, imagine what it would take to get the average Middle-Class American, after a hard day's work driving a six-wheeler on a long haul, and his wife, after eight long hours of checking groceries at Albertsons, cleaning house, and cooking dinner for the family, interested enough in tax legislation to write letters to their Representative and Senators and vote. Middle-Class Americans will never get in the game unless they can be made to understand what is in it for them, and if they do, they can win. Middle and low-income Americans will not get a personal income tax that is in their interest unless Joe and Jill Six-Pack, and tens of millions like them, get in the game and scare Congress into junking regular order.

Any President who wants to enact tax laws that improve the futures of middle and lower income Americans must generate so much fear in Congress that it dare not get in his or her way. Creating a commission whose recommendations are so attractive to the public that Congress must find them irresistible is the best card the President has to play in the tax game. While presidents can appoint commissions on any terms they wish, a commission whose recommendations do not attract broad public support fails. So, in establishing a commission, the President must make sure that its recommendations will be compelling to the public in general and middle and low-income Americans, in particular. If Middle-Class Americans cannot be convinced to sign up and let the politicians know where they stand, the effort will fail. This public support must be obvious to all, loud and sustained, or commission recommendations will not overcome regular order.

Getting commission recommendations that will do the job requires active and intimate presidential involvement in each of the following nine steps:

Step One:	**The commission's purpose should be to strengthen and expand the middle class through reforming the personal income tax.** Tax reform should not be regarded as an exercise in tax-law housekeeping, but as a necessity to preserve and expand the middle class so that millions more of Americans can live the American Dream.
Step Two:	**The public must be made to understand why tax reform that strengthens the middle class is essential to the national interest.** Americans are a busy people who are bombarded with all kinds of information from all kinds of sources. Only the President has the ability to cut through the clutter and explain the importance of a complex issue to the public. The presidential role of Educator-in-Chief can be as important as the role of Commander-in-Chief.
Step Three:	**The commission must be instructed to develop tax reform legislation (in finished form) that can be approved by Congress.** Congress must be presented with legislation that can be enacted in a single vote by each house without any amendment.
Step Four:	**The commission's charter must provide for (1) a board that represents the broad national interest and both parties, (2) fair procedures that assure that all points of view will be represented, and (3) an open process that will be subject to close scrutiny by the press and the public.** Unless the public believes that all points of view will have a chance to be heard in open proceedings, the commission's recommendations will not be credible with the public.
Step Five:	**The President must appoint members (1) whose credibility and expertise with both the public and the mainstream of both political parties is impeccable, (2) who will put the national interests ahead of partisan political interests or other special interests, and (3) who will be willing to help sell the recommendations to the public.** Unless the public believes that the board has expertise and has put the national interest ahead of partisan interest or other special interest, the commission's recommendations will not be credible with the public. And, unless the board members are willing to advocate the recommendations to the public, it will be difficult for the recommendations to attract public support.

Step Six:	**Before establishing the commission, the President must have assurance that his or her proposals will get full consideration by the commission.** The President must strike a delicate balance between making sure the recommendations are consistent with his or her policies against being perceived as having stacked the deck in favor of pre-determined policies. If the recommendations are believed by a significant minority of the public to have resulted from a rigged game, then there is little chance of success.
Step Seven:	**Once the recommendations are reported, the President must mobilize the members of the board, as many public policy interest groups as possible, influential leaders from all walks of life, and the media to attract public support.** Unless the public overwhelmingly supports the recommendations, the process will be for naught.
Step Eight:	**If the recommendations attract broad public support, the President must formally ask Congress to approve them.** Since in politics timing is almost everything, the President must pick the most opportune time to ask for Congress to suspend regular order and approve it.
Step Nine:	**As the recommendations are being considered by Congress, the President must bring ALL AVAILABLE POLITICAL RESOURCES to bear against opposing representatives and senators.** The width and depth of public support, the quality of the recommendations, the President's personal popularity, and the President's backroom, bare-knuckles political skills will determine the outcome.

Under the best of circumstances, by-passing regular order is tough, but in the case of tax reform, it is exponentially tougher. To get a middle-class friendly personal income tax will mean taking billions out of the pockets of the most influential and powerful interests in America and that will not come easy. Each step along the way to tax reform will require intense personal commitment by the President and even more important, guile, LBJ-style guile. Since any misstep would likely prove fatal resulting in all the energy and political capital going to waste, it will take a brave and persistent president to try, much less succeed.

As daunting as the task is for the President to use a commission to get tax reform, it affords a far better chance of success than relying on regular order. Under regular order, Congress sets the agenda and determines the pace, but by using a commission, the President sets the agenda and controls the pace. As dicey as it is, a presidential commission offers the only practical hope for tax reform that will strengthen the middle class.

So, only a popular president who deeply believes that tax reform offers the best way of strengthening the middle class and preserving the American dream for millions of Americans, and who has immense political courage, will dare to take on the task.

CHAPTER 7

THE MYTH OF THE MAKERS AND THE TAKERS

Myth: In taxing and getting stuff out of the government, America's upper-middle class are the makers who are bearing a burden made increasingly heavy by a growing crowd of low-income Americans who are the takers.

Reality: In taxing and getting stuff out of the government, America's millionaires and billionaires are the makers who are bearing a burden made increasingly heavy by many of America's middle and upper-middle class joining low-income Americans as takers.

Paraphrasing Sammy Cahn's 1955 song, *Love and Marriage*, Makers and Takers—Capital and Labor, one does not work without the other.

WHO ARE THE MAKERS & THE TAKERS?

America has always had its makers and takers. ***The makers are those who pay more in taxes than they get in government benefits. The takers are those who get more in government benefits than they pay in taxes.*** And, given wealth and income concentration at the top, the ranks of the takers are growing while the ranks of the makers are dwindling.

Paul Ryan, former Speaker of the House of Representatives, deserves much of the credit for popularizing the terms "makers" and "takers" although he later thought better of it. In 2009 the Tax Foundation published a study, Special Report 172, pointing out that a majority of Americans are getting more out of government than they pay in taxes. In 2010, Ryan, picking up on the Tax Foundation study, warned that "right now, about 60 percent of the American people get more benefits in dollar value from the federal government than they pay back in taxes. So we're going to a majority of takers vs. makers in America and that will be tough to come back from that." Repeating his warning a year later in 2011, Ryan again warned that "we're getting to a society where we have a net majority of takers vs. makers." If anything, the Tax Foundation study understated who gets what from the government and who pays for it.

Today, many upper middle-class Americans believe that they are makers because they pay what they think is a substantial amount of income tax and believe that most low-income Americans who pay little or no income tax and get stuff like food stamps, Medicaid, and education loans from the government are takers. This belief underlies Mitt Romney's campaign comment in 2012 about 47% of Americans living off of the other 53%. This is also like the myth common among many upper-income Americans who receive Social Security and Medicare—that they paid for those benefits. The harsh fact is that almost all Americans, including most upper middle-class Americans, are takers, and only a very few of the wealthiest and highest income Americans are makers.

Economic Forces at Work

Over at least the last two generations, an intensely competitive global economy, automation, and aging demographics have all joined to set in motion the following forces:

- The global economy has caused (1) the wages of ordinary American workers to fall closer to the wages of low wage foreign workers and (2) the wages of high skilled workers all over the world to increase dramatically.

- Technology has made (1) most non-technical skills increasingly less valuable and (2) most technical skills increasingly more valuable while also making such skills subject to the ongoing risk of obsolescence.

- Advances in medicine and public health have extended the life span for most Americans which has resulted in a growing number of retirees relative to a shrinking number of workers.

Almost all ordinary workers, joined by a growing number of extraordinary workers, have fallen, and continue to fall, from the ranks of the makers. Given globalization, technology, and demographics, few ordinary takers will have the ability to become makers, but many makers will be at risk of becoming takers if their skills become obsolete. Workers with ordinary skills and workers with extraordinary skills in danger of becoming obsolete can look forward to a future of anxiety driven by job insecurity. Not only do these forces show no sign of subsiding, but each of these forces appears to be accelerating. A growing imbalance between makers and takers, and a growing anxiety in both makers and takers about their futures, will affect how the tax game will be played over the next few years.

How to tax the makers and takers for the purpose of strengthening the middle class depends on an understanding of the following:

- (1) The necessity of granting increasing benefits to a growing number of takers, (2) taxing a shrinking number of makers to pay for it, and (3) the need to educate those of merit who lack means.

- The constraints on taxing both those with high and low incomes.

Before getting into how to tax, Americans should understand who the makers and takers are.

WHO ARE THE MAKERS AND THE TAKERS IN TAXING?

Every able-bodied American, including each man, woman, and child who becomes an adult, owes America an obligation to pay their *per capita* share of the cost of government, or put a better way, their share of the blessings of being an American. Sooner or later, all government debt must be paid, and someone has to pay it. To the extent that any American pays less than their *per capita* share of the cost of government, they get a free ride at the expense of those who make up the difference. In the world of taxing, it is those who get a free ride that are the takers. Most Americans, however, believe that taxes should be based on the principle of one's ability to pay in that someone with a $1,000,000 income should pay more taxes than someone with a $20,000 income. The ability to pay principle inevitably results in those with higher income paying more taxes than those with less income. There is no escaping the fact that the ability to pay principle both (1) redistributes after-tax income from the well-off to the less well-off and (2) has made America a land of many takers, and very few makers.

Focusing exclusively on tax issues, makers pull the wagon and takers ride in the wagon. To make the wagon roll faster, makers should be encouraged to make as much money as possible. A wagon that goes nowhere helps no one. Unless makers make a lot of money, there will not be enough tax revenue for the wagon to roll fast enough to take America where it needs to go.

Aside from taxes, virtually every American takes from the government in one way or another. Takers include, among others, the following: retirees and their non-working spouses who receive benefits from Social Security and Medicare; many unemployed workers who receive benefits from unemployment insurance; many of the poor who receive health care benefits from Medicaid and/or food stamps; young adults who receive loans for post-secondary education; and other individuals who qualify for hundreds of miscellaneous benefits of one kind or another from the government. Most of these benefit programs have been around for several generations and have become an integral part of American life.

To be a maker, an individual must be able to show that (over their lifetime) they have paid or will pay taxes in an amount not less than the sum of (1) their *per capita* share of the general cost of government (exclusive of the cost of Medicare and Social Security) and (2) the amount of benefits that they have received and will receive from government. Without a personal audit of what each individual American has paid to and gotten from the government, it is difficult to sort out exactly who the makers and takers are. But, by looking at budget and tax data, a clear picture emerges as to who does or does not likely qualify as a maker.

THE MAKING SIDE OF THE LEDGER

Children grow up, go to work, and pay taxes; both married spouses for the most part now work and pay taxes as couples; and those few non-working spouses are entitled to a half share of their working spouse's taxes on their earnings in determining if they are a maker or taker. Therefore, to qualify as a maker, all able-bodied Americans should pay (over their lifetime) their *per capita* share of the cost of government.

The federal personal income tax pays for about 75% of the tax revenue needed to pay for the costs of government other than Social Security and Medicare. The remaining 25% of the costs of government is paid primarily from the corporate income tax, the estate tax, excise taxes, and miscellaneous taxes. Given wealth concentration, few Americans below the top 10% in income and wealth own significant amounts of stock or bear any of the burden of the corporate income tax, and no Americans below the top 1% in wealth bear any of the burden of the estate tax. Almost all Americans, rich and poor alike, pay some excise taxes and some miscellaneous taxes, but these taxes account for very little of the overall cost of government.

Except for the personal income tax, only a very few Americans pay enough other federal taxes to make a dent in their *per capita* share of the cost of government. As a practical matter, then, only a very few very well-off Americans have a decent shot at paying their *per capita* share of the cost of government, and many of those very well-off Americans also take quite a bit from the government.

The Tax Test for Qualifying as a Maker

Table VI-1 shows that the *per capita* cost of government, exclusive of Social Security and Medicare, has averaged $6,168 over the last 31 years. All Americans have a responsibility to pay for America's bills, and to the extent that any American does not pay their *per capita* share, some other American must take up the slack.

Table VII-1
What it Would Take in 2011 for an Individual Born in 1980 to Pay Enough Taxes to Qualify as a Maker

Year	Government Outlays (Net of Social Security and Medicare) (1)	USA Population(2)	*Per Capita* Cost of Govt(3)	2011 Constant Dollar Factor(4)	*Per Capita* Cost of Govt in 2011 Constant Dollars(5)	National Debt as a % of GDP(6)
1980	$440,304,000,000	226,545,805	$1,944	2.73	$5,306	33%
1981	$499,508,000,000	229,466,000	$2,177	2.47	$5,377	33%
1982	$543,212,000,000	231,664,000	$2,345	2.33	$5,463	35%
1983	$585,052,000,000	233,792,000	$2,502	2.26	$5,656	40%
1984	$616,042,000,000	235,825,000	$2,612	2.16	$5,643	41%
1985	$691,899,000,000	237,924,000	$2,908	2.09	$6,078	44%
1986	$721,461,000,000	240,133,000	$3,004	2.05	$6,159	48%
1987	$721,545,000,000	242,289,000	$2,978	1.98	$5,897	50%
1988	$766,197,000,000	244,499,000	$3,134	1.90	$5,954	52%
1989	$826,238,000,000	246,819,000	$3,348	1.81	$6,059	53%
1990	$906,268,000,000	249,622,814	$3,631	1.72	$6,245	56%
1991	$950,722,000,000	252,980,941	$3,758	1.65	$6,201	61%
1992	$974,921,000,000	256,514,224	$3,801	1.60	$6,081	64%
1993	$974,249,000,000	259,918,588	$3,748	1.56	$5,847	66%
1994	$997,441,000,000	263,125,821	$3,791	1.52	$5,762	67%
1995	$1,020,041,000,000	266,278,393	$3,831	1.48	$5,669	67%
1996	$1,036,588,000,000	269,394,284	$3,848	1.43	$5,502	67%
1997	$1,045,849,000,000	272,646,925	$3,836	1.40	$5,370	65%
1998	$1,080,421,000,000	275,854,104	$3,917	1.38	$5,405	63%
1999	$1,121,358,000,000	279,040,168	$4,019	1.35	$5,425	61%
2000	$1,182,414,000,000	282,171,957	$4,190	1.31	$5,489	57%
2001	$1,212,504,000,000	285,081,556	$4,253	1.27	$5,402	56%
2002	$1,324,059,000,000	287,803,914	$4,601	1.25	$5,751	59%
2003	$1,435,786,000,000	290,326,418	$4,945	1.22	$6,033	62%
2004	$1,527,933,000,000	293,045,739	$5,214	1.19	$6,205	63%
2005	$1,650,014,000,000	295,753,151	$5,579	1.15	$6,416	64%
2006	$1,776,633,000,000	298,593,212	$5,950	1.12	$6,664	64%
2007	$1,767,126,000,000	301,579,895	$5,860	1.08	$6,328	65%
2008	$1,974,759,000,000	304,374,846	$6,488	1.04	$6,747	70%

2009	$2,404,621,000,000	307,006,550	$7,832	1.05	$8,224	85%
2010	$2,297,840,000,000	309,349,700	$7,428	1.03	$7,651	94%
2011	$2,386,597,000,000	313,914,000	$7,603	1.00	$7,603	99%
Average					$6,168	
Notes:						
(1) OMB Budget 2013, Historical Table 3.1.						
(2) U. S. Census Bureau, Statistical Abstract 2012, Tables 1 – 3.						
(3) Column 2 divided by Column 3.						
(4) U. S. Bureau of Labor Statistics at http://www.bls.gov/data/inflation_calculator.htm						
(5) Column 4 divided by Column 5.						
(6) OMB Budget 2013, Historical Table 7.1.						

Assuming a person lives a natural lifespan of 78 years, then that person's *per capita* share of the cost of government over their lifetime would be $481,104 ($6,168 x 78), and assuming that same person has a working life of 56 years, then that person would have to pay an average annual personal income tax of $8,591 ($481,104/56) to pay their *per capita* share. Since averages are only averages and many Americans will not live their full normal life span much less work for a full 56 years, the *per capita* share of the tax burden for those Americans who do have full life span and working life will be significantly higher than the average $8,591. Although it is difficult to know exactly what the annual *per capita* personal income tax share is for those who are lucky enough to live a full 78 years and diligent enough to work for a full 56 years, it is a good bet it is well over $10,000.

Very Few Makers

As Table VI-2 shows, only very few Americans pay enough taxes to qualify as a maker.

Table VI-2
Average Annual Personal Income Tax Paid by Taxpayers in Various Income Categories in Constant 2009 Dollars
(1986-2009)

	Average 100%>99% Tax	Average 99%>95% Tax	Average 95%>90% Tax	Average 90%>75% Tax	Average 75%>50% Tax	Median >50%< Tax
1986	$181,415	$29,638	$17,073	$10,019	$4,939	$1,910
1987	$163,013	$30,304	$16,233	$9,333	$4,472	$1,709
1988	$189,259	$30,948	$15,996	$9,408	$4,512	$1,684
1989	$169,808	$31,445	$15,937	$9,615	$4,559	$1,680
1990	$163,311	$30,074	$15,243	$9,384	$4,462	$1,624
1991	$154,478	$28,882	$15,495	$8,907	$4,290	$1,467
1992	$178,130	$29,650	$15,682	$8,827	$4,258	$1,396
1993	$189,862	$30,024	$15,551	$8,741	$4,168	$1,344
1994	$194,616	$31,452	$16,089	$9,037	$4,230	$1,367
1995	$214,053	$32,975	$16,751	$9,250	$4,252	$1,384
1996	$243,883	$35,215	$17,428	$9,464	$4,337	$1,397
1997	$266,051	$37,497	$18,175	$9,879	$4,506	$1,464
1998	$292,215	$40,124	$18,840	$9,891	$4,406	$1,494
1999	$324,953	$43,264	$19,766	$10,230	$4,475	$1,528
2000	$357,694	$45,510	$20,760	$10,629	$4,620	$1,590
2001	$282,638	$40,373	$19,414	$10,012	$4,381	$1,412
2002	$249,091	$37,110	$17,644	$8,949	$3,724	$1,094
2003	$233,200	$34,173	$15,621	$8,183	$3,444	$1,000
2004	$268,363	$36,796	$16,098	$8,082	$3,447	$1,021
2005	$305,362	$39,323	$16,478	$8,112	$3,393	$1,011
2006	$318,946	$40,479	$17,036	$8,248	$3,437	$1,020
2007	$329,234	$41,137	$17,251	$8,345	$3,428	$1,013
2008	$280,185	$38,148	$16,534	$8,059	$3,230	$857
2009	$230,496	$34,400	$14,821	$7,042	$2,622	$599
Average	$240,844	$35,373	$16,913	$9,069	$4,066	$1,336

Source: Data extracted from IRS Schedule dated 23/10/2012.

Assuming that the annual *per capita* tax share for each working American is at least $10,000, a taxpayer who lives a normal lifespan and is able to work for their entire working life of 56 years would have to average being in at least the top 25% of taxpayers every year for 56 years. Since this applies to all Americans, any couple in which one spouse does not work, the other spouse would have to make up for the taxes not paid by the non-working spouse. Given the taxes paid by the various taxpayer income categories, as shown in Table VI-2, only those whose average incomes, over their entire working lives, is above the top 25% have any hope of passing the tax test to qualify as makers.

All Americans, including non-working spouses, ought to keep track of how much they pay annually in personal income taxes, and if they do not average at least $10,000 in 2009 constant dollars, then they flunk the tax test and are takers. It is only an educated guess, but probably less than 5% of all Americans can pass the taxing test to qualify as makers.

THE TAKING SIDE OF THE LEDGER

Almost all Americans, rich and poor alike, are takers from government in that they get government-paid benefits out of Social Security, Medicare, and Medicaid, and also benefit from a grab bag of hundreds of government subsidy programs such as agricultural subsidies, food stamps, small business loans, education loans, and unemployment insurance. All Americans (regardless of income and wealth) who participate in Medicare and Social Security take more, and sometimes much more, out of these programs than they pay in social insurance taxes. The Social Security and Medicare taxes paid by almost all beneficiaries amount to only a pittance (for high-income taxpayers, a fairly large pittance, and for low-income taxpayers, a small pittance) of the benefits they receive.

Unless an individual passes the tax test with a very healthy surplus, their participation in Social Security and Medicare almost certainly guarantees their falling into the ranks of the takers—BENEFICIARIES OF REDISTRIBUTION. Only very few Americans, probably less than 3%, can pass both (1) the tax test by paying more than their per capita share of the cost of government and (2) the taker test by taking less from the government than they pay in taxes.

A Nation of Takers and a Nation of Contributors

Reconciling the making and taking sides of the ledger thins the ranks of the makers to only very few Americans, leaving the remaining 300 million or so down amongst the takers. Many upper middle-class Americans are takers, a humbling fact for many high-income Americans. Another name for maker is “redistributor”, and another name for taker is “redistributee.” So, America turns out to be land in which it is highly likely that over 97% of all Americans are redistributees when it comes to counting how much money they put into paying for the government against how much they take out.

Regrettably, with about 300 million Americans on the take in terms of getting more money from the government than they put into it, it falls on America’s millionaires and billionaires to make up the difference. America would be better off if those 300 million Americans had sufficient incomes so that there were many more makers and many fewer takers, but capitalism in today’s technological and global economy dictates otherwise. For America to be economically and politically healthy, it needs a growing number of makers and a shrinking number of takers. Until income disparities begin falling, more, not fewer, Americans will be takers.

All Americans should acknowledge what should be obvious that being a taker for tax purposes does not mean that a person does not contribute to making America great. While the investments made in the economy, the taxes paid, and the unique skills contributed by the makers all are essential to keeping America strong, so too are the contributions made by the vast majority of the 300 million takers.

Making and taking (in terms of taxes) is an income and wealth matter and ignores individual merit, good and bad. Many makers have money because of luck or happenstance instead of merit, and apart from paying taxes, they do little to make America better. Many takers, however, exert extraordinary effort in applying themselves in a variety of ways other than paying taxes and make America much better. Individual industry, effort, and honesty, on the one hand, and laziness, folly, and dishonesty, on the other hand, are not proprietary to either makers or takers. Apart from makers and takers, America needs as many individuals of industry, effort, and honesty as it can muster and should do all it can to encourage those who possess these traits.

Millions of takers make extraordinary contributions to America by (1) being part of a workforce that attracts global capital to America to produce goods and services, (2) educating (at the public school and higher education levels) the American workers of the 21st century, (3) making technical, scientific, and medical advancements that lead the global economy, (4) creating jobs through innovation and entrepreneurial risk-taking, (5) soldiering in the world's strongest military, and (6) accomplishing many other charitable, social, educational, and artistic activities that enrich a society. Not being a multi-millionaire or billionaire does not mean an individual American does not make an extraordinary contribution to improving America.

Many more millions of takers make ordinary contributions to America by doing the everyday jobs that someone has to do, paying as much (and sometimes more) in taxes as they can afford, doing the soldiering that keeps America safe, and providing a mass consumer base that makes it profitable for well-off capitalists to produce, sell, and distribute goods and services. For someone to be extraordinary, many more must be ordinary, and without the ordinary, America would not work. Imagine a world composed solely of wealthy, industrious capitalists—there would be no one to produce and consume their goods and services. **The world will not work without ordinary folks.**

Although ordinary Americans are not going to become rich unless they win the lottery, ordinary, hardworking, law-abiding Americans do deserve a decent standard of living. In contemporary America, a decent standard of living for these Americans means a reasonably comfortable retirement, affordable health care, and the opportunity for their children to get the post-secondary education they need to become productive members of America's workforce.

Siring and parenting America's extraordinary contributors and makers is among the most important contributions that ordinary folks can make. At any point in time, it is likely that most makers, and most of those who make extraordinary contributions, are the children of ordinary parents. There is no reason to suppose that any of this will change. Viewed in strictly economic terms, today's takers are incubating most of tomorrow's makers and extraordinary contributors and threatening the success of the incubation process by lowering the after-tax standard of living of millions of ordinary takers threatens America's future.

The Necessity of the Government Helping the Takers

For the last two generations, market forces have concentrated wealth and income at the top so that only very few exceptional-income Americans earn enough to pay their *per capita* share of the cost of government much less save for their retirement or pay for the post-secondary education of their children. Without help (another name for redistribution), very few above average-income Americans can afford to pay for their children's post-secondary education, much less their retirement and medical care.

America depends on takers; takers depend on government help; and for takers to get what they need to keep America working, the makers must pay for it one way or another. Without government help, most ordinary Americans will not have a middle-class standard of living enough to live the American Dream. It is a brutal fact that America will not work unless it taxes its very few makers to help its many more takers. In doing so, however, America cannot tax its makers so much that they lose their incentive to keep on making, and America must create and sustain a capitalistic market that enables its makers to be as productive as possible.

How Not to Help Takers: Jimmying Market Forces

The government could jimmy market forces for the purpose of redistributing market income and wealth more broadly so that more Americans can pay for their children's post-secondary education and their own retirement. Erecting trade barriers to insulate American workers from competition from cheap labor and businesses from foreign competition, liberalizing labor laws in favor of unions that lead to unproductive work rules, restricting legal immigration, relaxing patent protection, mandating that businesses provide more retirement and health care benefits to workers, forcing business practices that favor low-skill labor over automation, and a host of other efforts that meddle with market forces would all reduce the disparities in the incomes and wealth of Americans.

Each of these actions would, to a greater or lesser extent, redistribute income and wealth without increasing government spending. The absence of government spending, however, does not mean that these actions would be cost-free. Instead of these costs burdening the government's balance sheet, these costs would burden the balance sheet of businesses. Increasing the cost of businesses, in turn, would slow economic growth and erode productivity. **By slowing growth and eroding productivity, jimmying the market would put America on the path to economic decline–a path to nowhere for the middle class.**

PRESERVING MARKET FORCES

Flawed as the working of the market is, market forces drive the American economy, and undue tampering with them can damage economic growth and harm everyone. Damaging the economy will not provide the middle class with sustainable opportunity. Jimmying market forces could provide the middle class with a higher standard of living for a time, but only a very short time. While providing the middle class with the illusion of being better off, jimmying would corrupt the market, damage economic productivity, and sooner or later (probably sooner) cut everyone's standard of living.

Taxing (if done right) could provide the middle class with a higher standard of living but without interfering with market forces in a way that would harm economic productivity. U**nlike market jimmying, taxing does not necessarily erode economic productivity by corrupting the operation of the market. Middle-class opportunity depends on preserving the free market forces unfettered by anti-competitive or fraudulent practices.**

The Cost of Meritocracy & Financial Security: Higher Taxes

From America's beginning, it has led the way toward a merit-based society that has strived to shed the cultural hobbles that favor caste or class, whether hereditary, ethnic, religious, or economic, over merit. If America ever fails to do what it takes to advance those of merit (regardless of their background and economic wherewithal), then, along with the American Dream, America will lose its vitality.

America cannot succeed unless its businesses and workers succeed, and for each to succeed, government must provide an enabling environment. **There is only one source of revenue that can finance the public investments needed to provide an enabling environment for businesses and workers, and that source is taxes—higher taxes than are currently in effect.**

The goal of taxing rich and poor alike should be to raise the **requisite revenue** without impairing economic growth.

In the wake of the Great Recession and the pandemic of 2020, requisite revenue means getting enough tax revenue to pay the annual cost of government without increasing the national debt as a percentage of GDP. The Simpson-Bowles presidential commission, in its 2010 report, "Moment of

Truth," has recommended that (in order to be financially secure) the public debt to GDP ratio should be cut from the current approximate 100% down to about 40%, where it was in 1980. So, if America is to achieve financial security, requisite revenue means that current and future taxpayers must pay increased taxes to pay not only for (1) the government they get, but also for (2) the government their forbearers got and did not pay for.

Increasing the overall level of taxes converts the tax game from a game of under-taxing everyone in which all current taxpayers win to a game in which all current and future taxpayers are at risk of paying higher taxes. Once all taxpayers are at risk of paying higher taxes, the tax game descends into a zero-sum game in which no taxpayer can win unless another loses. Imagine a lifeboat with provisions for only 20 occupants but with 25 people, including 14 healthy adults, six children, and five frail, elderly occupants. Guess who will make the cut and who will not. In the zero-sum tax game, taxpayers of all income levels will have to duke it out to see who wins and who loses—a struggle that would make Darwin blush.

INVESTMENT VERSUS CONSUMPTION: THE NEED FOR BALANCE

Since investment and consumption both feed on and compete for the same national income, a perpetual tug of war exists between the two. Generally, makers are on the investment side, and takers are on the consumption side. But, it is a part of the DNA of all Americans, regardless of income, to put consumption ahead of investment. The investment/consumption tug of war complicates developing and implementing a coherent tax policy that encourages economic growth. At any moment in time, there is a finite amount of personal disposable income split between consumption and investment. Personal disposable income (also referred to as after-tax income) equals total personal income less personal taxes and is the income available for consumption and/or investment.

Income allocated to investment finances the productive resources that produce goods and services (the supply side), and income allocated to consumption pays for the goods and services produced (the demand side). Anytime either more goods and services are produced than can be consumed or demand exceeds the goods and services produced, an imbalance between investment and consumption exists. Put in the simplest terms, over-investment means factories producing goods that consumers cannot afford to buy, and over-consumption means consumers with money to buy but factories producing too few goods. An investment/consumption imbalance that tilts too far either way results is a misallocation of national income that slows economic growth.

Once taxpayers have enough income to subsist, all income thereafter can be spent on either investment or consumption. Subsistence in today's America means more than eating enough calories to survive, finding shelter that protects against inclement weather, wearing old feed sacks, getting around by walking, and dying when getting sick. Over the years, America has chosen an increasingly expansive definition of subsistence and that is unlikely to change.

The almost universal predilection of all Americans "to keep up with the Joneses," a predilection well understood by politicians, guarantees that consumption will almost always have the upper hand on investment. Almost always does not mean always, as proven by the Great Recession and pandemic. Periodically, unanticipated events, like the Great Recession and the pandemic, strike and upset the investment/consumption balance and wreak havoc on the economy. The Great Recession and the pandemic each ate into consumption as a result of high unemployment among middle and low-income workers while leaving plenty of investment capital to be financed from the intense growth in wealth of the wealthy over the last two generations.

The Great Recession (as shown on Table VII-3) led to an investment/consumption imbalance tilted in favor of investment.

Table VII-3 **Personal Consumption and Personal Savings as Percentages of Personal Disposable Income*, and Annual Growth of Personal Disposable Income in 2005 Chained Dollars (2004-2012)**			
	1	2	3
	Personal Consumption as Percentage of Disposable Personal Income	Personal Saving as Percentage of Disposable Personal Income	Disposable Personal Income Annual Percentage Growth, Chained (2005) Dollars
2004	93.04%	3.58%	3.40%
2005	94.89%	1.54%	1.40%
2006	93.80%	2.59%	4.00%
2007	93.75%	2.39%	2.40%
2008	91.03%	5.37%	2.40%
2009	91.83%	4.74%	-2.80%
2010	91.81%	5.09%	1.80%
2011	92.90%	4.24%	1.30%
2012	93.21%	3.94%	1.50%
Source: Extracted from BEA, Table 2.1, Personal Income and Its Disposition, 2013.			
Notes:			
* Personal Disposable Income equals Personal Income less Personal Taxes.			

Table VI-3 shows that in the four years following the onset of the Great Recession in 2008, (1) personal disposable income first fell in 2009 and then grew at a much slower pace than in the four years before the Great Recession, and (2) a greater percentage of personal disposable income found its way into investment and away from consumption. So, among other things, the Great Recession bequeathed an economy possessed of growing productive resources and shrinking consumption, a growing investment/consumption imbalance. This continuing investment/consumption imbalance worsened an economy ailing from high unemployment, disinflation bordering on deflation, stagnant and falling incomes for all but the top 10%, a collapsing housing market, crumbling consumer confidence, and economic uncertainty.

Excessive productive resources leads to waste, and excess demand leads to inflation. Over-investment results in factories with more capacity than needed to fill purchase orders, stores with overflowing inventories, growing unemployment, falling incomes among consumers, below average interest rates, disinflation, and economic uncertainty. Conversely, over-consumption results in factories that lack the capacity to fill their purchase orders, stores with empty shelves, inflation, an employment bubble, higher than average interest rates, and economic uncertainty. Using tax policy to encourage a proper balance between investment and consumption promotes economic growth which helps almost everyone.

Generally, tax policies that combat over-investment tend to redistribute money from the best-off to everyone else, and tax policies that combat over-consumption tend to redistribute money to the best-off from everyone else. Getting tax policy right requires detailed fact-finding by experts regarding (1) the magnitude of the investment/consumption imbalance and (2) the economic effects of the taxes chosen to redress the imbalance. Facts, not opinion, dictate whether tax policy will be successful.

Several years after the Great Recession, the economy still appeared to suffer from over-investment rather than under-consumption. Evidence of over-investment includes below-average interest rates and inflation as well as wealth and income concentrating in the top 1 percent. Further indicating that there was more than enough capital for investment, some, like former Chairman of the Federal Reserve Board, Ben Bernanke, contended that a worldwide capital glut was slowing global economic growth. Tax policies that remedy over-investment tend to redistribute money from the best-off to the less well-off. Since the best-off are the best equipped for and most adroit at playing the tax game, they hold a commanding edge in who will win. Given the ability of high-income taxpayers to win the tax game, fixing over-investment generally is many times harder than fixing over-consumption.

Makers and Takers: A Mutual Dependency

Squabbles between makers and takers are inevitable because they are each fighting over money, and that fight plays out in the tax game. Each time the tax game is played, the squabble continues with intensity relative to the stakes involved in each playing. Beyond the squabbles, however, makers and takers mutually depend on each other for the success of each.

The following are truths that should be (but all too rarely are considered) in allocating the tax burden between makers and takers:

- Capital is of no use without labor;
- Labor cannot produce anything without capital;
- Nothing can be consumed unless it is produced;
- There is no point in producing something that cannot be consumed;
- The richer the makers become the more taxes they will pay to meet the needs of the takers; and
- The richer the takers become the less in taxes the makers will have to pay.

America will always have both makers and takers, but it works best when the number of makers is growing, and the number of takers is shrinking. The primary purpose of tax policies should be to convert more takers into makers without converting any makers into takers and to make everyone richer by increasing economic growth.

CHAPTER 8

THE MYTH OF OVER-TAXATION

Myth: Americans are over-taxed.
Reality: Americans are under-taxed because they do not pay for the government they have, and they pay substantially less in taxes than any other modern economy.
Worldwide, in word association, maybe no word is more associated with America than "freedom." Americans who enjoy the blessings of freedom but bitch about paying for it could learn from the lyrics of Geddy Lee's and Neil Elwood Peart's song, *Something for Nothing*,
"Oh, you don't get something for nothing,
You can't have freedom for free, no
Whoa, you don't get something for nothing
You can't have freedom for free, no."

America's Spending & Taxing • The National Debt • The Limits to Borrowing • Under-Taxation and its Consequences • Common Gripes • The Endless and Pointless Questions of Fairness

AMERICA'S SPENDING AND TAXING

An Easy Sell—Americans are Over-Taxed

Taxes are the product of politics, and in politics, there is no easier sell than convincing voters that they are over-taxed; it is like convincing six-year-olds that ice cream is good for them because it tastes good, and the higher the fat and sugar content, the better the taste. Inbred in most taxpayers is the belief that they pay too much in taxes of all kinds.

If pressed, however, few taxpayers can define what being over-taxed means beyond they are paying more than they want, and few politicians dare to question taxpayer wants regardless of whether the wants are merited. Imagine how much easier it is to devise a myth that Americans are over-taxed compared with devising a myth that Americans are under-taxed when in fact the latter is true. As with most myths, the truth eventually wins out, but eventually can be a very long time. Since few have an incentive to debunk the myth that Americans are over-taxed, it should come as no surprise that it takes quite a while for the truth that Americans are under-taxed to surface.

Determining whether Americans are over-taxed or under-taxed depends on understanding two truths:

- **America must pay for its spending.**
- **There are limits to how much America can borrow.**

Since 1981 America has for the most part spent as much as it liked, taxed as little as it liked, and put the difference on the cuff, but now the bill threatens to come due.

America's Spending

Government must pay for what it spends, even if the spending is wasteful and/or foolish, or lose its credit. No sane creditor at either the individual or government level will loan to a deadbeat. Loss of credit can be fatal to a government (particularly one like America that owes a national debt of over $20 trillion) and would have a devastating effect on the economy. So, to avoid loss of credit, government must pay up for what it has spent, and paying up means some combination of borrowing and taxing.

Over more than the last half century, government has spent annually as much as 24.3% of GDP in 2011 and as little as 16.6% of GDP in 1965, as is shown on Table VIII-1.

Table VIII-1
Government Outlays by Function as a Percentage of GDP for the Period 1961-2014

Year	National Defense	Education, Training, Employment, and Health	Social Security, Medicare, and Veterans' Benefits	Physical Resources	Net Interest	Other Functions	Undistributed Offsetting Receipts	Total, Federal Outlays
1961	9.1	3.9	1.5	1.4	1.2	1.6	-0.9	17.8
1962	8.9	3.9	1.5	1.5	1.2	2.1	-0.9	18.2
1963	8.6	3.9	1.5	1.3	1.2	2.3	-0.9	18.0
1964	8.3	3.9	1.4	1.4	1.2	2.5	-0.9	17.9
1965	7.1	3.7	1.4	1.6	1.2	2.4	-0.8	16.6
1966	7.4	4.0	1.5	1.7	1.2	2.2	-0.8	17.2
1967	8.5	4.5	1.6	1.8	1.2	2.0	-0.9	18.8
1968	9.1	4.8	1.8	1.8	1.2	2.0	-0.9	19.8
1969	8.4	4.8	2.0	1.2	1.3	1.8	-0.8	18.7
1970	7.8	5.0	2.2	1.5	1.4	1.6	-0.8	18.6
1971	7.0	5.3	2.9	1.6	1.3	1.5	-0.9	18.8
1972	6.5	5.5	3.3	1.6	1.3	1.5	-0.8	18.9
1973	5.7	5.3	3.5	1.5	1.3	1.8	-1.0	18.1
1974	5.3	5.3	3.8	1.7	1.4	1.6	-1.1	18.1
1975	5.4	6.1	4.7	2.2	1.4	1.7	-0.8	20.6
1976	5.0	6.2	5.2	2.2	1.5	1.5	-0.8	20.8
TQ	4.7	6.1	4.9	2.0	1.5	2.0	-0.9	20.3
1977	4.8	6.0	4.9	2.0	1.5	1.7	-0.7	20.2
1978	4.6	6.0	4.6	2.3	1.6	1.7	-0.7	20.1
1979	4.5	5.9	4.5	2.1	1.7	1.6	-0.7	19.6
1980	4.8	6.3	4.9	2.4	1.9	1.6	-0.7	21.1
1981	5.0	6.4	5.1	2.3	2.2	1.5	-0.9	21.6
1982	5.6	6.5	5.2	1.9	2.6	1.5	-0.8	22.5
1983	5.9	6.5	5.5	1.6	2.5	1.7	-1.0	22.8
1984	5.8	6.1	4.8	1.5	2.8	1.4	-0.8	21.5

1985	5.9	6.2	4.8	1.3	3.0	1.6	-0.8	22.2
1986	6.0	6.1	4.5	1.3	3.0	1.6	-0.7	21.8
1987	5.9	6.0	4.5	1.2	2.9	1.3	-0.8	21.0
1988	5.6	5.9	4.4	1.3	2.9	1.1	-0.7	20.6
1989	5.4	5.9	4.3	1.5	3.0	1.0	-0.7	20.5
1990	5.1	6.1	4.4	2.1	3.1	1.0	-0.6	21.2
1991	4.5	6.4	4.9	2.2	3.2	1.2	-0.6	21.7
1992	4.6	6.4	5.6	1.2	3.1	1.2	-0.6	21.5
1993	4.3	6.3	5.9	0.7	2.9	1.2	-0.6	20.7
1994	3.9	6.1	6.0	1.0	2.8	1.0	-0.5	20.3
1995	3.6	6.1	6.1	0.8	3.1	1.0	-0.6	20.0
1996	3.3	5.9	6.1	0.8	3.0	0.9	-0.5	19.6
1997	3.2	5.7	6.1	0.7	2.9	0.9	-0.6	18.9
1998	3.0	5.6	5.9	0.8	2.7	0.9	-0.5	18.5
1999	2.9	5.5	5.6	0.9	2.4	1.0	-0.4	17.9
2000	2.9	5.4	5.6	0.8	2.2	1.1	-0.4	17.6
2001	2.9	5.4	5.9	0.9	2.0	1.0	-0.4	17.6
2002	3.2	5.8	6.3	1.0	1.6	1.1	-0.4	18.5
2003	3.6	6.0	6.5	1.0	1.4	1.1	-0.5	19.1
2004	3.8	6.1	6.2	1.0	1.3	1.1	-0.5	19.0
2005	3.8	6.1	6.2	1.0	1.4	1.1	-0.5	19.2
2006	3.8	6.2	6.0	1.2	1.7	1.0	-0.5	19.4
2007	3.8	6.0	6.3	0.9	1.7	0.9	-0.6	19.0
2008	4.2	6.3	6.5	1.1	1.7	1.0	-0.6	20.2
2009	4.6	7.6	7.4	3.1	1.3	1.1	-0.6	24.4
2010	4.7	7.3	8.8	0.6	1.3	1.2	-0.6	23.4
2011	4.6	7.2	8.5	1.1	1.5	1.2	-0.6	23.4
2012	4.2	6.7	7.9	1.3	1.4	1.1	-0.6	22.0
2013	3.8	6.2	8.3	0.5	1.3	1.1	-0.6	20.8
2014*	3.6	6.5	8.6	0.6	1.3	1.0	-0.5	21.1
Source: Data extracted from 2012 OMB Budget, Historical Tables, Table 3.1—OUTLAYS BY SUPERFUNCTION AND FUNCTION: 1940–2017								
Notes: *OMB Estimate								

The 24.2% of GDP high point of government spending in 2011 was overstated because GDP growth suffered a loss after the Great Recession of 2008 and spending on social programs (such as Medicaid, food stamps, and unemployment insurance) ballooned to counter the effects of the Great Recession; the 16.6% low point of government spending in 1965 was understated because of the rapid growth in GDP during the early 1960s and spending on Medicare had not yet taken effect.

With all the ups and downs, total government spending between 1961 and 2014 averaged 20.0% of GDP. Counterintuitively, during Lyndon Johnson's Great Society in 1965-1969 (the Golden Age of Big Government), the average spending of government as a percentage of GDP was a below-average 18.9% while the average spending of government during the Reagan Administration in 1981-1989 (the Golden Age of Conservatism) was an above-average 22.3%.

Retirement programs, including Social Security, Medicare, and veterans' pensions, account for all the increased cost of government over the last generation. In 1989 (the last year of the Reagan Administration), the cost of retirement programs was 4.3% of GDP and government spending (other than retirement programs) was 16.2% of GDP. In 2013, the cost of retirement programs had almost doubled since 1989 from 4.3% of GDP to 8.3%, and government spending (other than retirement programs) had fallen from 16.2% of GDP to 12.5%, or 3.7% of GDP less than it had been under the Reagan Administration. Had the cost of retirement programs been 8.3% of GDP under the Reagan Administration as it was in 2013, the total cost of government during Reagan's two terms would have averaged 25.8%—far and away the highest cost of government during any eight years stretch since the end of World War II.

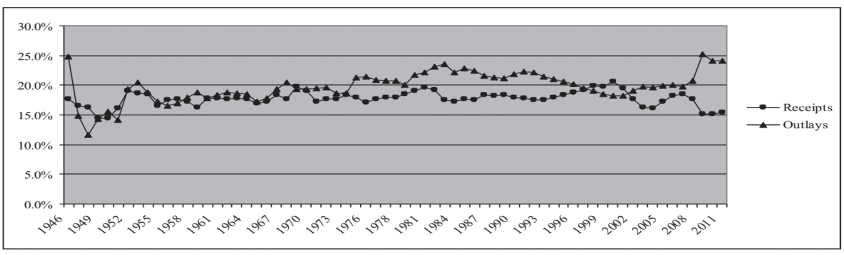
As the incomes of almost all Americans remain static or falling, Social Security and Medicare, as a practical matter, will be the only sources of help for all but a few retirees. Retirement savings for almost all Americans has gone the way of VHS tapes, an outmoded relic of a past economy. For private retirement savings to be practical, 90% or so of Americans must either earn much more income or cut a big chunk of their current consumption, a dubious prospect in today's economy. Even with governmental retirement benefits kept at current levels, Walmart and Home Depot will have no problem finding eager, elderly workers trying to supplement their retirement incomes. As ruthless as the tax game is, the fight over any effort to cut spending on Social Security and Medicare can be expected to be far fiercer than anything relating to taxes.

For the last half-century through the Cold War, the Vietnam War, two Mideast Wars, the Afghanistan War, the addition of Medicare in 1965 and its prescription drug supplement in 2003, several recessions, periods of high and low inflation, stock market bubbles, the parade of liberal governments and conservative governments, and periods of relative domestic turbulence and calm, Americans have spent on average about 15.1% of annual GDP (exclusive of retirement programs) on government. There is no reason to believe that Americans will be willing to cut non-retirement government spending much below the current 12.5% of GDP (which is already below the half-century average of 15.1%). Adding the cost of retirement programs, between 8% and 9% of GDP, to the other cost of government means that its overall cost can be expected to be at least 21% of GDP and rise with increases in pension costs.

America's Taxing

America has failed to match its zest for spending with a similar enthusiasm for taxing, at least since 1981. Graph VIII-1 shows a history of America's willingness to tax to pay for what it spends from 1946-2011.

Graph VIII-1
History of Taxing and Spending 1946-2011



Source: Data extracted from OMB 2016, Historical Tables, Table 2.3, RECEIPTS BY SOURCE AS PERCENTAGE OF GDP: 1934-2020.

As Graph VIII-1 shows, current taxes (1) mostly paid for current spending from 1946-1974, (2) failed to pay for current spending from 1975-1980, (3) almost paid for current spending in 1980, (4) failed to pay for current spending from 1981-1997, (5) not only paid for current spending but paid down the national debt from 1997-2002, and (6) have failed to pay current spending from 2002 onward. The greatest shortfalls in taxes relative to spending occurred first following the Reagan tax cuts of 1981, continued through 1997 when the Clinton tax increase of 1993 kicked in, again following the Bush tax cuts of 2001 and 2003, and have continued through to the present. Politically, spending is easy and taxing is hard.

Taxing Since 1981

From 1981 through 2012, there were four major bouts in the tax game between the tax cutters and the tax raisers along with quite a few minor bouts in between. The tax cutters won the first bout by the tax cuts enacted by President Reagan in 1981; the tax raisers won the second bout by tax increases enacted by President Bill Clinton in 1993; the tax cutters won the third bout in two rounds with the 2001 tax cuts and the 2003 tax cuts enacted by President George W. Bush; and the tax cutters and tax raisers split the difference in 2012 in the fourth bout enacted by President Barack Obama in 2012.

Bout #1 – The Reagan Tax Cuts included the following major components:

- **A 23% cut in individual income tax rates, where the top tax rate fell from 70% to 50%, phased in over 3 years;**
- **Accelerated depreciation deductions for businesses buying equipment;**
- **A 10% exclusion on income for two-earner married couples ($3,000 cap);**
- **Liberalization of IRAs;**
- **Expanded provisions for employee stock ownership plans; and**
- **A 15% net interest exclusion for taxpayers ($900 cap).**

In 1982 and 1984, President Reagan enacted two tax increases which took back several of the benefits granted by the 1981 law but left the tax rate reductions in place.

Bout #2 – The Clinton tax increases included the following major components:

- An increase of the top two individual income tax rates from 28% and 33% to 36% and from 35% to 36.9%;
- Subjecting all wage income to the 3.6% Medicare tax;
- An increase of the gas tax by 4.3 cents a gallon;
- An increase of the amount of wage income subject to Social Security tax;
- Limiting personal exemptions and deductions for high-income taxpayers; and
- Expanding the Earned Income Tax Credit.

In 1997, President Clinton agreed to cut the capital gains tax by cutting tax rates, permitting capital losses to offset other income, and for practical purposes eliminating capital gains on personal residences.

Bout #3, Round#1 – The 2001 Bush tax cuts included the following major components:

- A new 10% bracket was created for low-income taxpayers;
- The 15% bracket's lower threshold was indexed to the new 10% bracket;
- The 28% bracket was cut to 25%;
- The 31% bracket was cut to 28%;
- The 36% bracket was cut to 33%;

- The 39.6% bracket was cut to 35%;
- The child tax credit was doubled to $1,000;
- The standard deduction was increased;
- The capital gains tax was lower for certain types of investments for taxpayers in the 15% bracket; and
- Various tax benefitted retirement plans were liberalized.

Bout #3, Round#2 – The 2003 Bush tax cuts included the following major components:

- The top capital gains tax rate was cut from 20% to 15% for all taxpayers; and
- The dividends tax rate was cut from 35% to 15%.

Bout #4 – The Obama tax cuts and tax increases included the following major components:

- The Bush tax cuts were made permanent except the tax rate on individuals making $400,000 or more and couples making $450,000 or more were increased to 39.6%, and certain deductions and exemptions were curtailed for individuals making $250,000 and couples making $300,000; and
- The capital gains tax rate and the dividends tax rate were increased to 20% for taxpayers subject to the 39.6% tax rate; and
- The maximum tax rate for estates subject to the estate tax was increased to 40%.

Other than these bouts between the tax cutters and tax raisers, significant numbers of both the tax cutters and the tax raisers joined forces in 1986 to reform the income tax by dramatically cutting personal income tax rates in which 14 tax rates were consolidated into three rates, 33%, 28%, and 15%. The 1986 reform resulted from a grand bargain in which the tax cutters got low tax rates that were paid for by getting rid of a bunch of costly tax preferences that had long been targeted for elimination by the tax raisers.

THE NATIONAL DEBT

Any time government's expenditures exceed its revenues, it must borrow to make up the difference. The national debt, as of any moment, is the accumulation of all of government's unpaid borrowings. Each time the government borrows, the Treasury Department issues treasury securities, commonly known as bonds or notes, to evidence the debt.

Treasury securities are guaranteed by the full faith and credit of the United States government and are considered by international debt markets, based on the relative wealth of the American economy and America's political stability, to be the safest debt securities in the world. Treasury securities carry maturities from 30 days to 30 years. Except on very rare occasions when market factors cause short-term interest rates to exceed long-term interest rates, securities with longer maturities bear higher interest rates than those with shorter maturities. There is no danger that treasury securities will ever default because the Treasury Department can always issue new securities and use the proceeds to pay off the maturing securities—a process commonly known as rolling over the debt.

In terms of risk, there is a significant difference between owning a 30-year security as compared with a 30-day security. Although there is no difference in credit quality, 30-year bonds bear a much greater risk of inflation than 30-day bonds. Any number of surprises can strike over a long period, any of which could ignite inflation and devalue a long-term bond. Given inflation risk, investors usually demand a higher interest rate on long-term bonds, known in the trade as a "risk premium." As uncertainty and lack of confidence in America's financial stability grow, so too does the risk premium.

For the last several years, treasury securities have carried historically low-interest rates for a number of complex reasons, not the least of which is the strength of the American economy relative to all other major economies, low inflation, sluggish global economic growth, and plenty of available capital. As long as these conditions prevail, interest rates on treasury securities will continue to be low, but, at some point, one or more of these conditions will not prevail, and higher interest rates will return.

Each time treasury securities are issued, the Treasury Department (as the manager of the national debt) has to decide whether to issue short-term or long-term securities. Like a homeowner who takes out a short-term mortgage with a low-interest rate to save money in a gamble that interest rates will remain low, the Treasury Department gambles if it finances too much of the national debt with short term bonds, and, later, interest rates rise. Gambling is as dangerous for the government as it is for individuals.

Every week or so, the Treasury Department sells (in an auction-like process) newly issued securities in public markets, and uses the proceeds to either (a) redeem maturing securities as a means of rolling over existing debt, or (b) finance the ongoing cost of government to the extent that there are insufficient tax revenues for the current period. As of mid-2016, interest rates on treasury securities were at historically low levels. Among other things, the Great Recession has reinforced (at least for a while) the belief held by international credit markets that in times of worldwide economic strife, America's debt remains (despite America's current problems) the safest haven in an uncertain world.

America, however, must live with the reality that in today's dangerous world, any number of unforeseen events could detonate a financial crisis at any time, which in turn could cause interest rates to explode and the cost of financing the national debt to soar. With each new securities sale, the market renders a fresh verdict regarding any perceived risk arising from investing in treasury securities. Any loss of confidence in America's economy and political stability, any fear of increased inflation, and/or the appearance of a better investment alternative would likely cause interest rates on treasury securities to increase, with the size of the increase dependent on investors' perception of the gravity of the problem.

American taxpayers have a huge stake in maintaining the confidence of bond investors. A one percentage point increase in interest rates on Treasury bonds would increase the annual cost of carry on the national debt by about $200 billion costing Americans on average about $625 annually.

Public Debt and Government Debt

By the end of 2015, the total accumulated national debt had ballooned to over $19 trillion, amounting to over 100% of current GDP which is hardly a confidence builder for bond investors. Table VIII-2 breaks down the national debt into government debt and private debt. Barring corrective action, both the total national debt and that portion held by the public will continue to grow as a percentage of GDP.

Table VIII-2
National Debt 1981-2015

End of Fiscal Year	Gross National Debt ($Millions)	Debt Held by Government ($Millions)	Debt Held by Public ($Millions)	Gross National Debt (% GDP)	Debt Held by Government (%GDP)	Debt Held by Public (%GDP)
1981	994,828	205,418	789,410	31.7	6.5	25.2
1982	1,137,315	212,740	924,575	34.3	6.4	27.9
1983	1,371,660	234,392	1,137,268	38.7	6.6	32.1
1984	1,564,586	257,611	1,306,975	39.6	6.5	33.1
1985	1,817,423	310,163	1,507,260	42.6	7.3	35.3
1986	2,120,501	379,878	1,740,623	46.7	8.4	38.4
1987	2,345,956	456,203	1,889,753	49.1	9.5	39.5
1988	2,601,104	549,487	2,051,616	50.5	10.7	39.8
1989	2,867,800	677,084	2,190,716	51.5	12.2	39.3
1990	3,206,290	794,733	2,411,558	54.2	13.4	40.8
1991	3,598,178	909,179	2,688,999	58.9	14.9	44.0
1992	4,001,787	1,002,050	2,999,737	62.2	15.6	46.6
1993	4,351,044	1,102,647	3,248,396	64.0	16.2	47.8
1994	4,643,307	1,210,242	3,433,065	64.5	16.8	47.7
1995	4,920,586	1,316,208	3,604,378	64.9	17.4	47.5
1996	5,181,465	1,447,392	3,734,073	64.9	18.1	46.8
1997	5,369,206	1,596,862	3,772,344	63.3	18.8	44.5
1998	5,478,189	1,757,090	3,721,099	61.2	19.6	41.6
1999	5,605,523	1,973,160	3,632,363	58.9	20.7	38.2
2000	5,628,700	2,218,896	3,409,804	55.5	21.9	33.6
2001	5,769,881	2,450,266	3,319,615	54.6	23.2	31.4
2002	6,198,401	2,657,974	3,540,427	57.0	24.4	32.5
2003	6,760,014	2,846,570	3,913,443	59.7	25.1	34.5
2004	7,354,657	3,059,113	4,295,544	60.8	25.3	35.5

2005	7,905,300	3,313,088	4,592,212	61.3	25.7	35.6
2006	8,451,350	3,622,378	4,828,972	61.8	26.5	35.3
2007	8,950,744	3,915,615	5,035,129	62.5	27.3	35.2
2008	9,986,082	4,183,032	5,803,050	67.7	28.4	39.3
2009	11,875,851	4,331,144	7,544,707	82.4	30.0	52.3
2010	13,528,807	4,509,926	9,018,882	91.4	30.5	60.9
2011	14,764,222	4,636,035	10,128,187	96.0	30.1	65.9
2012	16,050,921	4,769,790	11,281,131	100.1	29.8	70.4
2013	16,719,434	4,736,721	11,982,713	101.3	28.7	72.6
2014	17,794,483	5,014,584	12,779,899	103.6	29.2	74.4
2015	18,120,106	5,003,414	13,116,692	101.8	28.1	73.7
Source: Data extracted from OMB 2017, Historical Tables, Table 7.1 FEDERAL NATIONAL DEBT AT END OF YEAR, 1940-2021.						

In 2015, the portion of national debt sold to the public amounted to 73.7% of GDP and the portion of national debt held by the government amounted to 28.1% of GDP. Debt sold to the public together with current tax revenues finances almost all government programs except for government transfer programs, the most significant of which include Social Security and Medicare, and a number of transportation and other miscellaneous programs.

Transfer and transportation programs are financed by dedicated taxes such as the payroll tax for Social Security and Medicare, and the gasoline tax for transportation. Dedicated taxes build up balances pending their use to pay for these programs, and these balances are held in government trust funds. In 1983, the government reorganized Social Security as recommended by the Greenspan Commission, an independent commission appointed by Congress and President Reagan in 1981, by increasing the payroll tax to a level above what was needed to pay current Social Security obligations, and provided that the surplus revenues be deposited into a trust fund for future beneficiaries. The purpose of the reorganization was to pre-fund a healthy chunk of Social Security payments in advance of the onslaught of the retiring baby boomers. Actuarially, without a payroll tax increase and accompanying surplus revenue built up in the trust fund, there would not be enough payroll taxes to pay beneficiaries full Social Security benefits beginning sometime in the second decade of the 21st century.

Transfer programs are called transfer programs because they use tax revenues to pay the beneficiaries of the programs—a transfer from taxpayers to program beneficiaries on terms as set from time to time by the politicians. Generally, transfer payments, such as Social Security, neither enrich nor impoverish the overall economy, neither improve nor impair the creditworthiness of American debt, and neither make government bigger nor smaller. Instead, transfer payments simply change the mix of consumption and investment depending on the comparative predilections of the taxpayers (who would have spent the money one way) and the Social Security beneficiaries and those of other similar programs (who may have spent it a different way). Transfer programs have the same economic effect as with parents who leave their money to one child instead of another. The same amount of money will circulate, but it will circulate differently depending on the spending and investment preferences of the child who gets the money instead of the one who did not.

Under law, the balances held in government trust funds must be invested in treasury securities. The overwhelming majority of government debt is held in trust funds dedicated to Social Security and Medicare. Unlike government debt, private debt is held by private investors, both foreign and domestic, who buy treasury securities in the open market. Interest rates on all government bonds are set by an international market that attracts the wealthiest and most knowledgeable private and governmental investors from all over the world. These investors are all both highly sophisticated and mercenary. The moment investors lose confidence in America's credit, interest rates will skyrocket, and/or investors will find alternative investments.

The National Debt and GDP

One of the key measures by which creditors evaluate the ability of a borrower to repay its outstanding debt is a "debt to income ratio," aka DIR. For example, if a debtor has outstanding loans of $7,500 and an annual income of $50,000, his DIR is 15%, and if his income doubles, his DIR falls to 7.5%. The lower a debtor's DIR, the easier it is to repay the debt. Credit analysts who monitor loans for lenders study debtor behavior and make underwriting judgments as to how high a DIR can grow without creating unacceptable credit risk.

Credit analysts who monitor America's financial stability use a ratio similar to the DIR to evaluate its ability to repay the national debt. Instead of a DIR, most economists use a "public debt to GDP ratio" in which public debt serves as a proxy for outstanding debt and GDP serves as a proxy for America's income. Most economists do not take government debt into account because they regard it as debt that America owes itself, not debt owed to third parties as is public debt. For accounting purposes, treasury securities held in government trust funds are treated as an asset, and the obligation to repay those same securities is treated as a liability. Since the assets offset the liabilities dollar for dollar, they cancel each other out and, therefore, are not treated as debt on the same basis as public debt. For purposes of measuring America's debt-paying ability, total personal income (which accounts for about 87% of GDP) is the most significant component of GDP because total personal income is what is there to be taxed.

As Table VIII-2 **shows, public debt as a percentage of GDP (and its major component, total personal income) has more than doubled during the last decade. Given this rapid increase, the strain on taxpayers' ability to pay down the public debt has intensified to a level not seen for over a half-century.**

As Model VIII-1 shows, even though the public debt increases in absolute terms, the public debt to GDP ratio will fall as long as the public debt growth rate is less than the GDP growth rate.

Model VIII-1 Decline in Public Debt to GDP Ratio Based on an Assumed Annual GDP Growth Rate of 3.5% and Annual Increase of Public Debt at 2.5%			
End of Year	GDP	Public Debt	Public Debt to GDP Ratio
1	$16,000,000,000,000	$16,000,000,000,000	100%
10	$21,806,357,652,114	$19,981,807,519,163	92%

Even though the public debt grew almost $4 trillion over 10 years, the public debt to GDP ratio fell because the public debt grew at a slower rate than GDP. Model VIII-1 teaches that for the growth rate of the public debt to be kept in check, two factors are essential:

- **GDP must grow, and the faster the better.**
- **The growth rate in the annual shortfall of current tax revenues to current government spending must be less than the GDP growth rate, and the lower the better.**

The National Debt and Intergenerational Debt Transfer

If in any year the politicians fail to tax an amount sufficient to prevent the national debt from growing as fast as GDP, then an amount equal to the shortfall in tax revenues will be pocketed by the current generation of taxpayers to spend as they wish. This tax shortfall, however, amounts to a gift doled out by the politicians to the current generation of taxpayers at the expense of future generations of taxpayers.

A national debt growing faster than GDP means more spending money for current taxpayers and less for future taxpayers. Future taxpayers are the donors of the tax break gift to current taxpayers.

In the tax game, those taxpayers whose taxpaying lives are spent mostly during years in which the politicians dole out tax break gifts are winners, and those taxpayers whose taxpaying lives are spent mostly during years in which the politicians pay for the tax break gifts are losers. For taxpayers, then, timing is everything when it comes to paying more or less than your fair share in taxes. Justifying a tax policy that shifts the obligation to pay for current government from the current generation to future generations of taxpayers (who must pay not only their own cost of government but that of prior generations) will tax the imagination of the most brilliant economists and public policy experts.

The National Debt and National Emergencies

Except in the case of a national emergency, there is no excuse for shifting debt from one generation of taxpayers to another. In a world of economic instability, climate change, pandemics, cyberwars, and international political turmoil, one or more national emergencies looms over America at all times and may erupt without warning. Examples of a national emergency that could demand a dramatic increase in the national debt include the following:

- **Deep Economic Distress.**

- **Natural Catastrophe.**

- **War.**

None of these events can be anticipated and none can be discounted, but if any of these events occur and threaten the national well-being, then the government must act, and acting will cost money. When Pearl Harbor was attacked in 1941, the national debt was 50.4% of GDP, and over the next 5 years during World War II, it more than doubled to 121.7% of GDP. President Roosevelt's response to Pearl Harbor was to mobilize the nation for war, not to call up America's creditors and ask for an extension on its line of credit.

When confronted by a national emergency, the government should not have to beg its creditors for permission to spend whatever it takes to save the country. If the West Coast suffered an earthquake that destroyed all major West Coast cities, it is unthinkable that America should not do what it takes to cope with such a disaster regardless of the cost. As a matter of national security, America needs a financial reserve to enable it to cope with the unforeseen.

THE LIMITS TO BORROWING

The Great Recession has ushered in a new era in which America's access to unconditional borrowing has been put in jeopardy. The American economy depends on the government having ready access to international debt markets to refinance the national debt and pay for ongoing revenue shortfalls. To maintain access to debt markets, America must do what it takes to put (and keep) its financial house in order. Putting America's financial house in order sounds good, but for over two generations the politicians have defined "financial order" to suit their political purposes, namely getting reelected by keeping their constituencies satisfied with low taxes unrelated to government spending. The conclusions reached by the Simpson-Bowles Commission have finally given a bipartisan objective definition to what financial order means, at least as it relates to the national debt.

The Simpson-Bowles Commission

More than a decade ago, Simpson-Bowles warned (after months of study and taking testimony from experts of all leading ideologies) that America cannot be great if it goes broke. America's businesses would not be able to grow and create jobs, and its workers would not be able to compete successfully for the jobs of the future without a plan to get control of the national debt.

As a bipartisan commission, Simpson-Bowles was the closest thing to a credible arbiter of what is necessary to get the national debt under control. In diagnosing the economic problems stemming from the national debt, Simpson-Bowles concluded the following:

- Our nation is on an unsustainable fiscal path. Spending is rising, and revenues are falling short, requiring the government to borrow huge sums each year to make up the difference. We face staggering deficits.

- Economic recovery will improve the deficit situation in the short run because revenues will rise as people go back to work, and money spent on the social safety net will decline as fewer people are forced to rely on it. But even after the economy recovers, federal spending is projected to increase faster than revenues, so the government will have to continue borrowing money to spend.

- By 2025 revenue will be able to finance only interest payments, Medicare, Medicaid, and Social Security. Every other federal government activity (from national defense and homeland security to transportation and energy) will have to be paid for with borrowed money. Debt held by the public will outstrip the entire American economy, growing to as much as 185 percent of GDP by 2035. Interest on the debt could rise to nearly $1 trillion by 2020.

- **Federal debt this high is unsustainable.** Eventually, the national debt will drive up interest rates for all borrowers (businesses and individuals) and curtail economic growth by crowding out private investment. By making it more expensive for entrepreneurs and businesses to raise capital, innovate, and create jobs, rising debt could reduce per-capita GDP, each American's share of the nation's economy, by as much as 15 percent by 2035.

- Rising debt will also hamstring the government, depriving it of the resources needed to respond to future crises and invest in other priorities. **Deficit spending is often used to respond to short-term financial "emergency" needs such as wars or recessions. If the national debt continues to grow faster than the GDP, interest rates will eventually rise, which will make it many times more difficult for the government to cope with a financial emergency.**

A burgeoning national debt puts America at risk in dealing with its foreign creditors. Currently, these creditors own more than half of America's public debt. If these investors ever lose confidence in America's financial stability, they could (and probably would) trigger a debt crisis, which would force the government to implement severe austerity measures. Such a debt crisis would most likely result in a sharp increase in interest rates. Even though creditors know that America will never default on its debt because of its ability to issue rollover debt, its creditors fear that America could issue too much debt and ignite inflation.

Being both sophisticated and mercenary, America's creditors will demand higher interest rates at the first sign that it is issuing too much debt. Higher interest rates are the means by which creditors hedge against inflation risk. Exploding interest rates at a moment when America's economy is in the midst of an economic crisis would inflict intense pain on millions of Americans, particularly its middle class.

Predicting the precise level of public debt that would trigger such a crisis is difficult, but a key factor may be whether the debt has been stabilized as a share of the economy or if it continues to rise. Investors, reluctant to risk throwing good money after bad, are sure to be far more concerned about rising debt than stable debt.

Simpson-Bowles pinpointed the national debt as the primary financial threat to America's economic prosperity.

The 40% Rule

To avoid catastrophe, Simpson-Bowles urged that immediate actions be taken to "[s]tabilize debt by 2014 and reduce [public] debt to 60% of GDP by 2023 and 40% by 2035."

Hence, the 40% rule, which means that (except in times of national emergency) that part of the national debt held by the public should not exceed 40% of GDP and that, if it does exceed it because of an emergency, the public debt to GDP ratio should be brought back down to 40% as quickly as prudence permits. The 40% Rule is a refined version of the public debt to GDP ratio that sets a definite numerical national debt ceiling as what financial experts believe is necessary to put America's financial house in order.

The premise of the 40% Rule is the same as the type of credit rule that says that a homeowner cannot afford a house payment greater than 30% of his take-home pay. A homeowner's pay has to cover not just housing costs but other living expenses, such as food, clothing, transportation, health care, utilities, and other miscellaneous expenses. Spending too much on a house can lead a homeowner into bankruptcy when his paycheck will not stretch to cover necessities and emergencies.

Just as there is a limit to how much a homeowner can spend on a house, there is a limit to how much debt the American economy can safely carry. The Simpson-Bowles Commission concluded that carrying public debt greater than 40% of GDP endangers the American economy in that, after paying debt service, there may not be enough national income left to support optimal private consumption and investment and pay the current cost of government, much less being able to cope with a national emergency.

The 40% Rule provides a simple and objective arithmetic test to determine whether America is over-taxed or under-taxed. Any time the public debt exceeds 40% of GDP, Americans are under-taxed, and, conversely, anytime the public debt falls below 40% of GDP, Americans are over-taxed. The over-under tax test has nothing to do with government spending which can be high or low depending on the temper of the time. **No matter what, however, the 40% Rule demands that enough taxes be collected to keep the public debt no greater than 40% of GDP except in times of national emergency.**

In the decade since the Simpson-Bowles Commission issued its report, the national debt has grown at an accelerating rate, the politicians have done nothing to get control over it, and the risk that America will be confronted by a debt crisis continues to grow.

An Emergency Reserve

Not only are death and taxes certain but so are national emergencies. One thing that all national emergencies have in common is that they cost a lot of money. Most families in today's America rely upon the unused credit portion of their credit cards to get them through a family emergency, like loss of a job or serious illness. The days when families had savings accounts that they could turn to for help in the case of emergencies have long since passed.

America is just like today's families in that its emergency reserve is the unused portion of its borrowing capacity. The lower the public debt to GDP ratio, the easier it is for America to borrow, and the less stress the added borrowing puts on the economy. Complying with the 40% Rule provides America with a margin of safety for any national emergency, and the extent to which America ignores the 40% Rule, the more difficult it will be to borrow at cheap interest rates to deal with the next national emergency. So, the 40% Rule protects America's current financial stability, but even more importantly, it protects long-term national security.

Only the strength of America's economy, relative to the rest of the world, has saved it from a debt crisis prompted by the pandemic. The fact that America has not been able to incur massive amounts of debt to mitigate the effects of the pandemic does not mean that there is no limit to its ability to incur more debt. Even if America survives the pandemic without a debt crisis, there is no assurance that it will be able to do so again when the next emergency strikes.

America continues to ignore the 40% Rule at its peril.

Under-Taxation and the Dole

Under-taxation (the failure to tax enough in any year to comply with the 40% Rule) puts the current year's crop of taxpayers on the dole; their artificially low taxes are no more than handouts. While it is the politicians who deliver the handout, it is a future generation of taxpayers who will pay for it. Handouts are generally given to those in need of charity, but most taxpayers are not charity cases. These tax handouts can be used by the recipients for one or more of the following two purposes:

- **Personal Consumption**
- **Personal Investment (which includes personal debt reduction)**

No matter the purpose to which the handout is applied, what is being spent is unearned money. **Tax handouts are not earned because of either personal effort or any type of economic transaction. Rather, tax handouts are no more than fabricated money doled out by politicians catering to their special interest supporters.** From the standpoint of the recipient, tax handouts are a gift, and most recipients abide by the time-honored admonition not to look a gift horse in the mouth.

Breaching the 40% Rule with Tax Handouts

From 1946 until 1981, the politicians, for the most part, successfully resisted the temptation to dole out tax handouts, but the politicians after 1981 repeatedly succumbed to the temptation except for a few years after 1993.

The 1981 Reagan tax cuts increased the public debt to GDP ratio from 26% in 1981 to 49% in 1993; the 1993 Clinton tax increases reduced the public debt to GDP ratio from 49% in 1993 to 32.5% by 2001; the 2001 and 2003 Bush tax cuts that increased the public debt to GDP ratio from 32.5% in 2001 to 54.1% by 2009; and the 2017 Trump tax cut has the public debt to GDP ratio headed for the heavens. **The Reagan, Bush, and Trump tax cuts have emasculated the 40% Rule.**

UNDER-TAXATION AND ITS CONSEQUENCES

Since 1981, America has been under-taxed most of the time, leaving it financially unprepared for the next national emergency. When the next emergency strikes, America will need the full array of financial tools to contend with the ensuing crisis. These tools, among others, include massive tax cuts, huge increases in spending on social insurance, increased infrastructure spending, and/or enormous aid to state and local governments. These actions will force the government to incur debt at an unprecedented level.

Eventually, America's creditors will force it to put its financial house in order by getting control of its national debt. Given the cost of paying for two generations of under-taxing and the growing cost of social insurance due to the aging of America, taxes will have to be raised to a level never before seen. Going forward, paying historically high taxes to redress past misdeeds will make it many times more difficult to further increase taxes to pay for the expanded social insurance necessary to meet the educational, retirement, and healthcare needs of the middle class.

America, Land of Low Taxes

For most of the last two generations, Americans have not paid for the government spending they wanted, and they cannot excuse it by claiming that they could not afford it. Comparing the taxes Americans pay against the taxes others in the world's most modern economies pay belies the belief that Americans cannot afford to pay more taxes. Table VIII-3 shows the per capita GDP and all taxes as a percentage of GDP for the world's leading economies.

Table VIII-3
Per Capita GDP and Taxes as a Percentage of GDP by Country – 2013

Country	Per Capita GDP – 2013[1]	Taxes as a Percentage of GDP – 2013[2]
Australia	$67,653	27.50%
Austria	$50,558	42.50%
Belgium	$46,625	44.70%
Canada	$52,309	30.50%
Czech Republic	$19,814	34.30%
Denmark	$59,819	47.60%
Finland	$49,493	43.70%
France	$42,628	45.00%

Germany	$45,601	36.50%
Greece	$21,843	34.40%
Hungary	$13,585	38.40%
Iceland	$47,493	35.90%
Ireland	$51,815	29.00%
Israel	$36,281	30.60%
Italy	$35,421	43.90%
Japan	$38,634	30.30%
Korea, Rep.	$25,998	24.30%
Luxembourg	$113,727	38.40%
Mexico	$10,173	19.70%
Netherlands	$51,425	36.70%
New Zealand	$42,308	31.40%
Norway	$102,832	40.50%
Poland	$13,776	31.90%
Portugal	$21,619	34.50%
Slovak Republic	$18,110	30.40%
Slovenia	$23,144	36.80%
Spain	$29,371	32.70%
Sweden	$60,283	42.80%
Switzerland	$84,669	26.90%
Turkey	$10,975	29.30%
United Kingdom	$42,295	32.90%
United States	$52,980	25.40%
Sources:		
(1) Data extracted from download from World Bank.		
(2) Data extracted from download from OECD. Stat.		

In 2013, America's GDP was $16.7 trillion, far and away the largest in the world, and it taxed—federal, state, and local—only 25.40% of its GDP, as compared with 35.50% for Germany, 32.90% for the UK, and 45.00% for France. Except for the Scandinavian countries and Australia, all with relatively small and homogenous populations, America's wealth (as measured by *per capita* GDP) exceeds all other countries. And except for Japan (a country not responsible for burdensome military expenditures), America has the lowest tax burden (as measured by taxes as a percentage of GDP) of all countries. **No other major country with a modern economy has America's taxing potential to meet its public needs, maintain its financial security, and still provide its people with the most after-tax income available for personal consumption.** So, America can pay its full tab for the cost of government and still have more after-tax income to consume frills and baubles than any other country of consequence.

COMMON GRIPES

A tax ought to be evaluated in terms of (1) if it is necessary to establish and maintain the financial soundness of America's credit, (2) how it affects each taxpayer's (a) incentive to earn the next dollar, (b) ability to invest in the economy, and (c) after-tax standard of living relative to all other taxpayers, and (3) whether it would lead to an imbalance between investment and consumption. Paraphrasing David Hume, a contemporary of Adam Smith, "ought" is one thing and "is" is quite another.

When it comes to paying taxes, neither a moral "ought" nor any economic justification will stop gripes like, "I don't care about any of this, I'm paying too much in taxes, case closed," a rant not a reasoned argument. Or, for a few taxpayers who are willing to discuss the merits of taxes, they often resort to "fairness" arguments like, "I'm paying too much because others are paying too little." Just as "beauty" exists only in the eye of the beholder, "fairness" in taxation exists only in the mind of interested taxpayers. In evaluating the need for and the proper structure of a tax, fairness arguments do not shed much light except for one narrow exception. While mediating what is fair between how much in taxes a high-income taxpayer should pay relative to a low-income taxpayer is not likely to lead to much, **a good case can be made that it is not fair for one taxpayer to pay significantly more in taxes than another taxpayer who has the same income**.

Like it or not, America's well-being—economically, politically, and socially—depends on having an efficient system of taxation that is supported by most taxpayers. To get such a system requires an understanding of facts and not mere acceptance of a litany of gripes.

High-Income Taxpayer Gripe: I Pay Too Much in Taxes

It is true that over the last 30 years the share of taxes paid by high-income taxpayers has grown leaving many arguing for a break. If that was all there was to it then they might have a point, but as with mirages, what is seemingly apparent is not necessarily real.

Table VIII-4 shows that over a 30-year period from 1986 through 2007 (the last full year before the Great Recession), the share of personal income taxes paid by taxpayers in the top 1% and taxpayers in the next 4% (in terms of adjusted gross income) increased by about 10 percentage points and 6 percentage points, respectively, while the share of personal income taxes paid by all other taxpayers fell.

Table VIII-4
Personal Income Tax Share by Descending Income Categories (the top 1%, the next 4%, the next 5%, the next 15%, the next 25%, and the bottom 50% in terms of Adjusted Gross Income) for the Period 1986-2009

	100%>99%	99%>95%	95%>90%	90%>75%	75%>50%	50%>0%
1986	25.75%	16.82%	12.12%	21.33%	17.52%	6.46%
1987	24.81%	18.45%	12.35%	21.31%	17.01%	6.07%
1988	27.58%	18.04%	11.66%	20.56%	16.44%	5.72%
1989	25.24%	18.70%	11.84%	21.44%	16.95%	5.83%
1990	25.13%	18.51%	11.72%	21.66%	17.17%	5.81%
1991	24.82%	18.56%	12.44%	21.47%	17.23%	5.48%
1992	27.54%	18.34%	12.13%	20.47%	16.46%	5.06%
1993	29.01%	18.35%	11.88%	20.03%	15.92%	4.81%
1994	28.86%	18.66%	11.93%	20.10%	15.68%	4.77%
1995	30.26%	18.65%	11.84%	19.61%	15.03%	4.61%
1996	32.31%	18.66%	11.54%	18.81%	14.36%	4.32%
1997	33.17%	18.70%	11.33%	18.47%	14.05%	4.28%
1998	34.75%	19.09%	11.20%	17.65%	13.10%	4.21%
1999	36.18%	19.27%	11.00%	17.09%	12.46%	4.00%
2000	37.42%	19.05%	10.86%	16.68%	12.08%	3.91%
2001	33.89%	19.36%	11.64%	18.01%	13.13%	3.97%
2002	33.71%	20.09%	11.94%	18.16%	12.60%	3.50%
2003	34.27%	20.09%	11.48%	18.04%	12.65%	3.46%
2004	36.89%	20.23%	11.07%	16.67%	11.85%	3.30%

2005	39.38%	20.29%	10.63%	15.69%	10.94%	3.07%
2006	39.89%	20.25%	10.65%	15.47%	10.75%	2.99%
2007	40.42%	20.20%	10.59%	15.37%	10.52%	2.89%
2008	38.02%	20.70%	11.22%	16.40%	10.96%	2.70%
2009	36.73%	21.93%	11.81%	16.83%	10.45%	2.25%
Source: Data extracted from IRS Table 5.–Returns with Positive Adjusted Gross Income (AGI): Number of Returns, Shares of AGI and Total Income Tax, AGI Floor on Percentiles in Current and Constant Dollars, and Average Tax Rates, by Selected Descending Cumulative Percentiles of Returns Based on Income Size Using the Definition of AGI for Each Year, Tax Years 1986-2009.						

High-income taxpayers then have a valid point that their total share of taxes has increased substantially over the last 30 years in that the tax burden of the top 5% grew substantially from 42% in 1986 to 58% in 2009. So, high-income taxpayers can justly ask, "Where does it end, and just how much of the tax burden must we bear?" The short answer is that they can pay higher taxes now and still be much better off in terms of after-tax income than they were 30 years ago.

Table VIII-5 shows that over the same 30-year period that the pre-tax income (as measured by adjusted gross income) of taxpayers in the top 1% and next 4% grew much more than that of other taxpayers, particularly those in the bottom 50%.

Table VIII-5
Percentage Increase in Adjusted Gross Income by Descending Income Categories (the top 1%, the next 4%, the next 5%, the next 15%, the next 25%, and the bottom 50%) from 1986 to 2007

Percentage Increase	100%>99%	99%>95%	95%>90%	90%>75%	75%>50%	50%>0%
Current Dollars	704.17%	397.90%	335.67%	301.08%	273.05%	256.40%
2009 Constant Dollars	372.29%	210.37%	177.47%	159.18%	144.36%	135.56%
Source: Data extracted from IRS Table 5.–Returns with Positive Adjusted Gross Income (AGI): Number of Returns, Shares of AGI and Total Income Tax, AGI Floor on Percentiles in Current and Constant Dollars, and Average Tax Rates, by Selected Descending Cumulative Percentiles of Returns Based on Income Size Using the Definition of AGI for Each Year, Tax Years 1986-2009.						

The top 1% enjoyed a healthy 372.29% increase in its pre-tax income while the bottom 50% suffered through an anemic 135.56% increase. In terms of a taxpayer's ability to pay more in taxes without reducing their standard of living, no taxpayer group fared nearly as well as those at the top.

Table VIII-6 shows that over the same 30-year period the after-tax income of all taxpayer groups grew, but none more than for those at the top.

Table VIII-6
Percentage Increase in After-Tax Income by Descending Income Categories (the top 1%, the next 4%, the next 5%, the next 15%, the next 25%, and the bottom 50%) from 1986 to 2007

Percentage Increase	100%>99%	99%>95%	95%>90%	90%>75%	75%>50%	50%>0%
Current Dollars	816.61%	405.67%	348.98%	313.30%	283.65%	263.57%
2009 Constant Dollars	431.74%	214.48%	184.51%	165.64%	149.97%	139.35%

Source: Data extracted from IRS Table 5.–Returns with Positive Adjusted Gross Income (AGI): Number of Returns, Shares of AGI and Total Income Tax, AGI Floor on Percentiles in Current and Constant Dollars, and Average Tax Rates, by Selected Descending Cumulative Percentiles of Returns Based on Income Size Using the Definition of AGI for Each Year, Tax Years 1986-2009.

For the top 1%, its after-tax income grew by 432% while its pre-tax income grew by 372%. For the bottom 50%, its after-tax income grew by 139% while its pre-tax income grew by 136%. After-tax income for a high-income group growing more than its pre-tax income means that taxes have become less progressive. Less progressive taxes results in those whose ability to pay is growing paying relatively less in taxes and those whose ability to pay is static paying relatively more in taxes—a potentially toxic political brew. **Unless progressivity in taxes keeps pace with income concentration, both income and wealth disparities can grow to unhealthy levels.**

With the recovery of the Great Recession well underway, and despite the restoration of the 39.6% highest marginal rate adopted in 2012 as a part of Obama's tax increase, the 30-year trend of after-tax income concentrating in the top 1% continues unabated. Nothing has happened since 2012 to change this trend.

Wealthy Taxpayer Gripe: The Wealthy are Wealthy Because of Their Superior Efforts

The wealthy might argue that it is unfair to condemn wealth concentration because it resulted from their superior effort, and in many instances it is true. Others can also argue that over the last generation the government has promoted policies that accelerated wealth concentration that had nothing to do with superior efforts of the wealthy. Trade agreements that enabled cheap foreign labor to replace more expensive American workers, tax cuts that favored the well-off, deregulation policies that made business more profitable at the expense of public safety and financial soundness, and tax subsidies that favored business and well-off individual taxpayers all contributed to wealth concentration and had nothing to do with superior effort. Wealth concentration, then, is by no means solely, or even in some instances primarily, due to the superior efforts of those who have it. So, is it "fair" to say that wealth accumulation is the result of superior effort?

Another High-Income Taxpayer Gripe: Everybody Should be Taxed at the Same Rate

Some high-income taxpayers might argue that having the successful pay taxes at higher rates than the less successful penalizes success. The less successful could respond that having the successful pay taxes at higher rates is not a penalty but a mathematical necessity forced by the intense concentration of income at the top. If everyone paid taxes at the same rates, then many millions of Americans would be pushed into poverty and many millions more would be pushed more deeply into poverty. Is it fair that millions of Americans be mired in poverty to keep high-income taxpayers from paying taxes at higher tax rates than the less well-off?

Hard-Working Taxpayer Gripe: I Worked Hard for my Money and Nobody Should Take It Away

The wealthy might argue that they work hard for their money, and it is unfair to tax it away. All others could respond that not only do some of the wealthy work hard, but they do too. A coal miner, a long-haul truck driver, a fireman, a soldier, and millions of others could argue that their jobs are harder and involve more personal risk than does that of a hedge fund manager, radio talk show host, or star athlete, and that the tax laws have nothing to do with how hard anyone works for their money.

Many of the wealthy worked hard for their money, but some got their money by luck, fortuity, inheritance, or winning the lottery. A CEO of a Fortune 500 Company may work 80 hours a week and have $50 million in taxable income while a ne'er-do-well wins the lottery and has $50 million in taxable income—both would pay a lot of tax. The amount of taxes a taxpayer pays depends on how much money they make, not how hard they work for it. Is it fair to tax on the basis of who works hard and who does not?

The Wasteful Spending Gripe: I Should Not Have to Pay for Wasteful Spending

The wealthy might argue that it is unfair to tax them to pay for wasteful spending. All others could respond that once a bill has been incurred whether it is by an individual or the government, then someone has to pay for it. Once a bill has to be paid, all taxpayers, including both the well-off and the not so well-off, have to pay it. **All should agree that the only financially sound way to cope with wasteful spending is to nip it in the bud and not to renege on paying for it later.** Is it fair that the wealthy be exempted from paying for government waste?

The Paying for Welfare Gripe: I Should Not Have to Pay for Things that Those with Low-Income Want but Cannot Afford

The wealthy might argue that it is unfair to tax them to pay for subsidies for food stamps, higher education, medical care, and so forth for the less well-off. The less well-off could argue that it is their low wages that account for their increasing need for subsidies for food, education, and health care. If their wages had kept pace with the better-off over the last generation, the need for these subsidies would not be nearly as great. The wealthy, moreover, have little to complain about because cheap labor results in higher profits for capitalists and lower costs for consumers. There is a price to be paid for low-cost babysitters, leaf blowers, construction workers, salesclerks, etcetera. Is it fair that many of the wealthy enjoy the fruits of cheap labor and do not have to pay taxes to help low-wage workers have a decent standard of living?

The Paying for Past Sins Gripe: The Wealthy Should Not be Taxed to Pay for Years of Deficits

The wealthy might argue that it is unfair to tax them now to make up for years of deficit spending. All others can argue that it was the wealthy who benefitted mostly from a generation of deficit spending because the Reagan, Bush, and Trump tax cuts were skewed in favor of the most well-off and were financed dollar for dollar by increasing the national debt. Taxing the wealthy now is no more than having them contribute to repaying a portion of the national debt that was jacked up to finance past tax cuts that disproportionately benefitted them. What goes around comes around. Is it fair that the wealthy pocket the Reagan, Bush, and Trump tax cuts without paying that part of the national debt that is attributable to them?

THE ENDLESS AND POINTLESS QUESTIONS OF FAIRNESS

Depending on whose ox is gored, questions about tax fairness can go on endlessly without making a useful point. Many taxpayers in all categories will never be persuaded by arguments—reasonable or unreasonable and fair or unfair—and in the end will resort to, “I don’t care about this, I don’t want to pay another penny in taxes.” But unless America cuts through the mindless griping and increases taxes, it will be financially insecure and will shrink instead of growing. It will be a world in which the American Dream will fade into middle-class obscurity for most ordinary Americans.

CHAPTER 9

THE MYTH OF TAX RATES & ECONOMIC GROWTH

Myth: Cuts in tax rates pay for themselves because they increase economic growth which results in increased revenues.
Reality: In the real world of taxation, cuts in tax rates rarely if ever increase economic growth and almost always cut revenue.
The Renaissance poet, Dante Alighieri, listed the "Seven Deadly Vices" that he believed influence (or pervert as he saw it) human behavior to include: pride, envy, wrath, sloth, avarice, gluttony, and lust. Some players in the tax game have seized on avarice as the primary motivator behind making people work harder by arguing that, on the one hand, rewarding the well-off with carrots is the best way to entice them to chase the next dollar but, on the other hand, striking those who are just getting by with sticks is the best way to force them to eke out a few more dollars. All kinds of humans, rich and poor alike, do all kinds of things for all kinds of reasons (avarice is only one of the reasons), and, many times, the other vices are more powerful than avarice.

Tax Rates and Economic Growth: Myth and Fact • The Laffer Curve • Dynamic Scoring • Tax Cuts: Theory & Reality • Junking Ideology in Favor of Common Sense in Tax Policy

TAX RATES AND ECONOMIC GROWTH: MYTH AND FACT

Economic growth in a competitive world economy depends on America having (1) the most productive businesses and workers, (2) enough investment capital to finance a public and private economic infrastructure that will enable America's businesses to operate more efficiently than their competitors, and (3) robust domestic consumption that encourages businesses to expand in America. Cuts in tax rates affect each of these factors but not always positively. A cut in tax rates that results in revenue loss can prevent America from educating its workforce and providing a world class infrastructure. And, if tax-rate cuts are targeted to the wrong groups, they can contribute to an imbalance between investment and consumption that can retard growth.

Economists have measured the effect of higher (in contrast to lower) individual personal income tax rates on economic growth and have debunked the myth that higher tax rates inherently retard economic growth and reduce revenue. No one disputes that taxes can be raised to a point that robs the best-off taxpayers of their incentive to earn the next dollar. However, there is plenty of room for dispute as to where that point is, and there is little, if any, evidence that marginal personal income tax rates have ever reached or exceeded that point.

In the practical world of personal income taxation, marginal tax rates have not exceeded 39.6% since 1987, and no credible player in the tax game is urging an increase much above that. Recent efforts to increase revenue by the Obama Administration concentrate on ending or curtailing tax preferences that especially benefit very high-income taxpayers, not by increasing marginal tax rates.

For a generation, a clique of evangelical economists have preached the gospel of the "Laffer Curve," a gospel which ordains that cuts in marginal tax rates will increase both economic growth and tax revenue. Conventional economists have disputed this gospel.

Once a tax has been levied and all relevant data relating to its economic effects has been evaluated by experts, the facts eventually emerge. With respect to the twin beliefs that taxes can be cut without sacrificing any significant loss of revenue and high marginal tax rates are inherently bad for economic growth, the facts speak for themselves.

As for tax cuts not sacrificing revenue, the Reagan and Bush tax-rate cuts both reduced revenue as a percentage of GDP by about 1.5% while the

Clinton tax-rate hikes increased revenue as a percentage of GDP by about 1.8%. As for the effect of these tax-rate cuts on spurring economic growth, in the eight years that followed the Clinton tax increases, GDP grew at an average annual rate of 3.65%; in the eight years that followed the Reagan tax cut, GDP grew at an average annual rate of 3.63%; and in the eight years that followed the Bush tax cuts, GDP grew at an average annual rate at 1.64%. So, contrary to the Laffer Curve gospel, the Reagan and Bush tax cuts did result in revenue loss while the Clinton tax increase did not prevent the economy from growing more than it did following the Reagan and Bush tax-rate cuts.

As for high marginal personal income tax rates discouraging economic growth relative to lower marginal rates, from 1946 through 2015, the top marginal rates ranged from 92% to 28% and annual GDP growth rates have ranged from -11.60% to 8.70%. Over this period, the top marginal rate was 50% or more for 40 years with the annual GDP growth rate averaging 3.20% while the top marginal tax rate was less than 50% for 30 years with the annual GDP growth rate averaging only 2.57%. So, there is no apparent correlation between economic growth rates and marginal personal income tax rates.

Facts, then, settled the argument (at least for most experts) in favor of the conventional economists (See the 2005 CBO Study published under the leadership of Douglas Holz-Eakin). As long as tax rates are not hiked above 50% (and maybe more) for the best-off, there is little (if any) credible evidence that economic growth would suffer. As a practical working principle for the personal income tax, tax-rate increases not exceeding 50% raise revenue and do not necessarily harm economic growth. For the time being, then, there is plenty of room for increasing personal income taxes on the best-off without quelling their thirst to make more money. The thirst to make money drives productivity.

The fancy of many tax cutters that tax-rate hikes almost always dampen economic growth and tax-rate cuts are almost always self-financing meshes nicely with the myth that Americans are over-taxed. All myths rest on some rationale that contains a seed of what seems to be an apparent truth. Even though the slightest scrutiny reveals that the apparent truth on which these myths rest is only a mirage, a mirage is good enough to support the belief of many. It is easy for many high-income taxpayers to believe these myths because they offer a compelling excuse to avoid paying higher taxes. For most, it is easier to believe that which is pleasant rather than that which is unpleasant, even if that which is unpleasant is true and that which is pleasant is false.

THE LAFFER CURVE

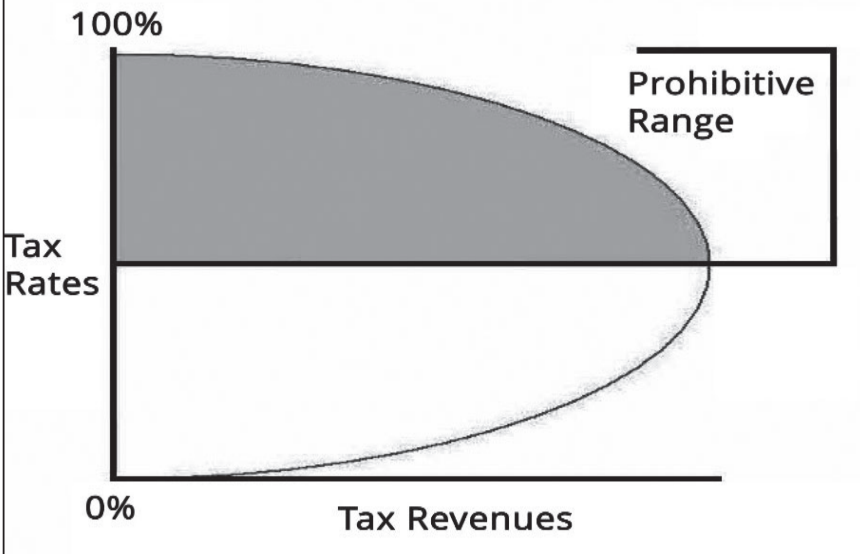
Although there is no factual evidence that tax-rate cuts cause increases in revenues and/or economic growth, there is factual evidence that they hardly ever cause any significant revenue loss either. However, correlation is not causation. So, it is worthwhile to examine the Laffer Curve and its rationale closely to see if there is a rational basis to believe that tax-rate cuts, in and of themselves, cause increases in both revenues and/or economic growth.

No one can explain the Laffer Curve better than its sire, Arthur Laffer, a leading conservative economist. In an article published by the Heritage Foundation in June 2004, Laffer described his offspring as follows:

"The Laffer Curve illustrates the basic idea that changes in tax rates have two effects on tax revenues: the arithmetic effect and the economic effect. The arithmetic effect is simply that if tax rates are lowered, tax revenues (per dollar of tax base) will be lowered by the amount of the decrease in the rate. The reverse is true for an increase in tax rates. The economic effect, however, recognizes the positive impact that lower tax rates have on work, output, and employment—and thereby the tax base—by providing incentives to increase these activities. Raising tax rates has the opposite economic effect by penalizing participation in the taxed activities. The arithmetic effect always works in the opposite direction from the economic effect. Therefore, when the economic and the arithmetic effects of tax-rate changes are combined, the consequences of the change in tax rates on total tax revenues are no longer quite so obvious."

In the same article, Laffer depicted the Laffer Curve as follows in Figure VIII-1.

Figure VIII-1
The Laffer Curve



Source: Arthur Laffer; An additional notation has been made to indicate the "Tax Rate Ceiling."

In the Laffer Curve, tax rates are the vertical axis; the tax base is the horizontal axis; and tax revenue is the amount shown where the curve traverses a perpendicular line extended from the horizontal axis. The extreme edge of the horizontal axis is the amount of tax revenue that would be realized absent at a given tax rate. The base of the curve begins at the intersection of the vertical and horizontal axes; it then arcs out to the edge of the horizontal axis; and finally, it arcs back to where the apex terminates on the vertical axis.

The tax-rate ceiling is where the outermost point on the curve meets the edge of the horizontal axis, and it marks the beginning of the prohibitive range which extends to the apex. According to the Laffer Curve, any tax rate below the tax-rate ceiling would cause tax revenues to rise arithmetically, and any tax rate above the tax-rate ceiling would causes tax revenues to fall as a result of the economic effect. With respect to his depiction of the Laffer Curve, Laffer made clear that it showed only a concept and did not predict the "exact levels of taxation corresponding to specific levels of revenues" as it relates to any particular tax or taxpayer. Since each tax and taxpayer have different characteristics, so too would the shape of the curve.

The location of both the tax-rate ceiling and the apex of the curve will vary according to the characteristics of each tax and taxpayer.

In describing how the Laffer Curve functions, Laffer said the following:

"At a tax rate of 0 percent, the government would collect no tax revenues, no matter how large the tax base. Likewise, at a tax rate of 100 percent, the government would also collect no tax revenues because no one would be willing to work for an after-tax wage of zero (i.e., there would be no tax base). Between these two extremes there are two tax rates that will collect the same amount of revenue: a high tax rate on a small tax base and a low tax rate on a large tax base. **The Laffer Curve itself does not say whether a tax cut will raise or lower revenues. Revenue responses to a tax rate change will depend upon the tax system in place, the time period being considered, the ease of movement into underground activities, the level of tax rates already in place, the prevalence of legal and accounting-driven tax loopholes, and the proclivities of the productive factors. If the existing tax rate is too high—in the 'prohibitive range' shown above—then a tax-rate cut would result in increased tax revenues.** [*emphasis added*] The economic effect of the tax cut would outweigh the arithmetic effect of the tax cut."

Laffer, being no fool, confined his rendition of the Laffer Curve to an abstraction that failed to offer a real-world example of what the tax-rate ceiling would be for a specific tax and taxpayer. Speculating in the abstract freed Laffer from the delicate issue of quantifying exactly where the prohibitive range begins for a particular tax and what the effect would be as tax rates for that tax travel along the prohibitive range curve. The quandary over what the tax-rate ceiling of a given tax is amounts to a current version of the age-old question: what straw will break the camel's back?

The Laffer Curve and the Personal Income Tax

The Laffer Curve attempts to explain the relationship between tax rates and tax revenues for all taxes, including sales taxes, property taxes, the corporate income tax, capital gains taxes, user fees, and, most importantly, the personal income tax. With respect to all of these taxes, the Laffer Curve makes the following two assertions:

- **First, if tax rates are raised above the tax-rate ceiling, then revenue will fall.**

- **Second, if tax rates above the tax-rate ceiling are lowered, then revenues will rise.**

These assertions are true but meaningless unless the tax-rate ceiling can be quantified with certainty. Without a precise tax-rate ceiling (which is verified by a consensus of experts) for the particular tax whose rates are being cut, the Laffer Curve contributes nothing to understanding how tax-rate changes affect tax revenue.

Concentrating on the personal income tax, the theory underlying the Laffer Curve contends that the more a taxpayer who works hard and smart is taxed the less the taxpayer will work which in turn will slow economic growth. So, if tax rates rise too high, taxpayers will not work as hard, and economic growth and tax revenues will suffer. To the extent that there is truth in this, Laffer Curve proponents bear the burden of explaining at what tax rate each income group of taxpayers will decide that chasing the next dollar just is not worth it and instead head for the hammock. Laffer Curve theory assumes that all taxpayers, rich and poor alike, make decisions about whether, and how hard, to work primarily based, if not exclusively, on if their tax rates are raised or lowered by a few percentage points which is a dubious assumption.

Common Sense and the Laffer Curve

It does not take a behavioral scientist or an economist to figure out that it is almost impossible to know what does and does not motivate workers to work harder and smarter and capitalists to invest more wisely than they are already doing. What motivates people to do more good things and fewer bad things affects many groups, including among others, employers who have to decide how best to motivate their employees, parents who have to decide how best to motivate their children, church leaders who have to decide how best to motivate their parishioners, teachers who have to decide how best to motivate their students, and doctors who have to decide how best to motivate their patients. If there were an easy answer about how best to motivate people of all classes to do better, then it would have been discovered long ago.

One commonsense generalization that can be made, however, is that although money (or put in classical terms, avarice) is a powerful motivator, it competes with other powerful motivators like the other six of Dante's seven deadly vices: pride, envy, wrath, sloth, gluttony, and lust. While avarice works as the primary motivator for many people much of the time, for others one or more of the other vices can be more powerful, and for everyone any of the vices can overpower any of the others at any time. So, it should be obvious that no one can state with any certainty what the primary motivator is for any particular person to do any particular thing at any particular time. Independently of what motivates a particular individual, some individuals are so self-motivated that they need no external motivation while others are immune to motivation of any kind. Predicting with any precision what the effects of any particular motivational factor will be on any individual or group is at best problematic.

Focusing on workers, they fall into a wide number of disparate categories, such as the following: some are highly skilled and work more with their brains than muscles and others do not; some have extensive education and others do not; some are innovative and others are not; some are highly disciplined and other are not; some are extroverted and others are not; some are mature and others are not; some get along with others and others do not; and some are self-directed and others are not. Given the many differences among workers, the notion that there is a single magic formula (money) which will make all workers work harder and smarter is a cruel fantasy.

Disciples of the Laffer Curve say that cutting tax rates by a few points will coax workers to work harder and smarter and capitalists to invest more wisely, and, as a result, everyone will be richer. If this were true, then by merely cutting tax rates by a few percentage points, Warren Buffet would become a wiser investor, Kevin Durant would sink a few more baskets, Tom Brady's passing percentage would go up, Al Pacino would pick up another Oscar or two, McDonalds' burger flippers would make tastier burgers, Stephen Hawking would develop the theory of everything, research scientists would discover the cure to cancer, policemen would catch more crooks, criminal defense lawyers would spring more crooks, teachers would teach better, students would learn more, and so on into infinity.

According to the Lafferites, cutting tax rates would make everyone work harder, and it would not cost anyone anything because the resulting economic growth would recoup the lost revenues leaving everyone to live happily ever after. It is truly a shame that like other getting-something-for-nothing myths, this myth too is false.

Commonsense Examples

To the extent tax cutting does affect worker and capitalist effort, the following four scenarios (each of which assumes a different annual income for a taxpaying household and a personal tax rate of 35% from the first dollar to the last dollar with no deductions or exemptions) help everyone use their own common sense to decide what does and does not make workers and capitalists up their game.

In Scenario #1, both spouses work in low-wage service jobs, and their combined annual income is $50,000. At a 35% tax rate, this household would pay $17,500 in taxes. A Scenario #1 household's income is barely above subsistence and cannot sustain itself without earning the next dollar even if it is taxed at 35%. The workers in this household have to work just to survive. There is no tax-rate ceiling at 35% for the Scenario #1 household.

In Scenario #2, both spouses work in professional jobs, and their combined annual income is $600 thousand. At a 35% tax rate, this household would pay $210 thousand in taxes. A Scenario #2 household maintains an upper middle-class standard of living and depending on its willingness to reduce its standard of living, could choose to work less. The workers in this household live to work and do not want to reduce their standard of living even if their income is taxed at 35%. There is no tax-rate ceiling at 35% for the Scenario #2 household.

In Scenario #3, one spouse works as an entertainer and the other is unemployed, and their annual income is $3 million. At a 35% tax rate, this household would pay $1.05 million in taxes. A Scenario #3 household maintains an upper-class standard of living, and depending on its willingness to reduce its standard of living, could choose to work much less. The entertainer in this household lives to work, and the couple does not want to reduce its standard of living even if its income is taxed at 35%. There is no tax-rate ceiling at 35% for the Scenario #3 household.

In Scenario #4, one spouse is a capitalist who owns an investment portfolio in excess of $3 billion and the other is unemployed, and their combined annual income is $275 million. At a 35% tax rate, this household would pay $96.25 million in taxes. A Scenario #4 household maintains a super-luxurious standard of living and invests what it does not spend. Except for overseeing his investments, the capitalist does not work for compensation and will not refuse to invest even if investment income is taxed at 35%. There is no tax-rate ceiling at 35% for the Scenario #4 household.

Notwithstanding the Laffer Curve, common sense says that adding or subtracting a few percentage points on the taxes of the workers and capitalist (as described in the four scenarios above) will not change much, if at all, the workers' work effort or the capitalist's investing wisdom. With respect to an increase in tax rates of a few percentage points, pity the worker whose work effort slackens; pity the employer who would tolerate an employee whose work effort slackens; pity the capitalist who refuses to invest as wisely as possible; and pity the economy whose workforce slackens their work effort and whose capitalists fail to invest as wisely as possible.

Facts vs. Economic Religion

Many Lafferites, probably excluding Laffer himself, are possessed of a religious-like faith in low tax rates as a panacea for whatever ails the economy, but the facts not only do not support their faith, rather they contradict it.

Table VIII-1 shows the highest marginal tax rates and annual GDP growth rates for the period 1946-2012.

Table VIII-1
Highest Marginal Personal Income Tax Rates and Annual GDP Growth Rates

Year	Highest Marginal Personal Income Tax Rate*	GDP Annual Growth Rate**	Year	Highest Marginal Personal Income Tax Rate*	GDP Annual Growth Rate**
1946	86.45%	-11.60%	1987	38.50%	3.50%
1947	86.45%	-1.10%	1988	28.00%	4.20%
1948	82.13%	4.10%	1989	28.00%	3.70%
1949	82.13%	-0.50%	1990	31.00%	1.90%

1950	91.00%	8.70%	1991	31.00%	-0.10%
1951	91.00%	8.10%	1992	31.00%	3.60%
1952	92.00%	4.10%	1993	39.60%	2.70%
1953	92.00%	4.70%	1994	39.60%	4.00%
1954	91.00%	-0.60%	1995	39.60%	2.70%
1955	91.00%	7.10%	1996	39.60%	3.80%
1956	91.00%	2.10%	1997	39.60%	4.50%
1957	91.00%	2.10%	1998	39.60%	4.50%
1958	91.00%	-0.70%	1999	39.60%	4.70%
1959	91.00%	6.90%	2000	39.60%	4.10%
1960	91.00%	2.60%	2001	38.60%	1.00%
1961	91.00%	2.60%	2002	38.60%	1.80%
1962	91.00%	6.10%	2003	35.00%	2.80%
1963	91.00%	4.40%	2004	35.00%	3.80%
1964	77.00%	5.80%	2005	35.00%	3.30%
1965	70.00%	6.50%	2006	35.00%	2.70%
1966	70.00%	6.60%	2007	35.00%	1.80%
1967	70.00%	2.70%	2008	35.00%	-0.30%
1968	75.25%	4.90%	2009	35.00%	-2.80%
1969	77.00%	3.10%	2010	35.00%	2.50%
1970	71.75%	0.20%	2011	35.00%	1.60%
1971	70.00%	3.30%	2012	35.00%	2.20%
1972	70.00%	5.20%	2013	39.60%	1.50%
1973	70.00%	5.60%	2014	39.60%	2.40%
1974	70.00%	-0.50%	2015	39.60%	2.40%
1975	70.00%	-0.20%			
1976	70.00%	5.40%			
1977	70.00%	4.60%			
1978	70.00%	5.60%			
1979	70.00%	3.20%			
1980	70.00%	-0.20%			
1981	69.13%	2.60%			
1982	50.00%	-1.90%			
1983	50.00%	4.60%			
1984	50.00%	7.30%			

1985	50.00%	4.20%			
1986	50.00%	3.50%			
Average GDP Annual Growth Rate		3.20%			2.57%
Source: Data extracted from the following:					
* Eugene Steuerle, As The Urban Institute; Joseph Pechman, Federal Tax Policy; Joint Committee on Taxation, Summary of Conference Agreement on the Jobs and Growth Tax Relief Reconciliation Act of 2003, JCX-54-03, May 22, 2003.					
** Bureau of Economic Analysis.					

Table VIII-1 establishes the following:

- The annual GDP growth rate averaged 3.2% over a 40-year period from 1946-1986 when the highest marginal personal income tax was 50% or greater and ranged up to 91%.

- The annual GDP growth rate averaged 2.6% over a 25-year period from 1986-2011 when the highest marginal personal income tax was 39.6% or less and ranged from down to as low as 28%.

- When the highest marginal tax rate was 50% or greater, the annual GDP growth rate exceeded 5% thirteen times.

- When the highest marginal rate was less than 50%, the annual GDP growth rate never exceeded 4.8%.

While it would be foolish to conclude from these statistics that high marginal tax rates promote economic growth, it would be even more foolish to conclude that lowering marginal tax rates will always (or even usually) lead to increased economic growth. Tax rates are only one piece of a complicated puzzle that must be solved for growth to prosper.

The Laffer Curve and the Clinton Tax Increases

Facing a growing national debt in 1993, President Clinton convinced Congress to enact a tax increase. Increasing the top two tax rates from 31% to 36% and from 35% to 39.6% (which took effect in 1994) was the centerpiece of the Clinton tax increase. Hitting the top two tax rates only affected the highest income taxpayers, primarily those in the top one percent. According to the Lafferites, it is the economic efforts of the highest-income earners that in large measure drive economic growth, and if these efforts are over-taxed, economic growth would suffer, and everyone would be poorer for it. Slowed economic growth, moreover, would result in reduced, not increased, tax revenues.

The Clinton tax increases presented an excellent case to test the Laffer Curve premise that tax increases (particularly on the most productive) harm both economic growth and tax revenue. Although Laffer himself had ten years of data to assess whether the Laffer Curve applied to the Clinton tax increases, he bypassed the opportunity in his 2004 article. If the Clinton tax increase had resulted in reducing both economic growth and tax revenues, then the application of the Laffer Curve would have been validated, but if economic growth and tax revenues increased, then it would be invalidated.

Table VIII-2 includes the tax and economic metrics as follows:

Table VIII-2
For the Years 1987-2001
Personal Income Tax Revenues as % of GDP, Share of Adjusted Gross Income Total of Top 1%, Share of Personal Income Tax Paid by Top 1%, Average Effective Tax Rate of Top 1%, Annual Increase (Year over Year) on Income Tax Paid by Top 1%, and Annual GDP Growth Rate.

Year	Personal Income Tax Revenue as % of GDP*	Share of Adjusted Gross Income Total of Top 1%**	Share of Personal Income Tax Paid by Top 1%**	Average Effective Tax Rate of Top 1%**	Annual Increase (Year over Year) on Income Tax Paid by Top 1%**	Annual GDP Growth Rate***
1989	8.3%	14.19%	25.24%	23.34%	-4.02%	3.5%
1990	8.1%	14.00%	25.13%	23.25%	2.82%	1.9%

1991	7.9%	12.99%	24.82%	24.37%	-.95%	-0.2%
1992	7.6%	14.23%	27.54%	25.05%	17.87%	3.3%
1993	7.7%	13.79%	29.01%	28.01%	11.19%	2.7%
1994	7.8%	13.80%	28.86%	28.23%	05.83%	4.0%
1995	8.0%	14.60%	30.26%	28.73%	15.36%	2.5%
1996	8.5%	16.04%	32.31%	28.87%	19.43%	3.7%
1997	9.0%	17.37%	33.17%	27.64%	13.46%	4.5%
1998	9.6%	18.47%	34.75%	27.12%	13.58%	4.2%
1999	9.6%	19.51%	36.18%	27.53%	15.84%	4.5%
2000	10.2%	20.81%	37.42%	27.45%	15.60%	3.7%
2001	9.7%	17.53%	33.89%	27.50%	-18.00%	0.8%
Source: Data extracted from the following:						
* 2016 OMB Budget Historical Table 2.3 Receipts by Source of Revenue as Percentage of GDP.						
** IRS Historical Tax Data, Table 5.–Returns with Positive Adjusted Gross Income (AGI):Number of Returns, Shares of AGI and Total Income Tax, AGI Floor on Percentiles in Current and Constant Dollars, and Average Tax Rates, by Selected Descending Cumulative Percentiles of Returns Based on Income Size Using the Definition of AGI for Each Year, Tax Years 1986-2009.						
*** Bureau of Economic Analysis.						

Comparing the economic and tax metrics for the five years preceding and following the 1994 effective date for the Clinton tax increase (as shown in Table VIII-2) reveals the following:

- Personal income tax revenue averaged 7.92% of GDP for the five-year period before the Clinton tax increase took effect and 8.58% for the five-year period afterward.

- The share of adjusted gross income for the top 1% averaged 13.84% of GDP for the five-year period before the Clinton tax increase took effect and 16.06% for the five-year period afterward.

- The share of personal income tax paid by the top 1% averaged 26.35% of GDP for the five-year period before the Clinton tax increase took effect and 31.87% for the five-year period afterward.

- The average effective tax rate of the personal income tax paid by the top 1% averaged 24.80% of GDP for the five-year period before the Clinton tax increase took effect and 28.12% for the five-year period afterward.

- The annual increase (year over year) of the personal income tax paid by the top 1% averaged 5.38% of GDP for the five-year period before the Clinton tax increase took effect and 13.53% for the five-year period afterward.

- The annual growth rate of GDP averaged 2.24% for the five-year period before the Clinton tax increase took effect and 3.78% for the five-year period afterward.

These comparisons of economic and tax metrics show that after increasing the marginal rates on those in the top 1% of personal income:

- personal income tax revenue increased,

- the share of adjusted gross income continued to concentrate in the top 1%,

- the share of personal income tax paid by the top 1% increased by an average of 5.52% percentage points,

- the average effective tax rate of the top 1% increased by 3.32% percentage points,

- the percentage of annual growth (year over year) in the income tax paid by the top 1% increased on average 8.15% percentage points, and

- The average annual GDP growth rate increased by an average of 1.54 percentage points.

Taken altogether, these metrics prove that the Clinton tax increase did not deter the top 1% from grubbing for the next dollar or increasing their share of total income. Despite the tax increase, the top 1% chose greed over more hammock time. Based on the data, there is no reason to suppose that the

Laffer Curve had any relevance as a metric regarding the Clinton tax rate increase.

DYNAMIC SCORING

The real-world example of increased economic growth and revenue springing out of the Clinton tax increase of 1993 did not seem to discourage the faith of many of the Lafferites in tax cuts as the pathway to economic growth. Two Lafferites, D. Mark Wilson and William W. Beach, wrote an article in 2001 (published by the Heritage Foundation) evangelizing for the enactment of the tax cuts proposed by President George W. Bush in 2001. In their article, Wilson and Beach gave witness to their faith that the Bush tax cuts promised an almost cost-free, cure-all to promote a growing economy and healthy governmental budget. Wilson and Beach diss what they call "static" budget estimates relating to tax cuts and their effects on tax revenues in favor of a "dynamic" approach, and then they compare the two approaches as follows:

"Dynamic tax analysis attempts to capture the many ways that taxpayer behavior changes following a significant tax policy change. For example, dramatic decreases in the taxes on labor or capital will cause more labor or capital to be employed in productive activities. A business owner who knows that his or her own labor will be taxed less may work more; a non-employed spouse may seek work outside the home once the taxes on labor fall. Overall, additional labor or capital can spur the economy to higher levels of output, which causes a growth in tax revenues as a result of the expansion of the tax base. Those who employ static analysis, like the Center on Budget and Policy Priorities and Citizens for Tax Justice, assume that taxpayers will not alter their behavior in the face of significant tax policy changes. Thus, a major drop in taxes produces no additional labor or new uses of capital, just a drop in federal revenues."

"Dramatic," as used by Wilson and Beach, makes all the difference. Stripped of the accompanying verbiage, dramatic is just another take on the Laffer Curve whose mantra teaches that the best way to raise tax revenue is to spur economic growth by liberating labor and capital from oppressive taxes. Like the Laffer Curve's tax ceiling, exactly when taxes become so oppressive as to slow growth is a question Wilson and Beach do not answer.

For dynamic scoring to apply, it must be proven that the tax rate to be cut was so high that taxpayers had already chosen leisure over money-making. Otherwise, cutting tax rates only reduces tax revenue dollar for dollar. The prevailing tax rates prior to the Bush tax cuts ranged from a top rate of 39.6% to a low rate of 15%. The Bush tax cuts reduced existing rates across the board by lowering the top rate to 35% and the bottom rate to 10%. In their article, Wilson and Beach inferred that the tax rates that preceded the Bush tax cuts had so burdened labor and capital that by lifting that burden the Bush tax cuts would result in more growth and tax revenue.

If Wilson's and Beach's inference was correct that the pre-Bush tax rates were oppressing labor and capital, then the Bush tax cuts would in part be self-financing, but if the pre-Bush tax rates were not oppressive, then the tax cuts would increase the national debt dollar for dollar.

In predicting the effects of the Bush tax cuts, Wilson and Beach relied on an economic model concocted by Heritage Foundation economists that included assumptions reflecting "dynamic responses" to the Bush tax cuts. These dynamic responses—presumably the incentives for increased productivity—were not specified. Since models are no better than their assumptions, the accuracy of the Heritage Foundation dynamic model depended on the validity of the undisclosed assumptions. In their article, Wilson and Beach made a number of predictions of the economic and tax revenue effects of the Bush tax cuts, including specific estimates of GDP growth rates and tax revenues.

Table VIII-3 compares the estimates of the effects of the Bush tax cuts predicted by the Heritage Foundation model with what happened.

Table VIII-3
Comparison of Estimates of Total Tax Revenue (as a % of GDP) and Annual GDP Growth Rates (prepared by Heritage Foundation Center for Data Analysis) with Actual Data as Obtained from OMB in the 2013 Historical Tables and the BEA

Year	Estimated Total Tax Revenue (as a % of GDP)	Actual Total Tax Revenue (as a % of GDP)	Shortfall of Estimated Total Tax Revenues to Actual Total Tax Revenues	Estimated Annual GDP Growth Rate	Actual Annual GDP Growth Rate	Shortfall of Estimated Annual GDP Growth Rate
2001	20.8%	19.5%	1.3%	2.8%	1.1%	1.70%
2002	20.9%	17.6%	3.3%	3.3%	1.8%	1.50%
2003	20.7%	16.2%	4.5%	3.7%	2.5%	1.20%
2004	20.3%	16.1%	4.2%	3.4%	3.5%	-0.10%
2005	19.8%	17.3%	2.5%	3.3%	3.1%	0.20%
2006	19.4%	18.2%	1.2%	3.2%	2.7%	0.50%
2007	19.3%	18.5%	0.8%	3.1%	1.9%	1.20%
2008	19.6%	17.6%	2.0%	3.1%	-0.3%	3.40%
2009	21.3%	15.1%	6.2%	3.1%	-3.1%	6.20%

Source: Tax Estimates prepared by Heritage Foundation Center for Data Analysis as published in article prepared by Mark Wilson and William V. Beach, April 27, 2001; Tax Revenue Data extracted from 2016 OMB Budget Historical Table 2.3 Receipts by Source of Revenue as Percentage of GDP; and GDP data extracted from BEA.

Table VIII-3 shows, leaving aside 2001 before the Bush tax cuts took effect and 2008 and 2009 when the Great Recession skewed the data, the following:

- Actual annual total tax revenues lagged estimated annual total tax revenues by as much as 4.5% of GDP and as little as .8%.

- Actual annual GDP growth rates lagged estimated annual GDP growth rates significantly each year except for a small increase in 2004.

Theory is one thing and reality another. The estimates of the total annual tax revenues and annual GDP growth rates made by Wilson and Beach were not only off but out of the ballpark. **The cost of their error was an increase in the national debt from 56.4% of GDP in 2001 to 69.7% of GDP in 2008—a 23.4% increase in just seven years.**

Reality has rendered a verdict on the viability of the Heritage Foundation dynamic model as a metric for estimating tax revenue and economic growth in response to changes in tax rates; the verdict is GIGO, garbage in, garbage out.

Jobs and Taxes

Economic growth is an abstract idea to most wage earners, but jobs are real. With all the talk about the necessity of low tax rates for growth, wage earners are interested in the effect of tax rates and the level of taxes on jobs.

Table VIII-4 tracks the relationship between tax rates and unemployment percentages for the period 1948 through 2015.

Table VIII-4
Highest Marginal Personal Income Tax Rates and Annual Average Unemployment Percentages
From 1948 – 2015

Year	Highest Marginal Personal Income Tax Rate*	Average Annual Unemployment Rate**	Year	Highest Marginal Personal Income Tax Rate*	Average Annual Unemployment Rate**
1948	82.13%	3.75%	1987	38.50%	6.18%
1949	82.13%	6.05%	1988	28.00%	5.49%
1950	91.00%	5.21%	1989	28.00%	5.26%
1951	91.00%	3.28%	1990	31.00%	5.62%
1952	92.00%	3.03%	1991	31.00%	6.85%
1953	92.00%	2.93%	1992	31.00%	7.49%
1954	91.00%	5.59%	1993	39.60%	6.91%
1955	91.00%	4.37%	1994	39.60%	6.10%
1956	91.00%	4.13%	1995	39.60%	5.59%
1957	91.00%	4.30%	1996	39.60%	5.41%

1958	91.00%	6.84%	1997	39.60%	4.94%
1959	91.00%	5.45%	1998	39.60%	4.50%
1960	91.00%	5.54%	1999	39.60%	4.22%
1961	91.00%	6.69%	2000	39.60%	3.97%
1962	91.00%	5.57%	2001	38.60%	4.74%
1963	91.00%	5.64%	2002	38.60%	5.78%
1964	77.00%	5.16%	2003	35.00%	5.99%
1965	70.00%	4.51%	2004	35.00%	5.54%
1966	70.00%	3.79%	2005	35.00%	5.08%
1967	70.00%	3.84%	2006	35.00%	4.61%
1968	75.25%	3.56%	2007	35.00%	4.62%
1969	77.00%	3.49%	2008	35.00%	5.80%
1970	71.75%	4.98%	2009	35.00%	9.28%
1971	70.00%	5.95%	2010	35.00%	9.61%
1972	70.00%	5.60%	2011	35.00%	8.93%
1973	70.00%	4.86%	2012	35.00%	8.08%
1974	70.00%	5.64%	2013	39.60%	7.37%
1975	70.00%	8.48%	2014	39.60%	6.17%
1976	70.00%	7.70%	2015	39.60%	5.26%
1977	70.00%	7.05%			
1978	70.00%	6.07%			
1979	70.00%	5.85%			
1980	70.00%	7.18%			
1981	69.13%	7.62%			
1982	50.00%	9.71%			
1983	50.00%	9.60%			
1984	50.00%	7.51%			
1985	50.00%	7.19%			
1986	50.00%	7.00%			
Average		5.66%			6.05%

Source: * Data extracted from Table VIII-1.
** Data extracted from BLS Unemployment Rate Report, dated February 8. 2017.

Table VIII-4 establishes the following:

- in the 38 years from 1948 through 1986 (when the highest tax rate was 50% or more) the average unemployment rate was 5.66%, and

- in the 28 years from 1987 through 2015 (when the highest tax rate was 39.6% or less) the average unemployment rate was 6.05%.

While correlation does not prove causation, it seems likely that unemployment percentages would have been lower during the 28 low tax years than during the 38 high tax years if low tax rates were the key to keeping unemployment low. Surprisingly, at least to the Lafferites, the average annual unemployment percentage was noticeably lower for the high tax years than the low tax years.

As further evidence that taxes and tax rates are not the only factors that determine the number of jobs in the economy, the number of jobs increased dramatically after both the Clinton tax increase in 1993 and the Obama tax increase in 2012. In the case of Clinton, the number of jobs created after the tax increase was 23.6 million, and in the case of Obama, the number of jobs created after the increase was 10 million. Further indicating that tax cuts are not the be all and end all to job creation, only about 2.5 million jobs were created after the Bush tax cuts of 2003.

What leads to economic growth and job creation is far more complex than whether tax rates and taxes go up or down. Common sense says that a well-educated and well-motivated workforce is more likely to have less unemployment than a poorly educated and poorly motivated workforce even if taxes are high.

History of Personal Income Tax Revenues

Facts can only be overcome by faith, and Table VIII-5 lays out the facts regarding personal income tax revenues from 1946-2011.

Table VIII-5 Personal Income Tax Revenue as a % of GDP: 1946-2011					
Year	Personal Income Tax % of GDP	Year	Personal Income Tax % of GDP	Year	Personal Income Tax % of GDP
1946	7.2%	1969	9.2%	1991	7.9%
1947	7.7%	1970	8.9%	1992	7.6%
1948	7.5%	1971	8.0%	1993	7.7%
1949	5.7%	1972	8.1%	1994	7.8%
1950	5.8%	1973	7.9%	1995	8.0%
1951	6.8%	1974	8.3%	1996	8.5%
1952	8.0%	1975	7.8%	1997	9.0%
1953	8.0%	1976	7.6%	1998	9.6%
1954	7.8%	TQ	8.4%	1999	9.6%
1955	7.3%	1977	8.0%	2000	10.2%
1956	7.5%	1978	8.2%	2001	9.7%
1957	7.9%	1979	8.7%	2002	8.1%
1958	7.5%	1980	9.0%	2003	7.2%
1959	7.5%	1981	9.4%	2004	6.9%
1960	7.8%	1982	9.2%	2005	7.5%
1961	7.8%	1983	8.4%	2006	7.9%
1962	8.0%	1984	7.8%	2007	8.4%
1963	7.9%	1985	8.1%	2008	8.0%
1964	7.6%	1986	7.9%	2009	6.6%
1965	7.1%	1987	8.4%	2010	6.3%
1966	7.3%	1988	8.0%	2011	7.3%
1967	7.6%	1989	8.3%		
1968	7.9%	1990	8.1%		
Source: Data extracted from 2016 OMB Budget Historical Table 2.3 Receipts by Source of Revenue as Percentage of GDP					

There were major tax cuts in 1981, 2001, and 2003, and there were significant tax increases in 1982 and 1983, and a major tax increase in 1994. For those believers in dynamic scoring, Table VIII-5 shows that (1) tax revenues fell after taxes were cut in 1981 (except for 1985 which reflected minor tax increases in 1982 and 1983) until taxes were raised in 1994, (2) tax revenues rose after taxes were raised in 1993 until when taxes were cut in 2002 and 2003, and (3) tax revenues fell after taxes were cut in 2001 and 2003. Neither the Reagan nor the Bush tax cuts were self-financing, and both were financed by increasing the national debt. **Lessons: In the real world of tax-rate changes, tax cuts reduce revenue, and tax increases raise revenue.**

A Non-Partisan View on Low Tax Rates

Congress created the CBO in 1974 for the purpose of providing it with expert, non-partisan advice on economic and tax policy. Over the years, CBO has earned a reputation with both political parties for acting as both a competent and honest broker on policy no matter which party controls Congress. As such, CBO reports carry great credibility in the sphere of public finance.

In 2005, the CBO published a study titled, "Analyzing the Economic and Budgetary Effects of a 10 percent Cut in Income Tax Rates," under the leadership of its director, Douglas Holtz-Eakin, a conservative Republican. The purpose of the study was to analyze the economic growth and tax revenue effects of a ten-year, ten percent across-the-board cut in all personal income tax rates without any other changes in taxing or spending.

With respect to an unpaid-for tax cut, the study sought to answer two questions:

- **Would it cause an increase in economic growth?**
- **Would it cause an increase in tax revenues that would wholly or partially offset revenue losses?**

As background, the CBO pointed out various factors that affect economic and tax policy as follows:

"Changes in marginal tax rates and changes in after-tax incomes affect people's choices about how they divide their time between work and leisure and how they divide their income between consumption and saving. Those choices in turn affect the amount of labor and productive capital available to generate economic output. Tax policy also influences overall demand for goods and services, which affects output in the short run. Finally, tax policy affects the composition and level of output by changing the relative returns to different economic activities. All those economic effects in turn influence the federal budget."

Identifying relevant factors leads to nothing unless they are quantified, and quantifying them means that assumptions must be made. For purpose of its analysis, CBO first established a tax revenue loss and economic growth baseline by using (1) the estimate made by the JCT that the tax cut would cause a loss of $1.241 trillion in tax revenues over ten years and (2) existing estimates of Gross National Product, aka GNP, growth rates (CBO used GNP as opposed to the more commonly used GDP for technical reasons relating to the flow of capital across national borders). Having established a baseline, CBO then compared the estimated tax revenue and economic growth effects of the tax cut to the baseline.

In making its estimates, CBO described the assumptions that it used as follows:

"CBO's analysis depends upon assumptions about how people and firms respond to changes in tax policy. Those assumptions are embodied in systems of equations referred to as 'economic models.' The estimated effects of the tax cut vary depending on which particular set of assumptions is used. Because there is insufficient evidence to conclusively identify which set of assumptions provides the most accurate estimates, CBO employed a number of such sets, which generated a range of results. However, that range does not span the possible effects of the tax cuts because people's behavior may differ from CBO's assumptions.

One important assumption concerns the degree of foresight and planning that households employ in making their economic decisions. Empirical evidence on that issue is mixed, so CBO employed three different assumptions regarding foresight. In the first ('no foresight'), households do not plan ahead and therefore respond only to current tax policy. Lower tax rates on labor encourage more labor supply, which tends to increase output. However, the tax cut also leads to higher consumption, which tends to reduce investment and the stock of productive capital and therefore decrease output. On net, this approach indicates that the tax cut, if implemented, would raise the level of output by 0.2 percent over the first five years on average and reduce it by 0.1 percent over the second five years.

Under the second assumption about foresight ('lifetime foresight'), households look forward and plan for what they expect to happen during their lifetimes. The final assumption ('unlimited foresight') assumes that households plan for the welfare of their descendants as well as their own. That means all future events, no matter how distant, can affect current behavior.

When people plan ahead in making their decisions, they must implicitly evaluate how the budget will be stabilized in the long run despite the lower tax receipts. Many different types of spending cuts and tax increases are possible. CBO used two simple assumptions to give some sense of the outcomes: in some simulations, the tax cut was ultimately followed by decreases in government spending on goods and services; in others, the tax cut was ultimately reversed through an increase in marginal tax rates. In each case, the balancing policies were phased in beginning 10 years after the initial tax cut.

In general, the analysis suggests that people would tend to work and save more during the first 10 years if they expected that tax rates would ultimately rise. The expectation of an eventual tax increase encourages people to work and save more in the meantime to prepare. In addition, people may shift some of their hours of work into the period with lower tax rates to take advantage of the higher after-tax wages. By contrast, under the assumptions used in this analysis, lower government spending on goods and services leaves more resources available for private consumption, so those who expect spending to fall in the future feel less need to work and save in the meantime.

Once the financing policy is implemented, however, the economic implications are reversed: an increase in tax rates will discourage work and saving once it occurs, implying relatively less output in the long run, whereas a cut in government spending on goods and services frees resources for both consumption and investment, implying relatively more output in the long run.

CBO also tested how the estimates are affected by the degree to which the U.S. economy is assumed to be open to flows of goods and finance from other countries: some simulations assumed capital could flow freely into and out of the country, whereas others assumed capital was immobile.

Under the different assumptions about foresight and the openness of the country to capital flows, the tax cuts are projected to increase output from 0.5 percent to 0.8 percent on average over the first five years and from 0.2 percent to 1.1 percent over the second five years. The estimates are most positive when the tax cut is expected to lead to future increases in tax rates and when people form their plans with maximum foresight."

Those assumptions imply that people fully anticipate a permanent future rise in taxes and thus increase saving and work effort accordingly.

In the no foresight scenario, CBO estimated that (1) tax revenue losses would be $33 billion more than the $1.241 trillion estimated by the JCT and (2) GNP would grow .1% faster than otherwise. So, without assuming that taxpayers would behave during the ten-year tax cut period as if they knew what tax and spending policy would follow thereafter, an additional $33 billion in tax revenues would be lost and the GNP growth rate would not be materially affected.

Only by assuming that taxpayers would work and invest on the basis of their presuming that certain tax and spending policies would follow the ten-year tax cut could CBO tease out any offsetting revenues. Using the unlimited foresight scenario with a tax increase to follow the ten-year tax cut, CBO estimated that there would be $245 billion in revenues to partially offset the $1.241 trillion revenue loss. All other foresight scenarios used by CBO resulted in less offsetting revenues than the $245 billion estimate.

Importantly, CBO omitted pointing out that if tax rates were increased in the period following the ten-year tax cut then economic growth would suffer when that tax increase went into effect. So, the $245 billion of offsetting revenues due to the ten-year tax cut would have been bought at the price of borrowing against the future. A slight boost in tax revenues during the ten-year tax cut would be paid for by the next generation of taxpayers—just another intergenerational transfer of wealth. The foresight assumption scenarios defy common sense. It is no more reasonable to assume that taxpayers will make today's economic decisions based on what they believe tax and spending policy will be ten years out than that they would make vacation plans ten years out based on a ten-year weather forecast. Stripped of unrealistic assumptions, CBO answered the two questions by finding that the unpaid, ten-year tax cut failed to produce either any offsetting tax revenues or any material increase to economic growth.

Final verdict on dynamic scoring: It is a fraud.

TAX CUTS: THEORY & REALITY

The Congressional Research Service, aka CRS, is an agency of the Library of Congress that was created for the purpose of conducting research and analysis on all issues of national policy for members of Congress and congressional committees. As with the CBO, the CRS has a reputation for providing accurate and non-partisan reports and is well respected by both parties. The CRS does not make legislative or policy decisions but confines its role to providing information for the benefit of policymakers.

In 2012, the CRS prepared a study of the inter-relationship of tax rates, economic growth, and income concentration. The CRS described the purpose of the study as follows:

"Advocates of lower tax rates argue that reduced rates would increase economic growth, increase saving and investment, and boost productivity (increase the economic pie). Proponents of higher tax rates argue that higher tax revenues are necessary for debt reduction, that tax rates on the rich are too low […] and that higher tax rates on the rich would moderate increasing income inequality (change how the economic pie is distributed). This report attempts to clarify whether or not there is an association between the tax rates of the highest income taxpayers and economic growth."

The study reached the following conclusions:

"Throughout the late-1940s and 1950s, the top marginal tax rate was typically above 90%; today it is 35%. Additionally, the top capital gains tax rate was 25% in the 1950s and 1960s, 35% in the 1970s; today it is 15%. The real GDP growth rate averaged 4.2% and real *per capita* GDP increased annually by 2.4% in the 1950s. In the 2000s, the average real GDP growth rate was 1.7% and real *per capita* GDP increased annually by less than 1%. There is not conclusive evidence, however, to substantiate a clear relationship between the 65-year steady reduction in the top tax rates and economic growth. Analysis of such data suggests the reduction in the top tax rates have had little association with saving, investment, or productivity growth. However, the top tax rate reductions appear to be associated with the increasing concentration of income at the top of the income distribution. The share of income accruing to the top 0.1% of U.S. families increased from 4.2% in 1945 to 12.3% by 2007 before falling to 9.2% due to the 2007-2009 recession. **The evidence does not suggest necessarily a relationship between tax policy with regard to the top tax rates and the size of the economic pie, but there may be a relationship to how the economic pie is sliced** [*emphasis added*]."

CBO and CRS, as non-partisan experts, have disappointed many of faith by concluding that neither dynamic scoring nor low tax rates can pay down the national debt and ignite economic growth. No magic will get these things done; only tough policy choices followed up with sustained effort will pay down the national debt and spark economic growth. Although many of faith will be disappointed by these conclusions, it is unlikely that their faith will be shaken. After all, the Easter Bunny, Santa Claus, and the Tooth Fairy have survived just fine in the age of science.

Final verdict on low tax rates as the key to economic growth: It is a fraud.

JUNKING IDEOLOGY IN FAVOR OF COMMON SENSE IN TAX POLICY

Since the Reagan tax cuts of 1981, a number of politicians (who are always influential and sometimes controlling in the playing of the tax game) have pushed policies based on the premise that most of the rich will get off their butts and work harder best if the government offers them carrots, and most of the poor will get off their butts and work harder only if they are beaten with sticks. The carrots for the rich include tax cuts, and the sticks for the poor include cutting, or better yet, taking away all their food stamps, unemployment benefits, subsidized school lunches, child-care subsidies, and other income support programs. For the most part, these politicians rely on (1) the Laffer Curve and Dynamic Scoring theories as the basis for keeping taxes low as an incentive for the rich and (2) the belief that income support programs encourage the poor to wallow in governmental dependency in order to avoid work as the basis for cutting income support programs for the poor.

Paul Ryan, former Speaker of the House and conservative economic spokesman, personifies the carrots for the rich and sticks for the poor theory of taxing and spending. As a rationale for this policy, Ryan cites Ayn Rand's objectivist economic theory, libertarianism on steroids. Ayn Rand's theories, in short, preach that if you are smart and play the money-making game well you should get to keep ALL of your winnings, and if you are a loser at money-making, you can starve; this approach, Rand's disciples argue, improves the stock of money-makers by getting rid of the weak and frail so that the strong can thrive. For much of the last generation, Ryan's theories, as embodied by his budgetary handiwork, the "Pathway to Prosperity," prevailed among many politically conservative politicians. Ryan's theories provided the rationale for many of the politicians who consistently voted to cut taxes that disproportionately benefitted the best-off and cutting income support programs that disproportionately benefitted the worst-off.

Distilled to its essence, this carrot and stick belief boils down to economic rewards best induce the rich to work harder and economic punishment best induces the poor to work harder. For this belief to be true, the believers should be able to prove that there is a difference in the DNA of the rich and poor that accounts for why rewards motivate the rich but not the poor and punishment motivates the poor but not the rich when it comes to grubbing for the next dollar. To date, however, no such convincing proof has been offered, and common sense refutes it.

From a commonsense point of view, human beings, rich and poor alike, share the same human traits in that some of each are industrious and some lazy, some are successful and some unsuccessful, some are moral and some immoral, some are attractive and some ugly, some are healthy and some unhealthy, some are lucky and some unlucky, and so forth. Siblings in the same families are often quite different even though they carry many of the same genes. In the absence of proof to the contrary, the working premise should be that all of us are motivated to work harder by a number of personal traits with some of us responding to some stimuli while others of us responding to different ones. As for the universe of personal traits that influence behavior, Dante's Seven Deadly Vices (pride, envy, wrath, sloth, avarice, gluttony, and lust) run the gamut. To suggest that greed, in the form of economic rewards and punishments, overrides the rest is at best presumptuous.

The tools available in tax policy to make people work harder are complicated to figure out. No doubt greed (in the form of monetary rewards and punishments) induces some rich and poor alike to work harder, but other traits also induce rich and poor alike to work harder. Some work harder out of pride to show that they are better than others; some work harder out of envy to make sure that they have as much or more than others; some work harder or do not work at all as a means of venting their anger; some are lazy and will not work regardless of the incentives; and some work harder to support their appetites. The problem is that no one knows for sure what, in any particular instance and for any particular individual, does and does not make a person work harder. Given this uncertainty about what makes a person work harder, those who set policy in the playing of the tax game should be careful not to let their ideological biases dictate policy.

So, in the playing of the tax game, little weight should be accorded to either carrots for the rich or sticks for the poor. All taxing and spending policies should be based on an analysis of what effect each such policy will have on America's economic growth and social equity. Facts as applied by reason, not beliefs based on blind faith, should control.

CHAPTER 10

THE MYTH OF JOB CREATION

Myth: Taxes cannot be increased on the very best-off, "job creators" as called by some, without losing jobs.
Reality: If government does not tax the very best-off enough to provide an enabling environment for businesses and workers, businesses and workers will suffer, and jobs will be lost.
The old adage, "It takes money to make money," is as true in tax policy as it is in business. In tax policy, however, the old adage can be rephrased to say, "it takes public investment paid for by higher taxes on the very best-off for businesses to make money."

Job Creation & Public Investments • Business Must Have an Enabling Environment • Tax Revenue as an Instrument of National Power • Taxation, Investment, & Consumption • Small Business and Job Creation • Tax Rates and Job Creation

JOB CREATION & PUBLIC INVESTMENTS

Making a myth that uniquely caters to the interests of the very best-off (roughly the top 1% in income and wealth), while at the same time appealing to many who live in despair because of having no job or living in fear of losing their job, challenges the imagination of mythmakers. But, the myth-makers have proven up to the challenge. The proposition that the very best-off cannot pay more taxes without slowing economic growth and costing the loss of jobs is an article of faith cherished by many tax-cutters, the leading missionary of which is the former Speaker of the House Paul Ryan who previously served as the Chairman of the House Budget Committee. As a rationale for this belief, the tax-cutters argue that many small business owners (whose businesses are organized as S corps and whose business profits are taxed at personal income tax rates) are robbed of their incentive to create more jobs because they pay taxes at a rate up to 37%. This rationale, however, ignores the facts that (1) owners of small businesses make up only a small portion of those who pay personal income taxes at a 37% rate, and (2) there is no clear evidence that a 37% rate costs jobs.

As with all myths, this myth contains a grain of truth, but a deceptively tiny grain of truth: anyone can be taxed at a level where they will not work for the next dollar, but taxing to pay for public investments to enable businesses and workers to compete globally does not require taxing at anywhere near that level. Like a business owner who takes money out of the business for a vacation instead of upgrading the business's computer system endangers the business's ability to compete, cutting taxes on the very best-off (so that they can upgrade their art collections instead of making needed public investments) endangers the economy's competitiveness. The "you cannot increase taxes on job creators without losing jobs" myth has been contrived to appeal both to those among the rich who do not want to pay higher taxes and to those who are so desperate to get or keep a job that they will grasp at straws. This is an especially cruel myth because the very best-off need no help and the jobless and those in fear of losing their job need real help, not an empty promise.

For jobs to be created, businesses and workers must compete successfully in global markets, and for them to do so, public investments must be made. Enabling businesses to compete successfully means making public investments that will (1) provide a superior transportation and communications infrastructure; (2) develop the most highly educated workforce; (3) keep labor costs low by removing, as business expenses, the cost of paying for employees' retirement, health care, and post-secondary education; (4) assure free access to international markets; (5) guarantee national security against foreign military threats; and (6) maintain open and free capital and labor markets.

Exploiting the Myth

Paul Ryan's "Roadmap to America's Future," the House Budget Plan of 2008 (as since updated by the House's 2010 and 2012 budget plans) exploits the "you cannot tax the job creators without costing jobs" myth by proposing tax cuts for the very best-off to be paid for by severe cuts in public investments. The most notable change from Ryan's original budget in 2008 to his budget in 2012 was to rebrand it as the "Path to Prosperity." This approach to taxation stemmed from the premise that in the money-making game, the winners should keep more of their take coupled with its corollary that losers are siphoning off too much of it. This premise is based on Ayn Rand's economic philosophy that it is the winners who advance society and taking from them to give to the losers only penalizes success and rewards failure. Losers, in Rand's world, are there to be used by winners and not coddled. As a devotee of Rand's economic philosophy, former Speaker Ryan's policies attempted to advance this philosophy to the furthest political extent possible.

The Path to Prosperity would have implemented the philosophy that the winners should get to keep more of their take and the losers should not get coddled through two complimentary policies, first, total taxes would be capped at 19% of GDP with the top personal income tax rate being no higher than 25% and, second, total spending would be capped at no more than 20% of GDP. Individually and together, the implementation of these policies would transfer significant income and wealth to those at the very top over time at the expense of everyone else.

Capping the tax rate for the very best-off at 25% would reduce, as compared with then existing tax policies, their share of the tax burden. With the generational trend of income concentrating at the top, the very best-off's share of the tax burden would have been reduced further. A 25% rate cap would have further concentrated after-tax income at the very top resulting in shrinking very best-off's share of the tax burden at everyone else's expense.

Capping spending at 20% of GDP over time would reduce well below the current levels of revenue available to pay for public investments, and without adequate public investments, America's businesses and workers will be unable to compete successfully in worldwide markets. In 2014, total spending amounted to 20.5% (just over the Path to Prosperity's 20% cap) with Social Security, Medicare and other health care programs accounting for 9.8% of GDP. As a result of the aging of the population and without the addition of any new benefits, CBO estimated (in its 2014 April Long-Term Budget Outlook and as updated in July and August) that these programs will have accounted for 11.5% of GDP in 2024, and 14.3% in 2039. So, if spending were to be held to then-current levels (except for growth in Social Security, Medicare and other health care programs), total spending in 2039 would have hit 25% of GDP, or five percentage points above the 20% cap.

Squeezing Everyone but the Very Best-Off

To hold spending to a 20% cap in 2039 would have meant either cutting those particular programs by about 46% or cutting all government spending across the board by about 20%. Since it is unlikely that the elderly would accept a 46% cut in their benefits, it is likely that other funding for public investments, like loans and grants for post-secondary education, transportation facilities, such as roads, bridges, and ports, national defense and intelligence-gathering, law enforcement, unemployment compensation during economic downturns, and so forth, would have had to be cut well below 20% from then-current levels.

Limiting total spending to 20% of GDP so that tax rates could be capped at 25% for the very best-off would have gone a long way toward realizing Ayn Rand's dream of America being a land ruled by fortune in which the winners could win without limit, losers could lose almost everything, and safety nets would be cut to shreds.

Timing is Everything and Now is Not the Time for the Roadmap

If incomes were not concentrating at the top, if the pool of investment capital were shrinking, if over-consumption threatened inflation, if the costs of health care and college were growing no faster than inflation, if middle-income workers had room in their budgets to save for their own retirement and the post-secondary education of their children, then the Path to Prosperity's prescription of cutting taxes for the very best-off might make some sense. But, since none of these things were happening, the Path to Prosperity's tax-cutting prescription for the very best-off and cuts in public investments made no sense. There is a time and place for everything, but the time was not right, and America was not the place, to implement the Path to Prosperity's tax-cutting policy. Thankfully, the Path to Prosperity was never implemented, but it still remains the dream of many who want lower taxes for the best-off.

BUSINESS MUST HAVE AN ENABLING ENVIRONMENT

Businesses (large and small) are the source of all wealth and employment in America, and as such, businesses must be nurtured with an enabling environment and not overburdened with taxes. By necessity, business and government are married to each other, and like all marriages, its success or failure depends on the respect that each participant has for the needs of the other. In their marriage, it is the responsibility of business to provide jobs for workers, goods and services to consumers, and profits to reward investors, and to pay taxes; and it is the responsibility of government to provide an environment that enables business to make the best of its opportunities.

For businesses to succeed, the government must provide an environment that includes, among others, the following components:

- **Free and open access to both domestic and foreign markets for all businesses:** For businesses to have free and open access to domestic markets, there must be a rule of law which includes law enforcement to provide security for persons and property, regulation to protect health and safety and prevent and punish fraud, improper restraint of trade, and anti-competitive practices, and a court system to enforce contracts. For American business to have free and open access to international markets, there must be a national security and military establishment that assures border security and open sea and air lanes and international trade agreements that assure American business access to foreign markets.

- **A skilled workforce suitable to the needs of business:** For business to have skilled workers, there must be an education infrastructure (both K-12 and post-secondary, including universities and technical and trade schools) that assures that all willing and able workers (regardless of their financial resources) are educated in marketable skills to the fullest extent of their ability.

- **Transportation facilities that assure the free flow of goods and services in commerce:** For business to have a free flow of goods and services in commerce, there must be transportation infrastructure that provides road, rail, port facilities, and air transport that connects all significant markets.

- **Communications facilities that assure the free flow of information in commerce:** For businesses to have access to commercial information, there must be an information infrastructure that enables information (in all forms) to be transmitted electronically over the airwaves—by land, sea, and air.

- **Government fiscal policy that promotes a growing economy and cheap capital for business:** For businesses to grow, the government must pursue fiscal policies that contain inflation and encourage low interest rates, stimulate demand or investment when either is abnormally low due to adverse economic conditions, and keep the national debt within financially responsible limits.

- **A social safety net that relieves businesses of providing health care and retirement benefits to workers from wages:** For American businesses to be competitive in the global marketplace where health care and retirement benefits are provided by governments or not provided at all, social insurance programs must be funded by taxes instead of higher wages in order to maintain the competitiveness of American business.

- **Social welfare programs that promote social and political stability:** For American businesses to prosper and capital markets to function efficiently, government must pursue social welfare policies that promote social and political stability.

The cost of an enabling environment is overhead like rent, labor, and utilities, and as such, this cost appears on a business's income statement under the category "taxes." Taxes, then, are just another cost of doing business. For the marriage of government and business to be fruitful, government must advance policies that create and maintain an enabling environment, and business must be willing to support the level of taxes necessary to implement these policies.

While all businesses are not equally dependent on each component of an enabling environment, all businesses are dependent to a greater or lesser extent on the success of other businesses. No business can succeed if other businesses with which it does business (such as its customers, contractors, sub-contractors, vendors, suppliers, and financiers) suffer or fail.

All businesses, therefore, have a mutual interest in maintaining an enabling environment for all–for any business to succeed, so too must many other businesses.

The Risk of Failing to Address Business' Need

Imagine an otherwise successful business mired in a disenabling environment confronted with any one or more of the following problems over which they had no part in creating and no ability to control:

- A business loses a contract because it cannot find enough skilled workers to fulfill a contract due to a broken system of education, K-12 through college.

- A business loses profitability because of an unanticipated explosion of energy cost due to a Middle East oil crisis.

- A business loses a contract because it cannot get its goods to market as a result of a major bridge on a heavily travelled interstate highway crumbling due to inadequate maintenance.

- A business fails because it cannot refinance its outstanding debt because of an unanticipated spike in interest rates due to market concerns of an out of control national debt.

- A business fails because of an oil spill (which occurred as a result of lax regulation) that causes a reduction in tourism due to environmental damage.

- A business fails because a competitor engages in illegal anticompetitive practices due to the failure of officials to enforce regulations.

- A business fails because of flood damage caused by the lack of maintenance of a system of public dikes and levees.

- A business fails because of an urban riot in a major metropolitan area as a result of pent up frustration from a growing underclass of unskilled workers.

- A business loses a contract to foreign competitors whose wage structures do not include health care and retirement benefits because the competitors either have these benefits provided by their governments or their workers do not demand these benefits.

Each of these examples (and a million more) illustrates how an individual component of a disenabling environment can cause millions of businesses to lose an opportunity or fail. Each time an individual component is underfunded, and a group of businesses suffers as a result, the businesses with whom these businesses do business also suffer. **A chain is no stronger than its weakest link**.

The Necessity of an Enabling Environment

Global capital, including much of American capital, can realize its highest return by hiring the most skilled, efficient, and cheapest labor in the global market. In this world, American workers will not be hired, even by American capital, unless they compete successfully with foreign labor in terms of skill, efficiency, and cost. A rising standard of living for American workers, then, depends on their becoming the most attractive workforce in the world to global capital.

Not only does the fate of American workers and their families depend on their winning the labor competition against foreign competitors, but the fate of that part of American business that serves primarily the domestic market also depends on the success of American workers. The greater the success of American workers, the more money they will earn and the more money there will be to consume the goods and services produced by American business. To the extent that American workers lose to foreign competition, many American businesses will share in the loss. Unless America's workers have an environment that enables them to compete in global labor markets, America's economic strength and social coherence will suffer.

The programs necessary to create an enabling environment for workers and their families should be designed not as entitlements for the individuals to be helped but as investments to build the world's most competitive workforce. Entitlements indemnify recipients for misfortune while investments are made in the expectation of a return. Life is unfair and government subsidies cannot redress the unfairness. Fate has made some smarter, more industrious, richer, more attractive, and luckier than others, and government subsidies cannot undo fate's handiwork. But, government subsidies can help those who have ability and drive (but who lack means) be all they can be and strengthen America.

The purpose of the programs that provide an enabling environment for workers is not to make the beneficiaries comfortable but to make them and their children productive. Taxpayers, like investors, have a right to expect a return.

The Risks of Failing to Address Workers' Needs

Social equity promotes political stability, and political stability promotes the free and efficient flow of markets and economic growth. Nothing will erode America's economic advantage in the global economy more than domestic political instability. A perception of a lack of social equity among a significant number of America's workers over time can lead to political instability.

For America, political stability is an intangible asset much like goodwill is in the business world. The fact that an asset is abstract and difficult to quantify does not mean that it is not real and does not have value. Just as costs spent to enhance a business's reputation are capitalized and carried as an asset on its balance sheet, so too should costs spent to enhance America's political stability be capitalized and carried on its balance sheet.

TAX REVENUES AS AN INSTRUMENT OF NATIONAL POWER

America's tax base empowers it to equip both its businesses and individual workers with all the resources needed to prevail in global economic competition. **America's ability to increase its tax revenues to meet national needs should be regarded as an instrument of national power which is more potent than its military prowess. As** Table X-1 **shows, America's tax base, as measured by GDP, and low taxes, as measured by taxes**

as a percentage of GDP, establish that the country has the resources necessary to provide its businesses and workers with more resources than any other major economy in the world.

Taxing to Invest Rather than to Consume

While America can raise taxes to make the public investments that will enable its businesses and workers to win a worldwide economic competition, it must be willing to do so. Willingness, however, depends on Americans choosing to tax and invest in public investments (not just private investments in business) rather than consume. **Investment (public and private) means that money spent on goods or services will yield a return over a period longer than a cycle while consumption means that money spent on goods and services will have no lasting effect beyond a cycle. In most instances, a cycle is a year.**

To subsist, individuals and organizations (including both businesses and governments) must consume a certain amount of goods and services. Once these individuals and organizations have spent enough money to subsist, they must then choose whether to spend any remaining money on more consumption or more investment.

Economists refer to the portion of income above what is needed to subsist as discretionary income. For those Americans who have discretionary income, they are burdened with daily decisions about whether to consume more or save and invest, and as their discretionary income grows, so too does the burden of their decision. Discretion means choice, choosing means thinking; and for many, thinking is a burden. Poverty stricken Americans, however, are largely freed of choice, and, as such, are burdened only by the daily challenge of survival.

For the most part, the American way of life has been for Americans to ratchet up their consumption from the barely adequate, to the adequate, from the adequate to the plush, from the plush to the luxurious, and from the luxurious to the ostentatious, and, in many instances, ahead of their income. The choice to consume above subsistence or invest pits the present against the future. Consumption leads to current bliss while investment leads to future wealth. History offers no more telling example of the consequences of succumbing to the temptation to consume than Aesop's cautionary fable of the grasshopper and the ant. Little has changed over the millennia.

Measured by two standards, the vast majority of Americans, particularly in the last generation, have favored the values of the grasshopper over the ant, enjoy now, and worry later.

Table X-2 tracks the personal savings of Americans as a percentage of personal income.

Table X-2
Personal Saving as A Percentage of Disposable Personal Income by Year

Year	Percentage	Year	Percentage	Year	Percentage
1929	4.30%	1957	8.40%	1985	8.20%
1930	4.00%	1958	8.50%	1986	7.60%
1931	3.70%	1959	7.50%	1987	6.50%
1932	-1.10%	1960	7.20%	1988	6.90%
1933	-1.70%	1961	8.40%	1989	6.60%
1934	0.90%	1962	8.30%	1990	6.50%
1935	4.20%	1963	7.80%	1991	7.00%
1936	6.20%	1964	8.80%	1992	7.30%
1937	5.90%	1965	8.60%	1993	5.80%
1938	1.90%	1966	8.20%	1994	5.20%
1939	4.40%	1967	9.40%	1995	5.20%
1940	5.70%	1968	8.40%	1996	4.90%
1941	12.20%	1969	7.80%	1997	4.60%
1942	24.10%	1970	9.40%	1998	5.30%
1943	25.50%	1971	10.00%	1999	3.10%
1944	26.00%	1972	8.90%	2000	2.90%
1945	20.40%	1973	10.50%	2001	2.70%
1946	9.60%	1974	10.70%	2002	3.50%
1947	4.20%	1975	10.60%	2003	3.50%
1948	6.90%	1976	9.40%	2004	3.60%
1949	4.90%	1977	8.70%	2005	1.50%
1950	7.10%	1978	8.90%	2006	2.60%
1951	8.40%	1979	8.80%	2007	2.40%
1952	8.40%	1980	9.80%	2008	5.40%

1953	8.20%	1981	10.60%	2009	4.70%
1954	7.50%	1982	10.90%	2010	5.10%
1955	6.90%	1983	8.70%	2011	4.20%
1956	8.50%	1984	10.20%		
Source: Data extracted from BEA, Table 2.1. Personal Income and Its Disposition.					

Table X-2 shows that compared with the past, Americans are saving much less. Over the 15-year period 1982-1996, Americans saved on average 7.17%, and over the 15-year period 1997-2011, Americans saved on average only 3.67%.

Table X-3 compares America's investment (as a percentage of national income) to other modern and emerging economies.

Table X-3
Gross National Income Less Public and Private Consumption Plus Net Current Transfers

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
World	21.06	20.49	20.56	21.49	21.82	22.75	22.52	21.39	18.65	19.32
Australia	21.32	22.07	21.50	22.16	21.76	23.41	23.90	24.87	26.74	25.12
Austria	23.61	25.25	25.21	25.42	25.37	26.10	27.56	27.80	24.71	24.85
Belgium		24.21	23.91	24.82	24.65	25.26	26.08	24.20	20.21	22.47
Brazil	14.00	15.20	16.49	19.05	17.86	18.03	18.46	19.22	14.95	16.85
Canada	22.88	21.75	21.89	23.42	24.27	24.69	24.08	23.73	17.73	18.75
China	38.13	40.72	44.21	46.90	48.39	51.65	51.75	52.96	53.40	52.66
Czech Republic	25.26	24.24	22.14	23.60	25.91	26.21	26.62	26.40	22.65	22.52
Denmark	24.33	23.60	23.75	23.88	25.15	25.55	24.75	25.08	20.90	22.38
Finland	29.20	27.96	25.00	26.50	25.52	25.91	27.26	25.64	20.45	20.33
France	20.81	19.62	19.05	19.57	19.20	20.02	20.55	20.01	17.14	17.16
Germany	20.15	20.22	19.79	22.08	22.06	24.07	26.19	25.21	21.81	22.70
Greece	15.03	12.98	15.74	15.55	12.46	13.15	10.39	7.47	5.17	4.76
Hungary	21.00	19.36	16.73	17.84	17.65	18.48	17.03	18.21	19.69	21.46
India	25.72	26.92	28.65	33.35	34.29	35.03	36.86	33.02	34.46	33.99
Indonesia	23.65	18.94	31.08	25.77	27.37	29.13	27.15	27.34	32.28	32.88
Ireland	27.13	27.46	29.37	29.72	29.21	28.58	24.50	19.14	14.81	14.77

Italy	21.05	21.27	20.33	20.83	20.17	20.34	20.90	18.96	17.46	17.07
Japan	26.43	25.49	25.59	26.22	26.52	26.88	27.53	25.89	22.38	23.15
Korea, Rep.	31.19	30.44	31.76	33.95	32.03	30.68	30.73	30.48	30.21	31.64
Netherlands	26.15	25.40	25.10	26.61	26.05	28.15	27.77	25.26	22.20	23.63
Norway	35.07	31.34	30.15	32.82	37.27	39.38	38.35	40.71	33.08	35.22
Poland	17.71	15.88	16.38	15.81	17.60	18.12	19.68	18.98	18.11	17.53
Russian Federation	33.44	29.28	30.00	31.53	31.94	31.70	30.88	33.17	23.81	28.59
Singapore	40.16	37.80	40.26	41.71	44.13	47.51	49.92	46.70	46.58	47.65
Slovak Republic		22.09	19.22	20.68	22.03	21.47	23.82	22.37	16.61	20.38
Slovenia	25.01	24.97	24.68	25.05	25.78	26.99	28.01	25.86	21.96	22.36
South Africa	16.07	17.13	16.10	15.34	14.79	14.66	14.60	15.43	15.84	16.79
Spain	22.79	23.72	24.08	23.26	22.72	22.66	21.77	20.23	19.67	19.08
Sweden	23.23	22.53	24.23	23.80	24.85	26.51	28.32	28.19	22.94	24.51
Switzerland	29.11	28.02	30.82	31.04	31.83	33.07	30.72	24.91	30.36	33.40
Turkey	18.66	18.70	15.34	15.84	15.78	16.46	15.75	16.69	13.05	13.75
Ukraine	25.92	28.03	28.06	31.78	25.88	23.64	22.46	21.01	15.90	17.52
United Kingdom	15.00	14.94	14.77	14.74	14.13	14.08	15.44	15.11	12.55	11.90
United States	16.01	14.29	13.56	14.07	14.51	15.52	13.84	12.17	9.55	10.87
Source: Data extracted from World Bank investment statistics.										

Table X-3 shows that (as a percentage of national income) America invests much less than other leading modern and developing economies. In 2001, as a percentage of its national income, America invested 76% of the world average, but by 2010, America invested only 57% of the world average. In the race to the bottom of investment and, conversely, the top of personal consumption, America was bested only by Greece. The trend during this period pointed to a persistent American disinterest in investing matched by an appetite for consumption.

Discretionary income spent on excessive private consumption intensifies momentary sensations which fade into memory while discretionary income employed in prudent public investments creates future wealth. Ignoring public investments in favor of private consumption and private investment threatens America's future.

TAXATION, INVESTMENT, & CONSUMPTION

The following choices represent some of the decisions America must make that will determine its future:

Table X-4
America's Choices

Private Consumption – The Plush, The Luxurious, and The Ostentatious for Now		**Public Investment – National Strength for the Future**
Oversized houses and mansions, yachts, country clubs, vacations, fine furniture, art collections, fine wine, jewelry, and other self-indulgent playthings.	***Versus***	Public Infrastructure for transportation, utilities, and flood control. Public and higher education subsidies to train new workers and workers displaced because of international competition. Wage, retirement, and health care subsidies to enable business to hire workers at a competitive global wage. A military and intelligence establishment that will assure national security and the safety of international trade. A government regulatory regime to maintain stable markets and a productive environment. A responsible debt to GDP ratio.

Under-investing in public investments is no different than America sending its soldiers into war with obsolete arms. In the 21st century, economic competition will be as knowledge-dependent as the wars of the 20th century were kinetic. **Developing and manufacturing kinetic devices comes cheap relative to developing and cultivating knowledge resources.** Just as with the wars of the 20th century, all of America's resources must be available for deployment to win the contest. If America fails to make the same commitment to provide the public investments that will arm its businesses and workforce for the 21st century global economic contest that it did to arm its military for the 20th century wars, then consequences will be tragic.

There are three essentials for businesses to prosper and jobs to be created, which include (1) consumption, (2) private investment, and (3) public investment. Unless a business has consumers with money to buy its products, it will fail. Unless a business has the private investment capital to finance the property, plant, and equipment necessary to produce its products, it will fail. And, unless public investments provide a business with, among other things, an educated workforce, open and free markets, a transportation and communications infrastructure that enables it to market its products, a military that assures peaceful international commerce, a legal system that protects its contract rights, financial stability that assures the lowest cost of capital possible, and political stability that promotes economic confidence, it will fail.

During times of plenty, no one prospers more than those at the top, and during periods of want, no one suffers more than those at the bottom. For 30 years before the onset in 2008 of the Great Recession, income had concentrated at the very top with everyone else's income remaining static or falling. During the Great Recession, those at the top had their accumulated wealth to get them through the roughest part, but for almost all others, they had only their ability to endure and a little help from the government to see them through. Since the end of the Great Recession, all income groups are doing better in terms of income but none more so than those at the top. For almost all Americans, they have yet to have their income reach pre-Great Recession levels. As Americans recovered from the Great Recession the disparity in income between those at the very top and everyone else continues as is shown in Census data released in 2016.

With income concentrating at the top and everyone else trying to catch up with where they were before the Great Recession, only those at the top have the resources to pay for America's public investments. Since it is the very best-off who have both the biggest stake in America's economic growth and the most income available to pay for needed public investments, it is they who will have to pay for most of them.

Taxing the Very Best Off
The myth that tax money paid by the very best-off and used to pay for public investments costs jobs ignores the economic reality that tax dollars do not just fall into a black hole and vaporize. Instead, money spent on public investment is spent on goods and services that, in turn, create jobs. So, just like money spent on consumption and private investment, money spent on public investments also contributes to economic growth. Although all money spent in the economy contributes to economic growth, not all dollars make the same contribution. Depending on the type of spending for public investment, private investment, or consumption, more or less growth and jobs will result, as shown by the following example.

Suppose that Peter, a successful hedge fund manager has an annual adjusted gross income of $20 million. Assume that there are three choices in striking the proper balance among spending on public investments, private investment, and consumption, as follows: Scenario #1, increase Peter's taxes by 5 percentage points, or $1 million, to pay for public investments; Scenario #2, do not increase Peter's taxes, and have him spend the $1 million on a private investment of his choice; and Scenario #3, do not increase Peter's taxes, and have him spend the $1 million on consumption as he sees fit.

SCENARIO #1 (PUBLIC INVESTMENT):

How the Money is Spent: Peter's $1 million is spent to pay for a public investment which provides 20 low-income students of merit with grants to study engineering, math, and physics. Forty years later it turns out that, of all the students who were provided grants, 16 lived up to expectations and became productive citizens and taxpayers who on average paid $15 thousand (inflation adjusted dollars) of income taxes each year over their 30-year careers for a total of $6.75 million.

The Economic Effects: The $1 million public investment benefitted (1) the 20 students who received the grants, (2) the universities and educators that educated the 20 students, (3) the businesses which employed the students, and (4) the taxpayers who received a 675% (inflation adjusted) return on their $1 million public investment. Additionally, over the working lives of the students, they provided the skills and imagination that enabled the businesses for which they worked to attract new business from all over the world and hire many additional employees.

SCENARIO #2 (PRIVATE INVESTMENT):

How the Money is Spent: Peter invested the $1 million in an energy futures fund in which he made a losing bet to the effect that that in one year the price of oil would double its current price.

The Economic Effects: The failed $1 million private investment benefitted the energy fund manager who made a 5% placement fee for selling Peter the investment. Few, if any, additional jobs were created.

SCENARIO #3 (CONSUMPTION):

How the Money is Spent: Peter spent the $1 million with his mistress by redecorating a Manhattan apartment complete with new furnishings and artwork.

The Economic Effects: The $1 million spend on consumption benefitted Peter's favorite decorator and art dealer. Few, if any, additional jobs were created.

In each of the scenarios, the $1 million rippled through the economy and benefitted various types of businesses and organizations. Regardless of whether the money spent on public investments, private investments, or consumption is considered wise, all of it has the potential to create more or less jobs depending on how it is spent.

The examples that follow show a few of the types of spending choices available to the very best-off and their effects on job creation:

Public Investments: (1) the construction of highways, roads, bridges, and ports which create construction jobs and facilitate commerce; (2) the construction of naval assets to protect the sea lanes which create manufacturing and technology jobs and additional military employment and facilitate international commerce; (3) the maintenance of income transfer programs, such as Social Security, Medicare, Medicaid, health care exchange subsidies, unemployment compensation, and food stamps which put money in consumer's pockets enabling them to buy goods in private markets, relieve business of the burden of factoring these costs into the wage base, and maintain political stability; (4) the funding of loans and grants to students of merit to enable them to obtain needed post-secondary education to improve the quality of America's workforce which leads to competitive, job-creating businesses ; (5) the maintenance of a system of law enforcement and civil and criminal justice administration which provides for the rule of law and economic growth; and (6) the funding of basic research in technology and medical science for the purpose of maintaining American leadership in technological advancement which creates technology jobs and makes new industries possible.

Private Investments: (1) the purchase of a stock in the secondary market which keeps a broker employed; (2) the purchase of a stock in a startup company which keeps a broker employed and may lead to the creation of new jobs; (3) the purchase of a debt or an equity security used to restructure the capital of an existing company which keeps a broker employed and may lead to the creation of new jobs; (4) the purchase of an equity security used to speculate in commodities markets which keeps a broker employed and may lead to the creation of new investment banking jobs; (5) the purchase of an equity security used to finance the construction of a new commercial property which keeps a broker employed and creates construction, maintenance, and managerial jobs; (6) an investment in a venture capital fund which keeps a broker employed and may lead to job creation in a number of technological areas; and (7) a purchase of collectibles, such as fine art, antiques, or other rare items, which keeps brokers employed.

Consumption: (1) entertainment, including five-star restaurants and hotels, the theatre, the cinema, the opera, and the symphony, which creates jobs in these industries; (2) recreation, including country clubs, golf, tennis, and personal trainers, which creates jobs in these services; (3) vacations, which create jobs in the travel industry; (4) general living standard, including luxury housing and upscale automobiles which create jobs in both the luxury housing and auto industries; (5) personal service which creates jobs for maids, lawn care workers, nannies, and other types of servants; (6) unlimited health care, including cosmetic surgery, which creates jobs in the health care industry; and (7) unlimited private education for all children from pre-school through graduate or professional school, which creates jobs for educators and provides an educated workforce.

Since each of the three of the essentials—public investment, private investment, and consumption—all compete for each available dollar, the effect on job creation depends on what choices are made. Sometimes more jobs will be created if the next available dollar is spent on public investment, sometimes private investment, and sometimes consumption. From a job creation standpoint, each expenditure must be evaluated on its own merits. Reason and experience, however, dispel the myth that taxing the very best-off to pay for public investments inevitably results in job loss.

SMALL BUSINESS AND JOB CREATION

Since the myth defines the owners of small businesses as job creators, debunking the myth begins with an understanding of how small businesses view job creation, what small businesses are, how they are taxed, and what taxes have to do with job creation. Although many government agencies define small businesses for tax and regulatory purposes and for the purpose of dispensing of government favors differently, the most commonly accepted definition comes from pages of abstruse regulations promulgated by the Small Business Administration, aka the SBA. After defining what constitutes a small business, it is then necessary to look at how taxes are paid on small business income and what their significance is as a part of the personal income tax.

Small businesses are like all businesses in that they are in the business of making a profit, not hiring employees just for the sake of hiring employees. If a small business decides that it needs to add an employee to increase its profit, it does so, and if it decides that it needs to fire an employee to increase its profit, it does that too. Sometimes a small business can increase its profit by replacing employees with technology, such as new software programs or robots, and sometimes a small business can replace American workers by outsourcing to cheaper foreign labor. So, small businesses sometimes are job creators, sometimes job destroyers, but always profit seekers.

There is no dispute that small businesses drive much of employment in the economy. A 2009 SBA report to the President emphasized the importance of small businesses to employment as follows:

"Small businesses employ about half of U.S. workers. Of 115.1 million non-farm private-sector workers in 2004, small firms with fewer than 500 workers employed 58.6 million and large firms employed 56.5 million. Firms with fewer than 20 employees employed 21.2 million, and firms with 100 employees, 41.8 million…. [S]mall firms create 60 to 80 percent of net new jobs."

So, lowering unemployment and keeping it low depends significantly on a healthy and prospering small business sector.

Since the SBA definition determines which businesses qualify for certain small business subsidies and loan guarantees, it is the politicians, not the economists, who do the defining—dispensing government favors is too important for politicians to leave to economists. Generally, politicians on the left who like to hand out federal benefits, as well as politicians on the right who like to dole out tax preferences (in each case to small businesses), like a liberal definition of what constitutes a small business.

Sifting through reams of SBA regulations, two basic criteria emerge for how it defines a small business. For most manufacturing and wholesale businesses, the standard is having no more than 500 employees, and for various types of service and retail businesses, the standard is having annual gross business receipts ranging from $7 million to $29 million per business, with $7 million applying to most local retail and service businesses and $29 million applying to larger retail businesses. Neither of these two criteria has much to do with mom and pop businesses, most of which have 20 or fewer employees and less than $2 million in business receipts.

For tax purposes, the overwhelming majority of small businesses organize as S corps, partnerships or limited liability companies (which as a group are commonly referred to as "pass-thru entities"), and pass-thru their business income to the owners who then pay income taxes on these business profits at personal income tax rates. The owners of the most profitable small businesses pay income taxes on small business profits at rates of 37%. Although almost all small businesses organize as pass-thru entities, many pass-thru entities are not small businesses. A substantial majority of income attributable to pass-thru entities, moreover, comes from businesses that hardly could qualify as small businesses, even under the expansive SBA standard.

The IRS does not classify pass-thru entities either as small businesses or by the number of their employees, but it does classify them by the size of their business receipts and, in some instances, the size of their assets. Occasionally, tax experts, the IRS, or Congress conduct special studies to learn more about the attributes of small businesses in terms of their net income and employment characteristics. One such study, prepared in 2005 by the IRS, broke down the net income of pass-thru entities by the size of their business receipts. Another such study, prepared in 2007 by tax experts for presentation to the 2007 National Tax Conference, broke down small businesses with less than $1 million in assets by the number of their employees.

Additionally, the IRS prepares annually certain reports regarding the net income and other data relating to certain pass-thru entities.

Table X-5 shows the percentage of pass-thru income attributable to small businesses (classified by size of business receipts), as reported in the 2005 IRS study based on 2002 tax data.

Table X-5
Pass-Thru Entities Net Income Classified by Size of Business Receipts – 2002

Business Receipts Categories	S Corp Net income (less deficit)	Percentage of S Corp Net Income (less deficit)	Partnership Net Income (less deficit)	Percentage of Partnership Net Income (less deficit)	All Pass-Thru Net Income (less deficit)	All Pass-Thru Percentage of Net Income (less deficit)
Total	$150,600,000,000	100.00%	$270,700,000,000	100.00%	$421,500,000,000	100.00%
<$25,000	-$8,400,000,000	-5.58%	-$34,900,000,000	-12.89%	-$43,300,000,000	-10.27%
$25,000 <$250,000	$9,400,000,000	6.24%	$13,600,000,000	5.02%	$23,000,000,000	5.46%
$250,000 > $1,000,000	$24,100,000,000	16.00%	$25,100,000,000	9.27%	$49,200,000,000	11.67%
$1,000,000 > $5,000,000	$33,300,000,000	22.11%	$35,700,000,000	13.19%	$69,000,000,000	16.37%
$5,000,000 > $10,000,000	$16,300,000,000	10.82%	$19,500,000,000	7.20%	$35,800,000,000	8.49%
$10,000,000 > $50,000,000	$37,600,000,000	24.97%	$50,800,000,000	18.77%	$88,400,000,000	20.97%
$50,000,000 >	$38,400,000,000	25.50%	$161,000,000,000	59.48%	$199,400,000,000	47.31%

Source: Data extracted from An Analysis of Business Organizational Structure and Activity from Tax Data, Tom Petska, Michael Parisi, Kelly Luttrell, Lucy Davitian, and Matt Scoffic, Internal Revenue Service, 2005, pages 20-21.

As shown in Table X-5, net income for all pass-thru entities is highly concentrated in the largest entities (classified by size of business receipts). S corps and partnerships with business receipts in excess of $10 million (businesses that clearly fail to qualify as small businesses) account for 68% of all pass-thru net income, and S corps and partnerships with business receipts less than $5 million (businesses that most likely would qualify as small businesses) account for only about a third of pass-thru net income.

In terms of generating pass-thru income that is subject to taxation, small businesses most likely provide less than one-third of what there is to tax.

Table X-6, summarizing an IRS report showing the net income of partnerships (classified by asset size), confirms that it is businesses other than small businesses that provide the two thirds or more of partnership pass-thru income subject to taxation.

Table X-6
Partnership Net Income and Assets Classified by Asset Size – 2008

Asset Sizes	Number of Partnerships	Percentage of Partnerships	Total Assets	Percentage of Assets	Total Net Income (loss)	Percentage of Net Income (loss)
All Asset Sizes	3,146,006	100.00%	$19,259,803,843	100.00%	$458,185,323	100.00%
>$0 >$10,000,000	3,017,671	95.92%	$2,234,820,597	11.60%	$102,016,084	22.27%
$10,000,000> $25,000,000	70,811	2.25%	$1,099,857,537	5.71%	$19,173,851	4.18%
$25,000,000> $50,000,000	25,072	0.80%	$872,785,358	4.53%	$19,674,606	4.29%
$50,000,000> $100,000,000	14,272	0.45%	$994,910,021	5.17%	$23,021,995	5.02%
$100,000,000 >	18,180	0.58%	$14,057,430,330	72.99%	$294,298,787	64.23%

Source: Data extracted from IRS Tax Stats, Table 15. All Partnerships: Total Assets, Trade or Business Income and Deductions, Portfolio Income, Rental Income, and Total Net Income, by Size of Total Assets, 2008.

As shown in Table X-6, partnerships with assets of $10 million or more (businesses unlikely to qualify as small businesses) account for 77% of partnership net income leaving partnerships with less than $10 million in assets accounting for only 23% of partnership net income.

Table X-7 shows the employment characteristics of small businesses with assets of no more than $10 million that were surveyed in the 2007 study presented at the National Tax Conference.

Table X-7
Small Businesses (*) Classified by Assets and Number of Employees

Asset Brackets	No Employees	1 to 5 Employees	6 to 10 Employees	11 to 15 Employees	16 to 25 Employees	26 to 50 Employees	More than 50 Employees	Total Small Businesses
$0 or less	1,147	214	18	8	3	(**)	4	1,394
$1 to $50,000	1,104	758	112	46	24	7	2	2,053
$50,001 to $100,000	325	284	102	40	13	12	3	779
$100,001 to $500,000	787	406	229	110	74	61	16	1,683
$500,001 to $1,000,000	286	50	57	27	46	24	23	513
$1,000,000 to $10,000,000	443	62	50	37	66	86	73	817
Total Small Businesses	4,093	1,773	567	269	227	191	122	7,242

Source: Data extracted from Estimates of U.S. Federal Income Tax Compliance for Small Businesses, presented at the 2007 National Tax Association meetings, Columbus, Ohio, DeLuca, Donald, John Guyton, Wu-Lang Lee, John O'Hare, and Scott Stilmar, Table 1.

Notes:
* Small businesses in thousands.
** Less than 1,000 businesses.

As shown in Table X-7, many entities categorized as small businesses have no employees. Of the 817 thousand small businesses with assets of $10 million to $1 million, 54% have no employees, and looking at all 7.242

million small businesses included in the survey, 57% have no employees. Many pass-thru entities engage in activities such as holding and investing in assets that do not require employees.

The data included in Tables X-5, X-6, and X-7 can be summarized as follows:

- **More than two-thirds of pass-thru income comes from pass-thru entities that it is highly unlikely would qualify as small businesses.**

- **Over one-half of businesses with assets of $10 million or less do not have any employees.**

Although the small business tax data does not correlate to the SBA small business definition, less than one-third of pass-thru entity income can at best reasonably be attributed to small business.

Small Business Income in Perspective

Not only does less than one-third of pass-thru income come from small businesses, but it accounts for only a tiny sliver of the total adjusted gross income of all taxpayers in the top two rates. **The myth that tax rates cannot be increased on those paying the top two rates without harming job creation in small businesses offers a convenient excuse not to raise revenues from the best-off taxpayers, including those who have no ownership in small business.**

Table X-8 shows the taxpayers (classified by the size of their adjusted gross income) who report pass-thru income and the amount of pass-thru income relative to all adjusted gross income. Virtually all taxpayers with adjusted gross income of $200 thousand or more pay their taxes at the top two rates.

Table X-8
Partnership and S Corporation Net Income for 2008
Shown for Groups of Taxpayers Based on Adjusted Gross Income

Size of Adjusted Gross Income	Taxpayers	Percentage of Taxpayers	Pass-Thru Net Income*	Percentage of Net Income
Taxable Returns, total	4,145,032		$463,801,344	

No Adjusted Gross Income	1,091	0.03%	-$570,076	-0.12%
$1 under $5,000	13,200	0.32%	$3,686	0.00%
$5,000 under $10,000	14,589	0.35%	$10,438	0.00%
$10,000 under $15,000	36,209	0.87%	$203,177	0.04%
$15,000 under $20,000	49,736	1.20%	$375,842	0.08%
$20,000 under $25,000	62,821	1.52%	$416,475	0.09%
$25,000 under $30,000	76,913	1.86%	$764,150	0.16%
$30,000 under $40,000	149,075	3.60%	$976,235	0.21%
$40,000 under $50,000	156,128	3.77%	$1,218,321	0.26%
$50,000 under $75,000	525,030	12.67%	$7,511,767	1.62%
$75,000 under $100,000	527,252	12.72%	$9,255,394	2.00%
$100,000 under $200,000	1,200,523	28.96%	$43,626,959	9.41%
$200,000 under $500,000	884,980	21.35%	$91,320,429	19.69%
$500,000 under $1,000,000	271,082	6.54%	$76,288,303	16.45%
$1,000,000 or more	176,404	4.26%	$232,400,247	50.11%
Source: Data extracted from IRS, Tax Stats, July 2009, Individual Income Tax: Business or Partnership, Size of Adjusted Gross Income for 2008.				
Note: * Income in thousands.				

As shown in Table X-8, $400 billion, or 86% of all pass-thru income, is concentrated in taxpayers whose income is $200,000 or more, and 50% of such income is concentrated in taxpayers whose income is $1,000,000 or more. At best, one-third of this $400 billion of income comes from small businesses, and an infinitesimal amount of that comes from mom-and-pop businesses.

Table X-9 shows taxpayers classified by adjusted gross income with and without pass-thru income.

Table X-9 **Number of Taxpayers with Adjusted Gross Income (AGI) in Certain Categories – 2008** **(millions)**			
Taxpayers	Number	AGI Exclusive of Pass-Thru Income	AGI Attributable from Pass-Thru Income
All Filers	142,450,569	$8,262,860,170	$542,454,108
Filers with Taxable Income	90,660,104	$7,583,461,595	$526,944,982
Filers with $200,000 or More AGI	4,375,659	$2,462,007,964	N/A
Filers with $200,000 or More AGI Having Partnership and S Corp Income	1,336,736	N/A	$446,954,373
Source: Data extracted from IRS, Tax Stats, Table 1. All Returns: Sources of Income, Adjustments, Deductions and Exemptions, by Size of Adjusted Gross Income, Tax Year 2008.			

As shown in Table X-9, there are about 4.37 million taxpayers with $200,000 or more of adjusted gross income who account for a total of $2.46 trillion of adjusted gross income. Within this group, there are about 1.34 million taxpayers, or about 31%, who account for $447 billion of pass-thru income. And, of this pass-thru income, only about one-third, or $131 billion, is likely to come from small businesses. All of this means that the myth-makers are seeking to shield over three million high-income taxpayers (who account for about $2.14 trillion of adjusted gross income) from any increase in tax rates even though these taxpayers have no small business income.

Shielding $2.14 trillion of adjusted gross income from an assumed five percentage point tax increase takes about $106 billion in revenue off the table. If this revenue does not come from the very best-off taxpayers, it must come from those less well-off—just one example of the stakes in who wins and who loses the tax game.

Simple Solutions and Hidden Agendas

Had there been any truth to the pretense that increasing the top personal income tax rates would kill small business jobs, a simple solution could have raised necessary revenues without affecting small business owners. Small business owners could be protected from tax rate increases without allowing the rich to amend the tax laws to define what constitutes a small business for tax purposes and then setting a ceiling for the highest tax rate that would apply to pass-thru income attributable to these businesses.

Such a solution would have raised billions in revenue from wealthy taxpayers, such as movie stars, sports figures, hedge fund operators, big shot lawyers, bankers, and accountants who can afford to pay higher taxes while leaving owners of small businesses unscathed. The failure of interest groups (who oppose an increase on the top two rates for all on the pretense that it would harm small businesses) to tax those wealthy taxpayers who do not own a small business exposes the real agenda of these groups: to protect the rich at all costs.

TAX RATES AND JOB CREATION

Facts have established that tax rates up to 50% (and maybe higher) have no material effect on the willingness and ability of individuals to work for the next buck, as opposed to opting for a siesta. There is no reason to suppose that a tax rate of 40% on owners of successful small businesses will dampen their incentive to grow their businesses. For those who fear that many small business owners will choose not to chase after new customers because they will only get to keep 60 cents on the next dollar of profits, they lack confidence that greed, pride, and industry will assure that others will fill the void. History proves that only the foolish bet against the greed, pride, and industry of small businesses. So, if a 40% tax rate results in a few lazy small businesses deciding to give up the chase, it is a good bet that plenty of others will seize the opportunity.

Tax experts have conducted studies and found that increasing tax rates on small business owners affect only a few businesses. As an example, William Gale of the Tax Policy Center wrote an article, "Small Business and Marginal Income Tax Rates," dated April 26, 2004, which concluded as follows:

"First, few small business owners face the highest marginal income tax rates. Less than 9 percent of returns with small business income are in tax brackets of 28 percent and above, less than 3 percent face rates of 33 percent and above, and only 1.3 percent are in the top bracket. Roughly 97 percent of small businesses would not be affected at all by increases in the top two tax rates. More than two-thirds of all returns with small business income are in the 15 percent or lower tax bracket, and 88 percent face rates of 25 percent or below.

Second, business income is not the dominant form of income in any positive tax bracket. It totals one-third of income in the top bracket, less than one-quarter in the second bracket, and smaller shares at every other positive tax rate.

Third, although many returns in the top two brackets have at least some business income, few returns have most of their income from small businesses. For only about one-third of households in the top bracket and one-fifth in the second bracket is more than half of their income from business income."

Tax rates at up to 50% will affect only a few small businesses, and there is no proof that it will slow job creation.

Belying the myth that taxes cannot be increased on the very best-off because it will result in job creators not adding jobs are the following facts:

- Most of the very best-off who pay the top personal income tax are not owners of small businesses;

- Owners of small businesses are not in the business of creating jobs unless it is in their interest to do so, and many times it is not;

- The overwhelming amount of income that is subject to being taxed at relatively high rates does not come from small businesses; and

- There is no evidence that having the owners of a successful small business pay a personal income tax rate of 50% will prevent them from adding jobs if it is otherwise in their interest to do so.

The level of taxation and who gets taxed will play out in the politics of the tax game. Since politics, and not economics, decides who the winners and losers are in the tax game, and since myths are powerful political weapons, politics demands dispelling the job creator taxing myth.

CHAPTER 11

PAYING TO RENEW AMERICA

In explaining why the very best-off should pay more taxes to renew America, the following principle laid out in Luke 12:48 (*King James Bible*) says it all:
"For unto whomsoever much is given, of him shall be much required: and to whom men have committed much, of him they will ask the more."

Paying to Renew America: The Enlightened Self-Interest of the Very Best-Off • America's Capitalists • Re-Establishing America's Financial Security • Two Models for Wealth and Income Distribution: 1979 or 2012 • America's Choices

THE ENLIGHTENED SELF-INTEREST OF THE VERY BEST-OFF

Of all the world's leading nations and modern economies, America is the world's most prosperous, as measured by *per capita* income, and this is due in large part to capitalism. No economic system allocates capital more efficiently or rewards effort, skill, and imagination more fairly than capitalism. Capitalism cannot work, however, unless capitalists—those who invest their capital in business enterprises for the purpose of realizing a profit in accordance with the principles of capitalism—can reap the rewards for their successful investments as well as suffer the losses for their bad ones.

Taxing capitalists requires striking a delicate balance. On one side of the scale, public investments necessary for capitalism to prosper must be made and paid for by taxing capitalists, and, on the other side of the scale, capitalists cannot be taxed so heavily that they lose their incentive to put their capital at risk. The best evidence of whether capitalists are being over-taxed is to check out how they are doing financially relative to others.

Although scant data is available to directly measure and track the ownership of wealth, much data is available from governmental sources, such as the IRS, the Treasury, the Census, the BEA, the Fed, and also private sources, that enable economists to inferentially measure and track the ownership of wealth. Relying upon both governmental and private data, two economists, Emmanuel Saez of the University of California, Berkeley, and Gabriel Zucman, London School of Economics and Political Science, published a study in October 2014, WEALTH INEQUALITY IN THE UNITED STATES SINCE 1913: EVIDENCE FROM CAPITALIZED INCOME TAX DATA, as NBER Working Paper No. 20625 (the S&Z Study), that has measured and tracked wealth and income concentration among American families over the last century.

In the S&Z Study, households (families) are defined to include both single persons aged 20 and married couples, in each case with children dependents, if any; wealth is defined as the current market value of all assets owned by households net of all of their debts; and national income is the sum of all personal income as determined by the BEA. As Table XI-1 shows, three facts underscore just how much wealth has concentrated in households at the top:

- first, the top .1 of 1% owns as much wealth as the bottom 90% combined;

- second, the average wealth ($371 million) of the top .1 of 1% is 283 times the average wealth ($1.31 million) of those in the top 90th through 99th percentiles; and

- third, the top 1% owns almost twice as much wealth as the bottom 90%.

Given these disparities, capitalism amply rewards those who are successful.

Table XI-1 Wealth Distribution among Households as of 2012 (current dollars)				
Ownership Groups	Number of Families	Wealth Thresh-old	Average Wealth	Wealth Share
Full Population	160,700,000			100%
Bottom 90%	144,600,000	$0	$84,000	22.8%
Top 10% – 1%	14,463,000	$660,000	$1,310,000	35.4%
Top 1% – 0.1	1,607,000	$3,960,000	$7,290,000	19.8%
Top 0.1 – 0.01%	160,700	$20,600,000	$39,700,000	10.0%
Top .01% >	16,070	$111,000,000	$371,000,000	11.2%
Source: Data extracted from S&Z Study Appendix, Table B1.				

As shown in the S&Z Study, this intense concentration of wealth is the result of a 30-plus year trend, which has been relentless and shows no sign of slowing. This trend has created winners and losers among income groups with groups at and closest to the peak being the winners and those at or closest to the base being the losers. Examples of the losers include the following households:

- The bottom 90% whose wealth share fell by 30%;
- The top 10% to 5% whose wealth share fell by 23%; and
- The top 5% to 1% whose wealth share fell by 15%.

Examples of the winners include the following households:

- The top .1% to the top 1% whose wealth share rose by 20%;
- The top 0.1% to the top 0.01% whose wealth share rose by 104%; and
- The top 0.01% whose wealth share rose by 330%.

From 1979 through 2012, the top 1% has reaped an ever-growing share of America's wealth while everyone else has either barely kept even or fallen behind.

AMERICA'S CAPITALISTS

Anyone can claim to be a capitalist, but to be a real one requires having money available to invest—it is the difference between being a fan and a player. Capital finances the property, plant, and equipment that make the economy run, and without it, there would not be an economy. Although capital takes many forms, it can be divided into two basic categories: first, "equity," meaning an ownership interest in a business or a bank, savings, or money market account, and second, "debt," meaning an ownership interest in an obligation of a borrower to repay a loan. With respect to capital in America as of 2012, the S&Z Study observed the following:

- capital represented 37.1% of America's total wealth with housing accounting for 16.4%, business assets accounting for 10.3%, and pensions accounting for 36%, and

- the ownership of capital was intensely concentrated with the bottom 90% owning less than 2%, the top 1% owning 75%, and the top .01% owning 28%.

From the overall increase in wealth and its intense concentration since 1979 in the top 1%, there is no hint that capitalists either are not being generously rewarded for putting their money at risk or cannot afford to pay more in taxes. Outside the top 1%, housing and pensions comprise almost all of its wealth, but for those in the top .1%, capital comprises almost all of its wealth. As a practical matter, capital is the only form of wealth that can be invested. **Fortunately, America has many champions of capitalism, but unfortunately, it has only a very few capitalists.**

Borrowed Household Wealth, The Classic Oxymoron

Although America's capitalists have never been wealthier, they are not quite as wealthy as it appears. A significant amount of today's capitalists' wealth is attributable to an oxymoron, borrowed household wealth. Since 1981, America has created significant private wealth through public borrowing which has increased the national debt. Imagine the folly of cutting taxes on a billionaire by $1 million, letting the billionaire bank the $1 million, financing the $1 million tax cut by adding it to the national debt, and having some set of future taxpayers paying back the $1 million plus interest. In that deal, the billionaire who pockets the current tax cut wins and all other taxpayers lose. Folly notwithstanding, that is exactly how a substantial amount of household wealth has been created. While past folly has been great for the billionaires of the last 30 plus years, it will not be so great for the taxpayers of the next generation or two who will most likely have to pay it back.

Grasping the significance of borrowed wealth requires understanding that (1) nominal household wealth, as measured by the S&Z Study, is the aggregate amount of all household wealth net of all private debt, and (2) borrowed household wealth is that portion of nominal household wealth which is equal to the national debt. America's real household wealth, then, is nominal household wealth less borrowed household wealth. Borrowed household wealth should be subtracted from nominal household wealth because nominal household wealth is encumbered by an unconditional obligation of the government to repay the national debt from all income and wealth subject to taxation. Just like a mortgage is an encumbrance against one's home, the national debt is an encumbrance against nominal household wealth.

From 1979 through 2013, both the GDP and nominal household wealth grew, but neither grew (in percentage terms) as much as the national debt, as shown by the following changes:

- nominal household wealth grew, as a percentage of GDP, from 252% to 380% resulting in 2013 nominal household wealth being $62.651 trillion;

- the national debt grew, as a percentage of GDP, from 32% to 106% resulting in the 2013 national debt being $17.548 trillion; and

- if the national debt in 2013 had been held to the same percentage of GDP that it was in 1979, it would have been $5.661 trillion, or $11.887 trillion less than it was; and

- borrowed household wealth (1) increased by $11.887 trillion from 1979 to 2013 and (2) accounted in 2013 for 28% of nominal household wealth as compared with 13% in 1979.

Borrowed household wealth grew by $11.887 trillion because America was unwilling to tax itself to pay for what it spent. Not coincidentally, this increase in borrowed household wealth occurred at the same time that the Reagan and Bush tax cuts (which disproportionately favored those with the highest income) substantially reduced revenue and increased the national debt. So, it is quite likely that much of the increase in borrowed household wealth can be found in the investment portfolios of high-income wealthy investors who squirreled away the Reagan and Bush tax cuts and otherwise benefitted from low taxation.

The S&Z Study shows that no group benefitted more from borrowed wealth than those with income in the top 1%. In 1979, the top 1% had a 24.4% share of nominal household wealth, but by 2013 their share had grown to 41.8%. Since total nominal household wealth in 2013 was $62.651 trillion, the increase of 17.4 percentage points (41.8% – 24.4%) in the top 1%'s share of nominal household wealth was worth $10.901 trillion. Again, not coincidentally, this increase in the top 1%'s share of nominal household wealth closely matches the $11.887 trillion increase in borrowed household wealth. Borrowed household wealth disproportionately benefits high-income taxpayers during years in which the national debt grows and disproportionately penalizes them during periods in which the national debt shrinks.

Although it is never good to increase the national debt (and therefore borrowed wealth), sometimes it is necessary in order to cope with a national emergency. During the period of 1979 through 2009, America was not confronted with a serious national emergency, but nevertheless it increased the national debt, as a percentage of GDP, from 32% to 68%. This increase in the national debt (and the accompanying increase in borrowed household wealth) made America less financially secure by increasing the debt to GDP ratio and redistributing wealth in favor of the top 1%. However, in late 2008 the Great Recession created a national emergency by plunging the economy into a free fall in which GDP was falling and unemployment was rising by 800 thousand jobs a month. To cope with this crisis, the government provided a fiscal stimulus which injected almost a trillion dollars into the economy. The stimulus included both spending increases on public investments and individual tax cuts targeted primarily to those with middle and low-incomes. Fortunately, the stimulus largely succeeded, but it came at the cost of adding substantially to the national debt.

If, as during the Great Recession, it becomes necessary to increase the national debt, it should be done in a way that does not unnecessarily concentrate more wealth in the top 1%. Increasing the national debt to finance both (1) increased spending on public investments that grow the middle class and (2) tax cuts that lead to increased individual consumption do not unnecessarily concentrate more borrowed household wealth in the top 1%. Increasing the national debt to finance tax cuts that enable the top 1% to bank them unnecessarily concentrates wealth in the top 1%. The fact that over the last 40-plus years the top 1% has substantially increased their share of America's wealth simultaneously with a growing national debt can be attributed almost exclusively to giving tax cuts to the top 1% that they were able to save. This policy was the cornerstone of the Bush tax cuts. Anyone who doubts the influence of those who represent the top 1% in the tax game need only look at their success in enacting tax cuts that uniquely benefited the top 1% by taxing the return on capital at rates lower than taxing wage income.

RE-ESTABLISHING AMERICA'S FINANCIAL SECURITY

In 2013, America's public debt ($11.983 trillion) to GDP ($16.498 trillion) ratio was 72%, the highest level in generations. To ensure that the economy creates real household wealth and establishes financial security, America must put its financial house in order by getting its public debt to GDP ratio down to a manageable level. As a reaction to the growing national debt wrought by the Great Recession, the 2010 Simpson-Bowles Report warned of a "Looming Fiscal Crisis" and argued that America will not be financially secure until it resets its fiscal priorities to reduce its public debt to GDP ratio to no more than 40% by 2036. In other words, America should conduct its financial affairs by complying with the 40% Rule. Tolerating public debt in excess of the 40% Rule exposes America to the same danger that confronts a family who taps out its credit card to have a vacation instead of reducing its debt. As long as the family does not have to deal with an emergency, things may work out, but if someone in the family has a medical emergency, there will be no way for the family to pay for a visit to the ER.

Financial security protects America against national emergencies much like fire insurance protects homeowners against fires. Paying the taxes necessary to maintain financial security is much like paying insurance premiums. If a homeowner's house does not catch fire, paying premiums seems a waste, but if the house burns down, in retrospect, then the premiums seem cheap. America, unlike an individual, cannot afford to go naked in the face of catastrophic risks—too much is at stake for too many.

By 2013, America's public debt had grown to $5.755 trillion over what would be required to satisfy the 40% Rule. To bring America into compliance with the 40% Rule would have required not only that no future additions be made to the public debt, but that America start paying it down. Complying with the 40% Rule would have been a heavy lift in that in 2013, as a percentage of GDP, total government spending was 22.7% and taxing was only 16.7%, a six-percentage point differential. Without even paying down any public debt, in 2013, taxes would have had to be increased by $990 million, or about 75% of the $1.316 trillion that was paid under the personal income tax in 2013, just to keep the problem from getting worse. Since 2013, the spread between spending and taxes has worsened. In 2016, the CBO (based on then-current law) projected for the period 2016 through 2046 that (as a percentage of GDP) government spending would increase from 21.1% to 28.2%; revenues would increase from 18.2% to 19.4%; and the public debt to GDP ratio would increase from 75.4% to 141.1%. In 2021, the national debt is over 100% of GDP and accelerating. America's capacity to cope with national emergencies has become dangerously imperiled.

In terms of financial security, America is much like a tight-rope walker who is performing without a net, and the price for America purchasing a net will almost certainly mean substantially higher taxes for an extended period.

Paying for America's Financial Security

As a practical matter, paying for America's financial security must be based on the ability to pay principle if for no other reason than that blood cannot be extracted from a stone. Increasing taxes on those whose income and wealth have stagnated or fallen over an extended period would result in intolerable economic, social, and political stress.

Comparing the 2012 model of wealth distribution among various income groups with the 1979 model, as shown in Table X-2, reveals which income groups have the greatest ability to pay higher taxes to assure America's financial security.

Table XI-2
Wealth Ownership Models, the 1979 Model Compared with the 2012 Model

	Bottom 90%	Top 10% to 5%	Top 5% to 1%	Top 1% to 0.1%	Top 0.1% to 0.01%	Top 0.01%
1979 Model	32.60%	16.40%	26.70%	16.50%	5.30%	2.60%
2012	22.80%	12.60%	22.80%	19.80%	10.80%	11.20%
% Change (+) (-)	-30.06%	-23.17%	-14.60%	+20.00%	+203.77%	+430.76%

Source: Source: Data extracted from S&Z Study Appendix, Table B1.

Table XI-2 shows that in 2012, compared with 1979, the share of wealth for the top 1% rose substantially while the share of wealth for the bottom 99% fell, and within the top 1% most of the rise went to the top .01%.

Table XI-3 shows, in 2012 dollars, how much less in wealth the bottom 99% had and how much more in wealth the top 1% had as a result of the $62.651 trillion in 2012 nominal household wealth being distributed on the basis of the 2012 model instead of the 1979 model.

Table XI-3
Changes in the Distribution of Nominal Household Wealth in 2012 Dollars if 2012 Nominal Household Wealth
Was Distributed as It Was in 1979
($Trillions)

Bottom 90%	Top 10% to 5%	Top 5% to 1%	Top 1% to 0.1%	Top 0.1% to 0.01%	Top 0.01%
-$6.140	-$2.381	-$2.443	+$2.067	+$3.446	+$5.388

Source: Source: Data extracted from S&Z Study Appendix, Table B1.

The 2012 model, compared with the 1979 model, resulted in the top 1% having $10.901 trillion more in wealth and the bottom 99% having $10.964 trillion less in wealth.

This shift in wealth ownership did not just happen; it is the product of (1) impersonal market forces and (2) politically determined tax policies. Two market forces—globalization and technology—have favored the return of capital over labor, as follows:

- Globalization gave American capital access to cheap foreign labor; and
- technology-enabled capital to reduce labor costs through automation.

With globalization suppressing wages and with automation eliminating many skilled jobs, labor income has either (1) stagnated or fallen for those many who have only ordinary skills or (2) sharply risen for those few who have extraordinary skills.

As evidence that both market forces and tax policies have favored capital over labor, the composition of national income has tilted strongly in favor of capital since 1979. In 1979, the labor share of national income was 78% and the capital share was 22%. By 2012 the labor share of national income had shrunk to 72% and the capital share had grown to 28%. As the capital share, relative to the labor share, of national income has grown, both capital income and labor income have concentrated at the top.

Table XI-4 shows that in 2012, compared with 1979, the share of capital income increased for households whose share of wealth is in the top 10% while the share of capital income for those in the bottom 90% fell, and within the top 1% the highest percentage increase went to the top .01%. The increase in capital income for the top .01% percent (1) stems from a trend beginning around 1980 that has resulted in capital consuming an ever-growing share of the top .01%'s wealth and (2) underscores the principle that capital tends to beget capital, particularly if it is taxed at lower rates than labor income.

Table XI-4 **Distribution of Capital Income by Households Ranked by Wealth Shares, 1979 Compared with 2012**						
	Bottom 90%	Top 10%	Top 5%	Top 1%	Top 0.1%	Top 0.01%
1979	29.5%	70.5%	27.0%	20.0%	10.3%	3.9%
2012	24.0%	76.9%	41.7%	34.5%	21.9%	11.0%
% Point Change (+) (-)	-5.5%	+6.4%	+14.7%	+14.5%	+11.6%	+7.0%
Source: Source: Data extracted from S&Z Study Appendix, Table B29.						

Table XI-5 shows that in 2012, compared with 1979, the share of labor income increased for households whose share of wealth is in the top 10% while the share of labor income for those in the bottom 90% fell, and within the top 1% the highest percentage increase went to the top .01%.

Table XI-5 **Distribution of Labor Income by Households Ranked by Wealth Shares, 1979 Compared with 2012**						
	Bottom 90%	Top 10%	Top 5%	Top 1%	Top 0.1%	Top 0.01%
1979	80.7%	19.3%	12.3%	4.8%	1.1%	.0.3%
2012	72.2%	27.3%	18.9%	6.9%	2.7%	0.6%
% Point Change (+) (-)	-8.5%	+8.0%	+6.6%	+2.1%	+1.6%	+0.3%
Source: Source: Data extracted from S&Z Study Appendix, Table B28.						

The CEO pay to typical worker ratio explains much of why this concentration has occurred. In 1978, the CEO to worker pay ratio was 29.9%, but by 2014 the ratio had grown to 303.4%, a more than tenfold increase. In today's economy, any worker who does not have an extraordinary skill and is not able to efficiently execute it cannot expect to command much of an income.

While income and wealth concentration attributable to impersonal market forces is natural, such concentration attributable to tax policy is not. Tax policies that tax capital income at lower rates than labor income in the midst of a long-term trend of capital concentration are the product of the raw politics of the tax game. All of this helps explain why wealth and income have intensely concentrated in the top 1%.

Taxing and the Top 1%

From 1979 through 2012, taxes were cut for all income groups, but none more than for the top 1%, and, within it, the top .01%, as shown on Table XI-6.

Table XI-6
Average Effective Tax Rates by Income Groups

	All	Bottom 90%	Top 10%	Top 1%	Top 0.5%	Top 0.1%	Top 0.01%
1979	14%	10%	22%	33%	36%	41%	44%
2012	12%	8%	17%	23%	26%	27%	28%
% Point Change (+) (-)	-2%	-2%	+5%	+10%	+10%	+14%	16%
% Cut	14%	20%	23%	30%	27%	35%	36%

Source: Data extracted from S&Z Study, Appendix Table B32.

Table XI-6 shows that taxes were cut by 30% for the top 1% and 36% for the top .01%. The tax game resulted in those with the highest incomes getting the largest share of tax cuts, not just in absolute terms but in percentage terms. Not coincidentally with these tax cuts, from 1979 through 2013 (1) the national debt (as a percentage of GDP) rose from 32.04% to 100.55%, and (2) borrowed household wealth increased by $11.887 trillion in 2013 dollars.

With taxes having been cut substantially more for the top 1% than everyone else, progressivity became a fatality of the tax game. For the period 1979-2012, the multiples by which the pre-tax and after-tax income of the top 1% of households ranked by wealth exceeded that of the bottom 90% grew dramatically, as shown on Table XI-7.

Table XI-7 Statistics Comparing Pre-Tax and After-Tax Income ($Trillions)									
	Bottom 90%			Top 1%			Top .01%		
Year	Pre-Tax Income*	Effective Tax Rate**	After-Tax Income	Pre-Tax Income*	Effective Tax Rate**	After-Tax Income	Pre-Tax Income*	Effective Tax Rate**	After-Tax Income
1979	$1.573	10.00%	$1.416	$0.218	33.00%	$0.146	$0.071	44.00%	$0.040
2012	$8.371	8.00%	$7.701	2.538	23.00%	$1.954	$1.160	28.00%	$0.835
Increase	532%		544%	1164%		1338%	1634%		2101%
Sources:									
*Data extracted from S&Z Study, Appendix Table B25.									
**Data extracted from S&Z Study, Appendix Table B32.									

Table XI-7 reveals two dominant trends from 1979 through 2012, as follows:

- First, the pre-tax income of the top 1% grew 242% more (1338%/552%) and the top .01% grew 380% more (2101%/532%) than that of the bottom 90%.

- Second, even more than pre-tax income, the after-tax income of the top 1% grew 246% (1338%/544%) more and the top .01% grew 3.86 times more (21.01/5.44) than the bottom 90%.

Increases in pre-tax income are prizes won in the marketplace while increases in after-tax income are prizes won in playing the politics of the tax game. While it is easy to understand why a very few extraordinary income earners and capitalists can win pre-tax increases in the marketplace, it is hard to understand why ordinary income earners who have millions more votes than extraordinary income earners and capitalists have lost the politics of the tax game for the last 40-plus years.

Since millionaires and billionaires already have plenty of money, they are able to save their tax cuts. Saved tax cuts, unlike spent tax cuts, compound wealth and income disparities because saved tax cuts are invested and yield a return to the investors. From the period 1979 through 2012, the bottom 90% at best saved very little and more often than not either saved nothing or drew down on savings while the top 1% more often than not saved in a range from about 35% to more than 50%. It is a safe inference that tax cuts that went to those in the bottom 90% were not saved, but those that went to the top 1% were saved and thereby compounded wealth and income disparities.

Given the long-term trend in the concentration of income and wealth in the top 1%, increasing their taxes is a good place to start in paying for America's financial security.

In a democratic society, too much wealth and income concentration becomes a bad thing when the vast majority of its citizens come to believe that it is a bad thing. Some things, as Aristotle might warn, can become so bad that they can fracture a society and threaten a nation's future (remember the Social War in Athens and Solon's solution). Given the trend of wealth and income concentration over the last 30-plus years, an increasingly large number of ordinary Americans are coming to believe that it has gotten out of hand. Rather than waiting to see where the breaking point is for excessive concentration, steps should be taken sooner rather than later to do something about it. Aristotle might advise that excesses are better avoided than remedied.

TWO MODELS FOR WEALTH AND INCOME DISTRIBUTION: 1979 OR 2012

Although many forces are working to increase wealth and income concentration, these forces are not inevitable. Globalization and technological advances could be slowed or even reversed, but to do so would be economically self-defeating. Instead, tax policies can either intensify or mitigate wealth and income concentration. In this respect, America has two models from which to choose—the 1979 model (with less intense concentration) or the 2012 model (with more intense concentration). Taxes can be either (1) increased to provide America with financial security and pay for the public investments necessary to grow the middle class or (2) cut to increase borrowed wealth and expose America to increased financial insecurity and social turbulence. Also, taxes can be made more progressive and simpler to mitigate income and wealth disparities or not. Over the next generation, Americans have a choice to make, do they want a 1979 model of income and wealth concentration or a 2012 model. Which model is chosen will play out in the tax game.

No mystery cloaks the reason for wealth and income concentration in the top 1%. Since 1979, those advocating the interest of the top 1% have consistently won all but a very few of the major contests in the tax game by enacting policies based on the following principles:

- Taxation should be less progressive.
- Tax preferences favoring the return on capital over labor income and giving advantages to some politically favored businesses should be expanded.
- Tax cuts are more important than making necessary public investments and reducing the public debt to GDP ratio to closer to 40%.

Adherence to these politically determined tax principles has resulted in more rather than less wealth and income concentration and has exposed the American economy to the danger of being unable to respond financially to a national emergency. These principles have substantially contributed to America trading in the 1979 model of wealth and income concentration for the 2012 model.

If after having tried out the 2012 model America decides that it prefers something more like the 1979 model, then new tax policies will have to be enacted based on the following principles:

- Taxation should be more progressive.
- Taxation should be simplified by ending all tax preferences.
- Tax rates should be adjusted from time to time to assure compliance with reducing the public debt to GDP ratio to 40%.

Enactment of policies consistent with these principles over time (sooner or later depending on the specifics) would move wealth and income concentration toward the 1979 model and away from the 2012 model.

Capitalism Has Been Good for America and the World

Not only has capitalism been good for America, but it has also been good for the world. Worldwide capitalism has created wealth on a scale never known before in world history, and nowhere more than among America's current crop of capitalists, those in the top 1%. Worldwide capitalism—America's gift to the world—was made possible because of (1) America's commitment after World War II to preserving world peace and (2) its example to peoples all over the world that the American way of life based on personal freedom and capitalism offered them the best hope for a better life.

Capitalism prospers best in a nurturing environment where (1) capital is free to roam EVERYWHERE in the world in search of its highest return, (2) contracts are sacrosanct EVERYWHERE capital is employed, and (3) disputes are resolved peacefully EVERYWHERE capitalists do business. All capitalists have an interest in supporting efforts, both nationally and internationally, which create and preserve an environment that nurtures capitalism. Throughout most of history, however, capitalism has had to contend with environments ranging from mildly unfriendly to downright hostile.

For the 1st, 2nd, and 3rd centuries, Rome's *Pax Romana* provided the rule of law, peace, and security for most of the civilized world; for much of the 18th and 19th centuries, Great Britain's *Pax Britannia* provided for greatly expanded international commerce as well as relative peace and security for most of the world; and for the last half of the 20th and first part of the 21st centuries, America's *Pax Americana* has greatly expanded the rule of law and international commerce as well as maintaining peace and security throughout most of the world. In between these periods, the world had to suffer through the Dark Ages, several plagues, religious wars, social upheavals, revolutions, and the catastrophic World Wars of the 20th century, all of which were terrible for business in general and capitalism in particular.

At the end of World War II, America, as the world's strongest nation—politically, economically, and militarily—took the lead in forming (1) a network of worldwide mutual security alliances, (2) a series of trading agreements that opened up international commerce as never before, and (3) international institutions like the United Nations to preserve world peace. These actions lead to what historians have called the "*Pax Americana*" under which a growing number of the world's nations have accepted (and now more or less attempt to live under) the following principles:

- **Adherence to the rule of law including in particular respect for property rights;**
- **Agreement to peacefully resolve all conflicts among nations; and**
- **The establishment and maintenance of free-capital and labor markets.**

As America has spread these principles, the world's under-privileged have seen for themselves how America's fusing of personal freedom with capitalism has made for a better life for more people than any other system. The American model has led to the peaceful triumph of capitalism over socialism and communism with a growing number of the world's have-nots now believing that capitalism, not socialism or communism, offers them their best chance for a better life. Internationally, the peace and expansion of the rule of law made possible by the *Pax Americana* and the triumph of capitalism as the world's accepted economic model for progress have combined to create worldwide capitalism.

The worth of worldwide capitalism to capitalists is of an incalculable value as measured by their money-making potential. Never in the world's history has capitalism had a more accommodating environment than now. However, the workings of worldwide capitalism and technology have now put the American model—the reality that personal freedom and capitalism working in tandem will produce a better life for all—at risk. While worldwide capitalism has increased the return on capital because of the unprecedented competition of the world's businesses for scarce capital, it has suppressed the wages of ordinary American workers by subjecting them to unprecedented competition from an abundance of cheap foreign labor and technological advances. Worldwide capitalism, then, has simultaneously made (1) capital more valuable (thereby enriching capitalists) and (2) the labor of ordinary workers less valuable (thereby impoverishing many ordinary Americans). Any economic system that creates excessive wealth in a very few and stagnating and falling incomes in the many will not last in a democratic society.

The *Pax Americana* did not magically appear. It arose out of a political consensus in which the vast majority of all Americans came to believe that (by becoming actively involved in world affairs to preserve international peace and extend the rule of law to more nations) America could make the world a better place and improve the lives of ordinary Americans. The American model also did not magically appear. It is the progeny of a century's work to (1) provide social insurance to the aged, infirm, and poor; (2) expand civil rights to all races, colors and creeds; (3) enact progressive taxes that enable those with middle and low incomes to have a higher standard of living; (4) increase educational opportunity for those with middle and low incomes; and (5) regulate industry to assure a more livable environment, all of which have created an American quality of life that is the envy of the world's have-nots. Creating and sustaining the *Pax Americana* and the American model have cost taxpayers (primarily upper-income Americans) trillions of dollars and the blood of hundreds of thousands of soldiers (primarily the children of middle and lower-income Americans). Contributions of blood and treasure both have been vital to creating and sustaining the *Pax Americana* and the American model, and both contributions should be respected by all.

Nothing continues forever and that includes worldwide capitalism. Two pillars—the *Pax Americana and* the belief of many of the world's have-nots that the American model offers them the best chance of a better life—support worldwide capitalism. These pillars, in turn, rest on a foundation grounded on the belief of an overwhelming majority of ordinary Americans that personal freedom coupled with capitalism offers them a better life than any alternative. If ordinary Americans ever lose their belief in the American model of personal freedom and capitalism, then the foundation on which the two pillars that support worldwide capitalism will collapse.

For capitalists who doubt the value of worldwide capitalism, they should imagine doing business in a world in which (1) domestically, America is afflicted with class and ethnic strife, political instability, an under-educated and demoralized workforce, and declining mass consumption; and (2) internationally, warfare is common, the rule of law is rare, and international commerce is problematic. In such a world, capitalism would work only sporadically in a few safe havens, and the prosperity that it has brought to capitalists would evaporate. **Out of pure self-interest, capitalists should support whatever is necessary to renew and bolster the belief of ordinary Americans that the American model offers them a better life than any alternative.**

AMERICA'S CHOICES

If America is to be renewed as a nation in which the vast majority of ordinary, hardworking, law-abiding Americans and their children are to live better lives, then America has a choice to make. Will all working Americans be permitted to share in Americans growing wealth, or will America's growing wealth be confined to the top 1%? The answer to this question will play out in the tax game where it will be nobly won or meanly lost. Renewal of America depends on getting its financial house in order and making the public investments necessary for economic growth and growing prosperity for all working Americans, and this requires raising taxes.

In deciding how much and who to tax, Americans will have to answer the following questions:

Should taxes be raised so that America can get its financial house in order?
[Y] [N]

Should taxes be increased or cut for those on the brink of poverty?
[Y] [N]

Should taxes be increased or cut for those with median and lower incomes?
[Y] [N]

Should taxes be increased or cut for those with above-average incomes?
[Y] [N]

Should taxes be increased or cut for those in the top 1%?
[Y] [N]

Should labor and capital income be taxed at the same or different rates?
[Y] [N]

Should any two taxpayers who make the same income pay taxes at different rates?
[Y] [N]

Should the after-tax income of working Americans reflect America's overall economic growth?
[Y] [N]

Should taxation be dramatically simplified?
[Y] [N]

Do the income and wealth disparities between the top 1% and bottom 90% of 1979 offer enough incentive for America's top 1% to be successful in business and invest their capital?
[Y] [N]

The answers to these questions will either renew America for ordinary Americans or leave America on the existing track of concentrating wealth and income in fewer and fewer.

CHAPTER 12

THE AMERI-SHARE TAX PLAN

"No society can surely be flourishing and happy of which by far the greater part of the numbers are poor and miserable."

Achieving a flourishing and happy society is not easy, when as Smith also observed:

"Our merchants and masters complain much of the bad effects of high wages [it could just as easily be high taxes] in raising the price and lessening the sale of goods. They say nothing concerning the bad effects of high profits. They are silent with regard to the pernicious effects of their own gains. They complain only of those of other people."

"It is not very unreasonable that the rich should contribute to the public expense, not only in proportion to their revenue, but something more than in that proportion."

"Wherever there is great property there is great inequality. For one very rich man there must be at least five hundred poor, and the affluence of the few supposes the indigence of the many. The affluence of the rich excites the indignation of the poor, who are often both driven by want, and prompted by envy, to invade his possessions."

Smith's observations about how capitalism works shows how difficult the struggle is to achieve a "flourishing and happy" society.

The Ameri-Share Tax is a tax designed to earn the adoration of Adam Smith.

Adam Smith, the Enlightenment's prophet of capitalism

A TAX TO KEEP AMERICA THE LAST BEST HOPE OF THE WORLD

Two inexorable economic forces—globalization and automation—combined with a politically driven policy of under-taxing the top 1% have conspired to endanger the American Dream for millions of Americans.

A recent academic study, "The Fading American Dream: Trends in Absolute Income Mobility Since 1940," authored by Raj Chetty, Maximilian Hell, Nathaniel Hendren, Robert Manduca, and Jimmy Narang, explains why millions of middle-class Americans are losing faith in their ability to live the American Dream. This study, which measured "absolute income mobility"—the fraction of children who earn more than their parents—since 1940, found the following:

"One of the defining features of the "American Dream" is the ideal that children have a higher standard of living than their parents. […]We find that rates of absolute mobility have fallen from approximately 90% for children born in 1940 to 50% for children born in the 1980s. Absolute income mobility has fallen across the entire income distribution, with the largest declines for families in the middle class. […]Absolute mobility fell in all 50 states, although the rate of decline varied, with the largest declines concentrated in states in the industrial Midwest, such as Michigan and Illinois. […] There have been two important trends that have affected the incomes of children born in the 1980s relative to those born in the 1940s and 1950s: lower Gross Domestic Product (GDP) growth rates and greater inequality in the distribution of growth. We find that most of the decline in absolute mobility is driven by the more unequal distribution of economic growth rather than the slowdown in aggregate growth rates. […]These findings show that higher growth rates alone are insufficient to restore absolute mobility to the levels experienced in mid-century America. [...] We conclude that absolute mobility has declined sharply in America over the past half century primarily because of the growth in inequality. If one wants to revive the 'American Dream' of high rates of absolute mobility, one must have an interest in growth that is shared more broadly across the income distribution."

Perceptions eventually catch up and overtake reality, and the new reality is that most Americans will not live as prosperous lives as their parents. From its beginning and even through economic downturns, most Americans have been confident and optimistic about theirs and America's future. But, with over 40-plus years of more and more ordinary Americans not only failing to maintain their standard of living but falling behind, many of these Americans have lost hope that theirs and America's future will be better. Mass pessimism and hopelessness are the makings of a troubled and dispirited middle class and all the social, political, economic, and financial ills that come with it.

For America to remain the last best hope of the world, it must be socially healthy, politically stable, economically prosperous, and financially secure. None of these things can be so without America having a vibrant and growing middle class.

To have a vibrant and growing middle class, **ALL** Americans, regardless of income, must have an opportunity to be all they can be, and **ALL** Americans must believe that if they work hard and play by the rules, they will be able to live the American Dream. For these things to be so, the government must adopt policies that convert aspiration into reality and that will cost money. The Ameri-Share Tax is designed to advance policies that will (1) revitalize and grow the middle class, (2) do it in a way that encourages both economic growth and social equity, and (3) assure America's financial security.

As a matter of patriotism, taxes must be the **SHARED** responsibility of all Americans. Taxes not only are the price of civilization, but they are the price of national greatness. Americans must come to believe that patriotism demands that each American should take pride in paying their taxes and feel shame for cheating on their taxes.

Americans will not equate paying taxes with patriotism unless they believe that their taxes are being spent wisely and are a shared responsibility of all.

The Ameri-Share Tax would provide all Americans with a shared opportunity to pay for sustaining America as the greatest nation on Earth through a simple tax based on the ability to pay that encourages productivity and treats those with the same income the same.

For the Ameri-Share Tax to become a reality, it must be fair to all Americans, and most Americans must believe it to be fair.

THE TASK AHEAD

Raising the overall level of taxes by about 6 or 7% of GDP is an ordeal, but a necessary one.

Known factors that will add political pressure to increase spending above the historical norm include: (1) making up for prior financial misdeeds by paying the public debt down to about 40% of GDP, (2) the aging of the population (which automatically increases the cost of Social Security and Medicare), (3) the need to provide access to adequate health care to millions of Americans for whom it has become increasingly unaffordable, and (4) the necessity of providing the growing number of children of the middle class with the post-secondary education essential to their becoming productive workers (all of which automatically increases the cost of federal subsidies for higher education). Unknown factors that might add political pressure to increase spending above the historical norm include: (1) unforeseen threats to national security, (2) economic downturns, and (3) natural catastrophes.

Since the factors that will dominate the politics of spending for the next generation cannot be predicted, spending levels are uncertain. With that caveat, however, the smart money is betting that the politics will increase spending from the historical norm of 22-23% of GDP to about 24-26% of GDP. No one votes more than old folks, and their bread and butter, Social Security and Medicare, are what soak up the money.

If GDP grows faster than the factors that add to spending, then tax increases will be smaller, but if not, tax increases will be larger. Just as the factors that lead to political pressures to increase spending cannot be predicted, neither can economic growth rates. To the extent that the GDP growth rate trails the spending growth rate, taxpayers will have a steeper hill to climb in paying their taxes.

All factors considered, taxes will likely have to be increased around 5-7% of GDP above current levels if the middle class is to be strengthened and America's financial security is to be assured—a daunting task.

THE AMERI-SHARE TAX: REPLACING MANY TAXES WITH ONE

Three major taxes—the personal income tax, social insurance taxes, and the corporate income tax—account for about 90% of tax revenue, and all tax income, individual and corporate. Using three separate taxes to tax income adds unnecessary complexity to taxation which could be avoided by replacing all of these taxes with a single, simplified personal income tax, the Ameri-Share Tax.

Although the estate tax taxes wealth and not income and raises little revenue, it is a nuisance that also adds great complexity to taxation. Eliminating the estate tax and raising the same revenue from the Ameri-Share Tax would simplify taxation. Except for the estate tax, America has no history of taxing wealth. Because most wealth is illiquid and difficult to value, taxing it is not practical. In taxing, income is where the money is, and, unlike wealth, it poses no problem of valuation or liquidity, and America already has a huge infrastructure in place to track and tax income, the IRS.

So, taxing income is the most practical way to raise revenue, and replacing all major taxes with a single, simple Ameri-Share Tax is the most efficient way to tax income.

Social Insurance Taxes

Social insurance taxes do three things: one of which is necessary; two of which do more harm than good; and all of which could be done differently and better.

First, social insurance taxes raise revenue necessary to pay for Social Security and Medicare. While this revenue is necessary to pay for social insurance, an equal amount of revenue could just as easily come from another source, the Ameri-Share Tax. Switching revenue sources would not require any change to either Social Security or Medicare in that income-based work credits could be credited to each beneficiary's account on the same basis as done under existing social insurance taxes, and the benefit structure could be left as it is.

Second, social insurance taxes impose a crushing burden on millions of middle- and low-income workers. Every dollar earned by an $8.00 an hour low wage worker is taxed at a rate of 15.3% to pay for Social Security and Medicare, with the employee's share and the employer's share each being 7.65%. The $16,000 in annual wages of such a full-time, low-wage worker would be taxed at $2,448, evenly divided between the employee and employer. According to the Department of Human Health and Resources, the poverty level in 2013 for a family of two, a single mother and child, was $15,510. Social insurance taxes have the effect of shoving a single mother with a child (whose income is $16,000) from barely above poverty into poverty. Replacing the flat-rate, first-dollar social insurance taxes with a progressive Ameri-Share Tax would lighten the tax burden of millions of low-wage workers and offer them a slight ray of hope of betterment for their families and themselves.

Third, social insurance taxes discourage businesses from hiring additional workers and reduce the amount businesses can afford to pay their employees. Employers pay a 6.2% tax on all employee wages up to a cap and another 1.45% on all wages. For the $8.00 an hour single mother, this amounts to $1,224 in annual taxes. Ending social insurance taxes would enable employers simultaneously to pay higher wages and increase their working capital. In an economy in which unemployment is high, penalizing employers who hire additional employees through social insurance taxes only adds grief to the sorrow of scarce jobs.

Social insurance has become an integral part of America's social contract, and as such, there is no reason why businesses, as opposed to all Americans, should pay for it. Paying for the social contract should be the SHARED responsibility of all Americans who have been financially blessed, not businesses, many of whom compete with global competitors unburdened by such a tax.

The Corporate Income Tax

The corporate income tax applies only to C-Corps and double taxes corporate income. Double taxation first hits C-Corps by taxing their profits, and second hits the owners of C-Corps by taxing both dividends and the capital gains on their shares. The income that is taxed as corporate profits to a business and as dividends to an individual emanates from the same stream of corporate income and is taxed at different rates in that C-Corp income is taxed at the corporate rate and dividends are taxed at the dividend rate.

From time to time the tax game has raised or lowered each of these rates resulting in growing or shrinking rate differentials. Rate differentials invite tax planning gamesmanship. Smart tax professionals can convert a high percentage of most types of corporate income to capital gains anytime capital gains rates get low enough relative to other rates to make the effort worthwhile.

Other than rewarding those taxpayers and their tax professionals who game the system, this sort of gamesmanship adds nothing to making businesses more efficient or permitting investment capital to find its most lucrative return, independent of taxes. Ending the opportunity to make profits by gaming the tax laws would encourage all businesses to devote their energy and resources to earning their profits based on market factors instead of exploiting tax preferences (loopholes). Profits based on market factors strengthen the economy while profits based on gaming the tax laws weaken it. Ending the corporate income tax would force businesses to abandon financial strategies based on exploiting tax loopholes in favor of concentrating on market fundamentals that would produce real growth.

To prevent a C-Corp from keeping excessive profits in the business in order to avoid distributing taxable dividends to shareholders, it would be necessary to impose an accumulated retained earnings tax. The sole purpose of this tax would be to deter C-Corps from engaging in tax gamesmanship by sheltering profits from being taxed as dividends. Assuming businesses distribute dividends in accordance with sound business practices and not in an effort to game the tax laws, the accumulated earnings tax would not raise revenue.

No longer being subject to the double taxation of corporate profits and being freed from the complexity of the corporate income tax should make American businesses more competitive in international commerce. **Since dividends and capital gains would be taxed under the Ameri-Share Tax, ending the corporate income tax would not result in corporate profits escaping taxation, but it would greatly simplify taxation and get politics out of most of business.**

The Estate Tax

When a wealthy person dies, there are two ways to tax the accumulated wealth comprising their estate, one burdensome and complex, and the other simple and efficient.

Presently wealth is taxed by the estate tax which taxes the estate of the deceased and not the beneficiaries of the estate. Alternatively, the beneficiaries of the estate could be taxed on the income they receive. Many states, in fact, have no estate tax but do have an inheritance tax that taxes beneficiaries on the income they receive from the deceased. The tax game has riddled the estate tax with so many tax preferences (loopholes) that it does little to raise revenue and primarily creates work for tax planners representing super-wealthy clients. Ending the estate tax and taxing inheritances as income under the Ameri-Share Tax would both (1) simplify the tax laws without losing any revenue and (2) be equitable in that those with high-income would pay a higher rate on their inheritances than those with low-income. To enable some wealth to pass to the middle class without an undue burden, the Ameri-Share Tax would exempt from taxation a certain amount (*i.e.*. $1 or $2 million) of inherited income to those beneficiaries whose income is below a certain threshold.

GETTING RID OF SUBSIDIES & TAX PREFERENCES

For the last several generations, the government, responding to the demands of a myriad of special interest groups, has indulged America in a cancerous disease—the excessive subsidization of the wrong things for the wrong reasons. Subsidies come in two forms, tax preferences and appropriations that fund social safety net programs, including, among others, Social Security, Medicare, Medicaid, unemployment insurance, food stamps, and other similar programs. Tax preferences, labeled by experts as "Tax Expenditures," spend taxpayer money just the same as social safety net programs spend taxpayer money, and both spend plenty of taxpayer money on upper-income (and in some cases filthy rich) Americans.

Nowhere does the proliferation of subsidies to the un-needy play out more than in the tax game through tax preferences. Although social safety net programs, such as Social Security and Medicare, subsidize to some extent the un-needy, the subsidies to the un-needy in those programs pale in comparison with those in tax preferences.

Nothing but raw politics of the worst kind justifies doling out taxpayer money to un-needy individual Americans. While identifying the needy can be difficult, identifying the un-needy is easy. **No American with an income exceeding the median income of all working Americans should by any rational standard be considered needy enough to justify being granted a taxpayer subsidy unless there is a damn good reason.**

While subsidization can be a valid tool for coping with serious social, educational, and economic problems, it should be regarded as an instrument of last resort, not as an opportunity for politicians to dispense favors. Unchecked subsidization has led to an overwhelming majority of politicians of all stripes using taxpayer money to buy their favorite things for their favorite people as a sure path to a successful career.

To give taxpayers confidence that taxpayer money will not be used to pay subsidies to the wrong people for the wrong things, the Ameri-Share Tax would end all subsidies to the un-needy relating to taxation and the social safety net.

Ending Tax Preferences

The Ameri-Share Tax would end almost all tax preferences, including rate differentials for dividends and capital gains and favorable treatment of various types of non-wage income, but permit two simplified credits, the first being a work credit and the second being an investment credit. The work credit is targeted to enable all below-average wage workers to share in economic prosperity and the investment credit is targeted to assure that the economy will have sufficient investment capital to promote growth. No special interest group will be favored under the tax laws over any other special interest group, and all income of all kinds will be taxed at the same rates for all taxpayers who earn the same income.

Under the Ameri-Share Tax, Congress would be forbidden to create any new tax preference of any kind unless such tax preference is approved by a two-thirds vote of both houses and approved by the President.

By the single act of ending of all special interest tax preferences, special interest politics would largely be taken out of the tax game, market forces would replace political forces in allocating investment capital, tax rates for the vast majority of taxpayers would be reduced, thousands of pages of tax regulations would be cut, tax evasion would be sharply curtailed, and compliance with the tax laws could be simplified so that almost everyone could figure their own taxes.

Ending Social Safety Net Subsidies for Those Who Do Not Need Them

The Ameri-Share Tax would end all subsidies under all social safety net programs to those who do not need them.

Under the Ameri-Share Tax, all federal agencies that administer any social safety net program would be required to provide the IRS and each beneficiary annually with a tax statement (known in the tax trade as a Form 1099) showing the amount of total benefits received and the amount of such benefits that were subsidized.

Subsidized benefits would include those benefits that exceeded the amount of (1) the contributions made by the beneficiary and the beneficiary's employer or deemed made by either and (2) the accumulated interest earnings on such contributions and deemed contributions. Deemed contributions would include the contributions made on behalf of the beneficiary and the beneficiary's employer to social insurance programs under the Ameri-Share Tax.

In the case of Social Security, the Department of Health and Human Services would be required to calculate the sum of (1) all contributions made by or on behalf of the beneficiary and the beneficiary's employer for the beneficiary's account and (2) the accumulated interest buildup on such contributions by applying an interest factor. This sum, as of any date, would be the cash value of what the beneficiary had paid into Social Security. The amount by which a beneficiary's total benefits exceeded the cash value of the beneficiary's contributions would be the subsidized amount of benefits.

In the case of Medicare, the Department of Health and Human Services would be required to calculate the sum of (1) all contributions (in the form of insurance premiums and taxes) made by or on behalf of the beneficiary and (2) the accumulated interest buildup on such contributions by applying an interest factor. This sum, as of any date, would be the cash value of what the beneficiary had paid into Medicare. The amount by which a beneficiary's total benefits exceeded the cash value of the beneficiary's contributions would be the subsidized amount of benefits.

In the case of all other social safety net programs, a similar procedure also would be required.

Under the Ameri-Share Tax, all taxpayers whose income exceeded the median income of all similarly situated working Americans as a result of receiving subsidized benefits under all social safety net programs would pay an Un-Needy Subsidy Tax. The rate on the Un-Needy Subsidy Tax would be 100%. Knowing that taxpayer financed social safety net subsidies are not going to the un-needy should give all taxpayers confidence that their tax dollars are not being wasted.

For Americans to treat paying taxes as a badge of patriotism and evading taxes as a betrayal of patriotism, Americans must believe that tax dollars are necessary to make government work. Ending the subsidization of the un-needy (in all forms) should build taxpayer confidence that their tax dollars are not being handed out to the wrong people for the wrong reasons.

Non-Profits & Charity

Tax-exempt non-profit corporations (often referred to as 501(c)(3) corporations because that is the section of the tax code that governs them) whose purposes include social welfare, health care, education, charity, and religion render invaluable and irreplaceable services to millions of Americans and would be able to continue to do so under the Ameri-Share Tax.

Under existing law, many types of non-profits enjoy an exemption from paying taxes on their profits and are not taxed on the donations made to them. Under the Ameri-Share Tax, however, only non-profits whose purpose is limited to social welfare, health care, education, charity, or religion would be entitled to an exemption from paying tax on profits and/or donations.

By ending all tax preferences, taxpayers would no longer be able to deduct from their taxes charitable donations made to these non-profits, but because these non-profits would not be required to pay taxes on donations or income, they should be able to continue to serve public interest.

The Rate Structure

In determining who pays what, the Ameri-Share Tax adopts a rate structure based on the following principles:

- **No high-income American should be taxed at a rate so high that it deprives them of a reasonable incentive to earn the next dollar.**
- **No low-income American should be taxed to the extent that that their after-tax income is less than 125% of poverty.**
- **Tax rates for all income groups in between the highest and lowest should be based on the taxpayers' ability to pay.**
- **The first and last dollar of income should be taxed at the same rate.**
- **Taxpayers who have the same income should be taxed the same amount.**

To protect Americans living in and on the edge of poverty from taxation, the Ameri-Share Tax would replace the existing standard deduction with the Ameri-Share Exemption. The Ameri-Share Exemption would be based on the number of people comprising the family/household of the taxpayer and would consider family/household income levels based on the annual "Poverty Guidelines" published by the Department of Health and Human Resources.

Living in or near poverty is not a decent standard of living, and in America decency should prevail over poverty. Since there is no objective test for what constitutes a "decent standard of living," the Ameri-Share Tax makes a reasonable (but arbitrary) determination that a minimal decent standard of living in today's America should not be less than 125% of poverty. To make sure that no American is taxed into or near poverty, the Ameri-Share Exemption would exempt from all taxation taxpayers in families/households whose income is at or below the amounts shown the current, annual Poverty Guidelines. An example of the Poverty Guidelines for 2013 is shown below in Table XII-1.

Table XII-1
2013 Poverty Guidelines for the United States

Persons in Family/ Household	Poverty Guidelines	Ameri-Share Exemption
1	$11,490	$14,363
2	$15,510	$19,388
3	$19,530	$24,413
4	$23,550	$29,438
5	$27,570	$34,463
6	$31,590	$39,488
7	$35,610	$44,513
8	$39,630	$49,538
Source: The Department of Health and Human Resources		

As a taxpayer's income rises above the poverty level, the Ameri-Share Exemption would be phased out. As an example, Table XII-2 shows (1) the Ameri-Share Exemption for a family/household of four, (2) the rate of phase-out as taxpayer income rises, and (3) the resulting taxable income of the taxpayer at various levels of income.

Table XII-2
Ameri-Share Exemption for a Family/Household of 4 Phase-Out

Total Income	Ameri-Share Exemption* (Adjusted)	Taxable Income
$29,438	$29,438	$0
$35,000	$26,657	$8,343
$40,000	$24,157	$15,843
$45,000	$21,657	$23,343

$50,000	$19,157	$30,843
$55,000	$16,657	$38,343
$60,000	$14,157	$45,843
$65,000	$11,657	$53,343
$70,000	$9,157	$60,843
$75,000	$6,657	$68,343
$80,000	$4,157	$75,843
$85,000	$1,657	$83,343
$90,000>	$0	$90,000
Notes: *The Ameri-Share Exemption for a family/household of 4 in 2013 would have been $29,438, or 125% of the poverty level of $23,550, and is adjusted downwardly by $.50 for every dollar of income above $29,438.		

The Ameri-Share Exemption can be adjusted in two ways to make it more or less progressive. First, the 125% ratio of the Ameri-Share Exemption could be increased or decreased, with increases making it more progressive and decreases making it less progressive. Second, the phase-out rate of $.50 per every additional dollar of income could be increased or decreased, with increases making it less progressive and decreases making it more progressive. Once income exceeds the phase-out, or $90 thousand for a four-person household, all income from the first to the last dollar would be taxed at the same rate. So, unlike the existing personal income tax, the Ameri-Share Tax would tax all income at the same rate.

The rate structure (1) sets a tax rate for those with the highest income, (2) sets a threshold—the Ameri-Share Exemption—for exempting from taxation those with the lowest income, and (3) sets differing rates for taxpayers in all income groups in between based on each groups' ability to pay. While multiple tax rates add complexity, they are necessary to assure that taxes are based on a taxpayer's ability to pay. Table XII-3 shows an example of what the Ameri-Share Tax's rate schedule might be, as follows:

Table XII-3
Rate Schedule for the Ameri-Share Tax

Tax Rates	Income Brackets*	
	Starting Point	Ending Point
0.00%	$0	$29,438

25.00%	$29,439	$82,500
27.50%	$75,001	$109,094
30.00%	$100,001	$162,500
32.50%	$150,001	$269,232
35.00%	$250,001	$535,715
37.50%	$500,001	$800,001
40.00%	$750,001	$1,062,501
42.50%	$1,000,001	$2,647,060
45.00%	$2,500,001	$5,277,779
47.50%	$5,000,001	$10,526,317
50.00%	$10,000,001	N/A
Notes: *A taxpayer whose taxable income is subject to two brackets would pay taxes based on the lowest bracket. For example, a taxpayer whose taxable income is $80,000 would be subject to a 25% rate. The purpose of over-lapping brackets is to smooth the transition from a lower rate to a higher rate.		

The final brackets and tax rates would depend upon the revenue needs of the time. In this respect, the annual amount of revenue needed is set each year when Congress and the President agree upon a budget which sets both the level of spending and revenue. Once the amount of revenue is set, income brackets and tax rates then would also be set.

If necessary, the income brackets can be adjusted in two ways, first to increase or decrease revenue, and second to increase or decrease progressivity. To raise revenue, the income thresholds for each bracket can be lowered and the brackets narrowed, and conversely, to lower revenue, the income thresholds for each bracket can be raised and the brackets widened. To increase progressivity, the income thresholds for the lower brackets, relative to the upper brackets, could be raised and widened, and conversely, to reduce progressivity, the income thresholds of the upper brackets, relative to the lower brackets, could be raised and widened. By adjusting the income brackets, the Ameri-Share Tax rate structure both (1) raises whatever revenue is required and (2) meets whatever progressivity standard is appropriate. From time to time, progressivity may be increased if the pre-tax income for taxpayers with very high incomes increases faster than their after-tax income, and conversely, progressivity may be decreased if their after-tax income is growing faster than their pre-tax income.

The rate structure of the Ameri-Share Tax would be both simpler and easier to administer than the rate structure for the existing personal income tax.

A LIVING WAGE

While falling wages are bad for workers lacking extraordinary skills, it is not bad for everyone. For capitalists, low wages mean higher business profits, and for upscale consumers, low wages mean cheaper goods and services. One person's loss can be another's gain. Despite being displaced, these workers are Americans, and as Americans, they still aspire to the American Dream for themselves and their children. Having millions of displaced workers and their families demoralized because of their loss of faith that they will share in the American Dream hurts not just them but all Americans. An America plagued by social strife, torn by political division, economically hampered by a workforce that cannot compete with foreign workers, and challenged by a shrinking consumer and tax base can no longer be the world's last best hope. To be great, America must ensure that the American Dream remains alive for all Americans, even those who have only ordinary job skills.

There are two ways to redress stagnating wages for middle- and low-income Americans—either business could be mandated to increase wages for all workers who lack extraordinary skills, or the government could provide wage subsidies. Neither is desirable, but elements of both are necessary if millions of Americans are to retain any hope for living the American Dream.

The Ameri-Share Tax has assumed that a living wage for families/households of a given number is 125% of the poverty guidelines, as determined from time to time by the Department of Health and Human Resources, see Table XII-1. Admittedly, what makes for a decent standard of living and a living wage to support it can be argued. Taking the argument from the general to the specific, Table XII-4 shows a monthly budget for two families, one, a single mom with one child, and the other, a family of four, based on the Ameri-Share Living Wage. Imagine that the wage earners in both families work at least 2,000 hours a year and live in some place like Peoria, Illinois. For those who argue that the Ameri-Share Living Wage is too generous, they are challenged to fill in the blanks in Table XII-4 and show the amount of the surplus.

Table XII-4 **Budget Example**		
	Single Mom and One Child	**Family of Four**
Total Monthly Income	$19,388	$29,438
Monthly Expenses		
Housing		
Food and Clothing		
Clothing		
Car Payment/Insurance		
Utilities/Phone/Cable		
Child Care		
Health Care		
Recreation/Entertainment		
Total Monthly Expenses		
Taxes		
Federal		
State and Local		
Savings		
Surplus		

Ultimately, politicians will decide what qualifies as a decent standard of living for full time workers working in low-skill jobs. As those politicians play God and decide what their standard of living should be, they should answer the following questions:

- **Suppose a child in the household is autistic, who is to pay for taking care of the child?**

- **Suppose a child in the household is gifted, who is to pay for educating the child through college to its full potential?**

- **Suppose a wage earner in the household becomes infirm and cannot work for an extended period of time, how is the family to get by?**

- **Suppose the wage earner in the household becomes an unemployed displaced worker (along with many others in**

a flooded labor market) because of an international trade agreement, how is the family to get by?

These are just a few of the questions the God-playing politicians should answer as they balance the interests of high-end taxpayers and the working poor. How many of the risks of life should the working poor bear, and how much should the well-off pay in taxes to mitigate those risks? For those high-income taxpayers who bemoan the possibility of the government mitigating the personal misfortune of the poor, they should take inventory of the existing tax preferences that mitigate their own losses—those who live in glass houses ought not throw bricks.

In balancing these interests, the Ameri-Share Tax adopts the principle of that which best advances the American Dream for all, poor and rich alike, realizing that the American Dream for all will be in jeopardy if there is little or no economic growth.

Mandating a Living Wage

One way to raise the wages of workers with less than extraordinary skills is to mandate that businesses do so. Conventional capitalists argue that mandating a business to pay a living wage will increase the business's cost of goods sold, raise the prices the business must charge, drive down their business's EBITDA (in non-investment banking lingo, Earnings Before Interest, Taxes, Depreciation, and Amortization), cut its value, threaten the ability of the business to grow, and result in self-defeating job losses among their least productive employees. To a greater or lesser extent, all of this is true. Each case, however, turns on the facts peculiar to that case. In some instances, the increase may be so small that only an obsessive bean counter will notice, and in other instances it may force a business owner to cut jobs.

The capitalists who argue against a living wage never bother to say how their employees are going to live on less than a living wage. Just to enable many low-wage workers and their families to subsist, governments (federal, state, and local) have been forced to institute a number of subsidy programs to provide food (food stamps), health care (Medicaid), housing (low-income housing tax credits), transportation (subsidization of public transportation), and higher education (student loan subsidies) to mention only a few of such programs. In capitalistic terms, businesses whose business model relies on workers being paid less than a living wage live off of taxpayer subsidies to the extent that taxpayers subsidize a bare subsistence standard of living. Imagine a clever capitalist who owns a warehousing business that relies on a low skilled workforce and locates his warehouse in a jurisdiction that has no minimum wage. The capitalist thrives from paying low wages, and, governments at all levels pay a substantial portion of the funds needed to feed, house, and provide medical care for their workers and their families.

Libertarian capitalists, unlike conventional capitalists, argue that individual freedom and self-fulfillment demand that capitalists are entitled to all the profits their greed commands and workers must accept the lowest wage that their desperation dictates. Libertarians make a moral argument oblivious to the economic implications—the individual freedom of a capitalist to make all the money they can trumps all other considerations. The economic implications of this argument, given the economic forces ignited by globalization and automation, would inevitably result in an America splintered into a few elegant, well-guarded gated communities and an ever-growing number of shanty-towns.

For capitalists in pursuit of profit, paying a less than living wage and letting taxpayers pay for their workers to subsist makes for a successful business model. For many communities, having one of their businesses add below living-wage workers (who cannot afford to pay the taxes that educate their children and provide fire and police protection and other local services) only burdens other taxpayers. If below living-wage workers can barely subsist, they will not be able to save for their own retirement leaving the quandary of what is to become of them when they get too old and infirm to work. Paying less than a living wage can be great for capitalists and certain consumers, but a raw deal for the taxpayers who have to foot the bill for government subsidies to make subsistence for low-wage workers possible.

Capitalists who argue that they cannot pay a living wage because it would force them to raise their prices fail to point out that labor is only one of the many types of the costs of doing business—such as rent, raw materials, utilities, taxes, and other costs—that determine the cost of goods sold. If any of these many costs go up, so too does the cost of goods sold, and so too do prices. Labor is only one of the costs of doing business and, as such, is subject to the same fluctuations as other costs. Sound business practice requires that businesses pay the unsubsidized cost of each of the various types of the cost of doing business and that if a business cannot pay such costs then its business model is not valid. **Any business that depends on subsidies of any kind is always at peril of failing if the subsidies are withdrawn.**

As to the libertarian capitalist moral argument that capitalistic greed and worker desperation should be left unfettered to sort out profits, wages, and prices, accepting this argument would result in destroying the middle class. The libertarian argument ignores that the American Dream is founded on the belief that there is more to life and more to being a good American than one's money-making abilities. There is a reason that almost all adults outgrow their sophomoric infatuation with Ayn Rand.

In the interest of weaning businesses whose profits are attributable to paying below living wages from taxpayer subsidies, the Ameri-Share Tax would require that all businesses (subject to a small business exemption similar to the existing exemption from the minimum wage) to pay a living wage to all adult workers.

THE AMERI-SHARE WORK CREDIT

Mandating that businesses must pay adult workers a living wage addresses the lowest skill, lowest wage issue, but it does nothing to address the issue of stagnating wages for millions of low- to middle-income workers whose wages exceed a bare-living wage. Mandating any business to pay wages above a living wage would intrude into the right of the business to manage its personnel in an efficient manner. Only a business can determine the relative value of its employees and what their compensation should be. The government cannot substitute its judgment for that of a business in compensation matters without leading to politics replacing economics.

While government sponsored relief from stagnating wages cannot come from a mandated wage scale, it can come through the Ameri-Share Work Credit. This tax credit would grant all below average-wage and salaried workers (who work in the private economy) a tax credit if their wages and salaries grew slower than the average for all workers. The credit would be determined, as shown in Table XII-5:

Table XII-5

Ameri-Share Work Credit Schedule

Cohorts[1]	Average Hourly Wage[2]	Year over Year % Change[3]	Wage Short-fall % [4]	Hourly Wage Credit[5]
1	$27.02	3.22%		
2	$27>$26	3.00%	0.22%	$0.02
3	$26>$25	3.11%	0.10%	$0.01
4	$25>$24	2.88%	0.34%	$0.03
5	$24>$23	3.04%	0.18%	$0.02
6	$23>$22	2.91%	0.30%	$0.03
7	$22>$21	2.82%	0.40%	$0.04
8	$21>$20	2.75%	0.46%	$0.05
9	$20>$19	2.27%	0.95%	$0.10
10	$19>$18	2.17%	1.05%	$0.10
11	$18>$17	2.06%	1.15%	$0.12
12	$17>$16	2.26%	0.95%	$0.10
13	$16>$15	2.00%	1.21%	$0.12
14	$15>$14	1.99%	1.23%	$0.12
15	$14>$13	2.10%	1.11%	$0.11
16	$13>$12	1.75%	1.47%	$0.15
17	$12>$11	1.69%	1.53%	$0.15
18	$11>$10	1.52%	1.69%	$0.17
19	$10>$9	1.49%	1.73%	$0.17
20	$9>$8	1.26%	1.96%	$0.20
21	$8>$7	1.16%	2.06%	$0.21

Notes:

(1) Each cohort comprises the workers whose wages fit within the “Hourly Wage” brackets.

(2) The Bureau of Labor Statistics reports that the average wage for all workers in 2012 was about $23.50.

(3) All year over year percentage wage increases for each cohort are fictional and presented only for purposes of illustration.

(4) The “Wage Shortfall” is the percentage of each dollar of wages by which the year over year increase in the average wage exceeds the increase in the hourly wage for each cohort.

(5) The Hourly Wage Credit is the product of the Wage Shortfall percentage multiplied by $1.00.

To determine the amount of a worker's credit, the worker first would determine the cohort (as shown in column 1) into which they fall and second multiply the "hourly wage credit" (as shown in column 5) for their cohort times the number of hours they worked. For example, a worker earning $17.50 an hour whose "hourly wage credit" is $0.1153 and who worked for 2,100 hours would earn a work credit in the amount of $242.13 (2,100 x $.1153).

The Ameri-Share Work Credit would enable all below average wage workers to participate in the growth of America's economy with no government meddling in setting wages. To qualify for a work credit, a taxpayer must work, and the amount of the work credit would depend on how many hours the taxpayer worked. The Ameri-Share Work Credit would provide millions of below average wage workers with a share of America's economy and would offer them an incentive to work harder and longer.

The Ameri-Share Work Credit would contribute to worker productivity by incentivizing all below average wage workers to work more hours and to qualify themselves for jobs with higher wages. **Above all, the Ameri-Share Work Credit would contribute to social and political stability by giving all low-wage Americans a belief that they too can share in America's prosperity.**

THE AMERI-SHARE INVESTMENT CREDIT

Americans' standard of living depends on maximizing their consumption of goods and services not just for the current generation but for future generations. Consumption is what people eat, drink, and wear, where they live, how they transport and entertain themselves, what kind of health care they have, and all the other ways in which they spend their money that make-up their standard of living. Investment is how much current income is saved for the purpose of providing sufficient capital to maximize the production of goods and services from one period to the next. Each American decides for themselves how much of their income they will consume and how much they will save, and as with all decisions, Americans do not always get the balance right.

Two examples illustrate how investment/consumption decisions affect individual families. First, a family uses its current income to take a vacation (consumption) instead of saving it for their kids' college (investment). While vacations are great for the here and now, they can come at the cost of the next generation's future earning capacity. Second, a family uses its current income to purchase an extravagant house (an investment) instead of buying an affordable one. While living in an extravagant house can bring personal satisfaction, it comes at the cost of cutting consumption of other things that also bring personal satisfaction like food, clothes, and recreation. Striking the right balance between investment and consumption is tough for individuals, families, and governments, and it is at least as easy to get it wrong as it is to get it right.

To have the greatest possible standard of living that is sustainable into the indefinite future, the right balance must be struck between consumption and investment. Too much consumption leads to a shortage of investment capital which in turn leads to an inadequate capacity to produce goods and services in the future, and conversely, too much investment leads to too little current consumption which means a lower than necessary standard of living. To assure a proper balance between the two, economists use concepts like (1) the Golden Rule level of investment (based on the Solow-Swan economic growth model developed by the Nobel Prize winning economist, Robert Solow); (2) the Golden Rule savings rate; and (3) the marginal product of capital (MPK) to strike the proper balance. The Biblical term, "Golden Rule," was coined by one economist to admonish each generation that in striking the balance between consumption and investment the current generation should treat future generations as they would want to be treated. In the spirit of the Golden Rule, the current generation should not consume so much that it is unable to invest enough to provide for maximum consumption by future generations.

Simply put, the Golden Rule level of investment is that amount of capital which supports a level of production consistent with maximizing consumption per worker; the Golden Rule savings rate is that rate of savings which provides sufficient investment capital to assure that consumption per worker will be maximized from one period to the next; and MPK is that point at which adding more capital will not increase production. Each of these concepts—the Golden Rule level of investment, the Golden Rule savings rate, and MPK—is expressed by complex mathematical formulas and can be quantified based on data inputs relating to, among other things, the nature of the capital employed in the production of goods and services, the depreciation of such capital, technological advances, and population changes. The accuracy and precision of the quantification of these concepts depends on the quality of the data inputs and the skill of the economists who apply them. Fortunately, America has plenty of expert economists in the private sector, academia, and the government who can offer useful advice on what is the proper balance between investment and consumption at any point in time.

MPK is an especially important concept because it marks the tipping point where adding more investment capital does not result in more production and therefore becomes self-defeating and wasteful. Stripped of economists' jargon, two phrases sum up what happens first when the MPK point is crossed and second if there is an increase in investment thereafter.

- First, think of adding capital that crosses the MPK threshold as being the straw that breaks the camel's back mindful that a camel with a broken back is not any good to a caravan.

- Second, think of adding capital after the MPK threshold has been crossed as carrying coals to Newcastle mindful that all coal brought to Newcastle was wasted.

Breaking the camel's back and carrying coals to Newcastle both impoverish, not enrich, America because the added capital reduces consumption and results in waste.

Symptoms (but not necessarily causes) of over-investment include an economy with above average and growing business profits coupled with falling consumption and either disinflation or deflation.

Symptoms (but not necessarily causes) of over-consumption include an economy with below-average and falling business profits coupled with increasing inflation.

Generally, increases in capital income tend to disproportionately increase investment while increases in labor income tend to disproportionately increase consumption. Since the relationship between capital and labor income is always changing, the balance between consumption and investment is always in flux. Not only do shifts in the relationship between capital and labor income affect the investment/consumption balance, but so too does tax policy. Two tax policies especially affect the investment/consumption balance. First, taxing capital and labor income at different rates tilts the balance in favor of the type of income taxed at the lowest rate. Second, making taxes less progressive tilts the balance in favor of investment while making them more progressive tilts it in favor of consumption. With the investment/consumption balance always in flux, tax policy either mitigates or exacerbates it. To mitigate an imbalance created by shifts in market income, tax policy can be changed as follows:

- First, if capital income increases relative to labor income, then tax rates can be made more progressive and/or capital income can be taxed at a higher rate; and

- Second, if labor income increases relative to capital income, then tax rates can be made less progressive and/or labor income can be taxed at a higher rate.

While ideally tax policy should work in tandem with the market to encourage a proper investment/consumption balance, in the real world of the tax game it does not. Politicians responding to selfish interest groups, not high-minded economists, set tax policy. **All Americans should realize, however, that an investment/consumption imbalance slows growth and makes most Americans poorer.**

For the last 30 plus years, capital income has grown faster than labor income, all income has concentrated at the top, and inflation has been relatively low, all of which strongly indicates that the balance has tilted in favor of investment over consumption. Also, for most of the last 40-plus years, capital income has been taxed at a lower rate than labor income and taxes have become less progressive. Given these long-term trends in both market income and tax policy, it is more likely that any investment/consumption imbalance tilts in favor of excessive investment. Any change in the tax laws should consider what should be done to assure a proper balance between investment and consumption and should be based on non-partisan expert advice.

If at some point a shortage of investment capital arises, the Ameri-Share Tax provides an investment tax credit—the Ameri-Share Investment Credit—to redress the shortage. The Ameri-Share Investment Credit is a tax credit available to any taxpayer who makes a qualifying investment and would be anywhere from five to ten percent of the amount of the qualifying investment. A qualifying investment (which could be in the form of either debt or equity) would be limited to an investment used to acquire an asset which must be used in a business to produce a product and which has not been used previously.

Since the Ameri-Share Investment Credit is intended to be a temporary measure aimed at redressing a particular problem, it becomes effective only if the President submits to Congress the terms of the credit, including its scope, its duration, and its size, and neither house of Congress rejects the proposal within 60 days of its submission. The President would be empowered to submit a proposed investment credit only if (1) the rate of GDP growth was less than one percent for two consecutive quarters, and (2) the President certifies (based on a finding by the Secretary of the Treasury) that the level of capital in the economy is less than the Golden Rule level of investment. The sole purpose of the Ameri-Share Investment Credit is to establish and maintain a proper balance between investment and consumption to promote maximum economic growth.

ASSURING AMERICA'S FINANCIAL SECURITY

To provide America with financial security by cutting the public debt to GDP ratio back to 40%, the Ameri-Share Tax would institute budgetary reforms to assure that it does.

Unlike almost all state and local governments, the federal government has largely disconnected taxing and spending. While almost all state and local governments are required by law, as a part of their annual budget process, to tax to pay for what they spend, the federal government has no such law. Under the Ameri-Share Tax, no annual budget could take effect unless the "Annual Financial Security Requirement" was satisfied. The Annual Financial Security Requirement would be the sum of two components, a "Current Spending Requirement" and a "National Debt Reduction Requirement."

The Current Spending Requirement would set the amount of taxes necessary to pay the current cost of government spending as included in the annual budget. The National Debt Reduction Requirement would set the amount of taxes necessary to amortize over a 25-year period the reduction of the public debt to GDP ratio to 40%. The Secretary of the Treasury would be required to determine the amount needed to satisfy the Annual Financial Security Requirement (from non-partisan data gathered by the CBO) and certify such amount to Congress and the President.

Once the Annual Financial Security Requirement has been set, all income brackets would be reset to raise the required revenue. In resetting income brackets, the Ameri-Share Tax would mandate that brackets be reset with the goals of both (1) maximizing worker productivity and (2) striking the proper balance between private consumption and private investment.

No annual budget could take effect unless the budget included a level of tax revenue sufficient to satisfy the Annual Financial Security Requirement.

Unlike state and local governments, the federal government has responsibilities to address national emergencies arising, among other things, from war, depression, and natural disasters. When confronted with a national emergency, the federal government is expected to act notwithstanding the cost. So, to enable America to cope with a national emergency, the Ameri-Share Tax would include a safety valve that would temporarily suspend the application of the Annual Financial Security Requirement.

Referencing national emergencies is easy; defining them is tough. Realizing that all human endeavors are subject to mischief, the President should be given the power to declare a national emergency subject to the President's declaration being overridden by a majority vote of both houses of Congress within 30 days of the declaration. Absent a national emergency, the Ameri-Share Tax would raise annual revenues sufficient to not only pay the current cost of government but to reduce over a 25-year period the debt to GDP ratio to 40%.

ADMINISTERING THE AMERI-SHARE TAX

In an economy as dynamic as the American economy, each year budgetary needs change and pre-tax income distribution shifts. As these changes occur, the Ameri-Share Tax requires updating to (1) adjust the total amount of revenue required to be raised and (2) reset income brackets to raise such revenue. If the budget increases, then more revenue will be needed, and if pre-tax income concentrates, then brackets will have to be reset to redress the concentration. This means that Congress frequently will likely be required to do two impolitic things, raise taxes and redistribute the tax burden.

In redistributing the tax burden through resetting income brackets, the Ameri-Share Tax mandates that the reset should be based solely on economic principles that promote worker productivity and growth, not political principles based on ideology and vote-getting. Since Congress does politics and not economics, someone other than Congress must administer the Ameri-Share Tax. Historically, there are many examples in which Congress has recognized that it is incapable of administering important and delicate matters that transcend politics. When faced with a compelling need that Congress knows that it is incapable of meeting, Congress has created independent regulatory commissions. Since there is a long and rich history of creating commissions, a way could be found if Congress has the will.

There are many examples of independent regulatory commissions which regulate complex economic, environmental, communication, and financial matters including, among others, the Environmental Protection Agency, the Securities & Exchange Commission, the Federal Trade Commission, the Federal Communications Commission, the Federal Reserve Board, and the Federal Deposit Insurance Corporation. To be effective, commissions must use non-partisan expertise to balance all interests and make decisions in the public interest. Congress does not abdicate its authority over the matters within the jurisdiction of these commissions because it can always enact statutes that either (1) override their actions or (2) if Congress becomes too displeased with commissions, kill them.

The Ameri-Share Tax would have Congress create an independent, non-partisan commission to administer it subject to Congress' power to override its decisions. To be effective, the commission would have to be perceived by Congress and the public to be above partisan politics. To do that, the commission would have to have members whose patriotism and non-partisanship are beyond question, and it would have to have open and fair procedures and conduct its business with complete transparency. Without an independent commission that has the confidence of the public to administer the Ameri-Share Tax, it could not function effectively over time.

Advantages of the Ameri-Share Tax over Existing Taxes

The Ameri-Share Tax would revolutionize taxation, and revolutions come hard. Unless the Ameri-Share Tax would substantially improve America in general and its middle class in particular, getting it enacted would not be worth the effort. A point-by-point comparison between the Ameri-Share Tax and existing taxes will help Americans decide if enough of them believe their lives would be bettered enough to make it happen.

Compared to existing taxes, the Ameri-Share Tax would promote economic growth and increase jobs by:

- lowering the cost of business through eliminating the corporate income tax;
- lowering the cost of employment through ending social insurance taxes;
- lowering marginal tax rates for almost all taxpayers;
- employing a rate structure that encourages worker productivity and balances private consumption and investment;
- ending the practice of businesses making investment decisions based on exploiting tax preferences (loopholes) instead of applying free market principles; and
- lowering the cost of tax compliance to all taxpayers because of tax consolidation and ending all tax preferences.

Compared to existing taxes, the Ameri-Share Tax would advance the middle class by:

- **INCREASING THEIR AFTER-TAX INCOME** through increased progressivity in the rate structure; and
- providing below-average wage workers with a share in the wage growth in the economy.

Compared to existing taxes, the Ameri-Share Tax would treat all taxpayers fairly by:

- taxing all taxpayers who have the same income (regardless of source) the same amount;
- not rewarding taxpayers for their skill in procuring political favors by (2) ending all tax preferences (except for the work credit and investment credit) and (2) making it difficult to create new ones; and
- reducing cheating among many taxpayers through taking away the opportunity to commit fraud with respect to (1) tax preferences and (2) tax complexity.

Compared to existing taxes, the Ameri-Share Tax would depoliticize taxes by:

- ending all existing tax preferences which are the source of most mischief in taxation;
- requiring a two-thirds majority in Congress and the approval of the President to create any new tax preference; and
- transferring the authority to determine annual tax levels and income bracket resetting over to an independent non-partisan commission.

Simplifying Compliance

Compared to existing taxes, the Ameri-Share would simplify tax compliance by ending the corporate income tax, the estate tax, and social insurance taxes as well as all tax preferences under the personal income tax.

Cutting the Cost of Government

Compared to existing taxes, the Ameri-Share would cut the cost of government by:

- reducing the need for social safety net programs such as food stamps, Medicaid, and childcare through increasing the after-tax income of low wage workers; and
- reducing the cost of administering the tax laws through ending the corporate income tax, the estate tax, and social insurance taxes.

Cutting the Tax Gap

Compared to existing taxes, the Ameri-Share Tax would dramatically cut the approximately one-third of a trillion dollar annual tax gap because most lost revenue is attributable to fraud regarding (1) tax preferences and (2) tax complexity.

THE POTENTIAL FATAL FLAW

Despite the many advantages of the Ameri-Share Tax compared to existing taxes, the Ameri-Share Tax suffers from a potentially fatal flaw. While the Ameri-Share Tax would substantially better the lives of hundreds of millions of Americans, it would also cause both a few million (largely very high-income) Americans to pay substantially more in taxes and many highly paid tax professionals who feed off of existing tax laws to look for real work. The flaw is not that a few million high-income taxpayers would have to pay more in taxes—somebody has to and who better than they. The flaw is that those few million know who they are; they know about how much more they would pay; and most importantly, they are the most adroit at playing the tax game. The millions of middle- and low-income taxpayers who would benefit the most from the Ameri-Share Tax do not know who they are, do not know how much they would benefit, and most importantly, barely know that a tax game exists much less have a clue as to how to play it.

Existing tax laws have artificially created a number of highly profitable industries whose well-being depends on the *status quo.* To mention just a few of these industries: much of the insurance industry is tax driven; much of the high end residential real estate market is tax driven; almost all of the tax-exempt bond market is tax driven; much of the commercial real estate market is tax driven; much of the leisure and hospitality industry is tax driven; many overseas corporate investments are tax driven; and almost all estate planning is tax driven. A vast army of tax professionals—highly paid tax lawyers and accountants, upscale real estate brokers, high-end insurance brokers who peddle life insurance used in estate planning and group health insurance coverage, an array of investment bankers, financial advisors, and other financial experts who service the municipal bond industry and corporate finance industry, and a host of very well-off estate planners—all earn very high-incomes by inventing tax driven deals and making them work.

Many (maybe almost all) wealthy taxpayers and high-end tax professionals will fight like hell to maintain what for them is a lucrative and comfortable *status quo*. These taxpayers and professionals know the stakes and know how to play the game. Almost all other taxpayers accept the *status quo* because they have become accustomed to it and/or they feel helpless to do anything about it.

So, in the tax game managed by Congress, a well-disciplined, well-armed, and well-financed army of a few million wealthy taxpayers, tax professionals, and lobbyists is opposed only by a hapless, undisciplined, and poorly equipped mob of hundreds of millions of low- and middle-income taxpayers. For over a generation, this small, well-disciplined army has triumphed over the huge mob of ordinary taxpayers with each annual playing of the tax game, and in the absence of a seismic change, there is no reason to suppose that any future outcome will be different.

A LOOMING CRISIS AWAITING THE MIDDLE CLASS

Almost certainly the *status quo* in tax policy will (for the most part) remain intact until some calamitous event occurs that forces a rethinking of the fundamentals of taxation. In the meantime, the growing gulf in each of two disparities will continue to shrink and impoverish America's most precious asset, its middle class, and eventually force a change in the *status quo*. The first disparity is the widening gap in how much more income and wealth are concentrating in the top 1% than in the bottom 90%, and the second disparity is the widening gap in America's ongoing unwillingness to increase taxes to pay for what it spends.

The effect of the first disparity—the widening gap in the over-concentration of income and wealth in the top 1%—is the top 1% has a growing ability to pay much more in taxes without lowering their standard of living while the bottom 90% has a falling ability (in terms of their market income) to live the American Dream.

With each passing year, the gaps in both the disparities in income and wealth and taxing and spending continue to widen. This seemingly inexorable widening makes the narrowing of these gaps many times more challenging when reality eventually compels it. America's borrowing power, as things now stand, is not limited because of increases in its debt-to-GDP ratio, but in a changing world, current conditions do not prevail forever. As with unseen, subterranean forces that eventually force a volcanic eruption, an increasing debt-to-GDP ratio will eventually force America to put its financial house in order by getting control over its borrowing. When "eventually" finally arrives is anyone's guess, it could be at any moment, but it could also be many years.

THE ARRIVAL OF "EVENTUALLY"

Most likely "eventually" will arrive as a result of some unanticipated calamity that forces America and many other nations to incur enormous amounts of debt to finance a recovery. Because America can issue new debt to pay for its outstanding debt, it will always have the ability to borrow unlimited amounts. However, if America's creditors (1) find other debt more attractive than America's debt, (2) become uneasy about the credit quality of America's debt, (3) become fearful of inflation, and/or (4) lose much of their capital, they almost certainly will demand that America pay much higher interest rates. Right now, these risks seem remote, but in a world racked by two recent calamities—the Great Recession of 2008/2009 and the pandemic of 2020—the eruption of one or more unanticipated worldwide calamities poses an ever-present risk from which America is not immune. The world now lives under the constant danger that at any moment many countries could be confronted by a climate catastrophe, a financial debacle, another pandemic, a crisis arising from a cyber-attack or biological-attack, or some other unforeseen catastrophe that would wreak havoc on the global economy. It is a near certainty that one or more of these calamities will strike sometime in the next generation or so and will force America and other nations to borrow many trillions to recover. Given that current levels of public and private debt are at historic highs in the wake of the Great Recession and the pandemic, there is an increasing probability that the next calamity will spark a seismic spike in interest rates.

As of early 2021, interest rates are at or near historic lows with the interest rate on the benchmark 10-year treasury bond barely over one percentage point. For those who assume that continuing low interest rates are the new norm, they should check out the early 1980s when the interest rate on the benchmark 10-year treasury note soared above 10% and stayed there for more than a year. In the early 1980s when the national debt was about 40% of GDP, each one percentage point increase in the interest rate on the national debt only required a .4 of a percentage point increase in taxes to pay the additional debt service, but with the national debt at 129% of GDP, each one percentage point increase in the interest rate on the national debt would require a 1.29 percentage point increase in taxes to pay the additional debt service.

THE PRESIDENT AS THE MIDDLE CLASS'S CHAMPION

The major players who will decide whether to side with the top 1% on low taxes or the middle class on increased spending on social insurance are the President and Congress, each of whom must approve of each decision. Deciding these matters in Congress is always a messy sausage-making process in which the President can be either a sideline player who passively accepts what Congress passes or the leading on-field player who dominates the process by mobilizing public opinion and convincing Congress that his or her policies are best for America. As between the President and Congress, the President is by far the better bet to champion the middle class's interests.

The President and all members of Congress share at least one trait, they are all politicians. As such, they all respond to what their voters think. What the voters think depends on which politicians they believe; which politicians they believe depends on how convincing the politicians' message is; and how convincing a message is depends on how it is framed. To be convincing, a message must be focused, direct, simple, and tailored to its targeted audience. Framing a taxing or spending issue to appeal to the middle class is challenging because the middle class is so diverse. It includes Americans from different political parties, ethnic groups, income levels, and educational, cultural, and religious backgrounds, as well as those who are employees or owners of small businesses. All members of the middle class, however, share in common the following interests regarding taxing and spending:

- The share of taxes paid by the middle class, relative to that of the top 1%, must go down.

- The social insurance programs on which the vast majority of the middle class depends for a substantial part of their standard of living must be preserved and expanded.

Even if a message is convincing, it cannot convince voters unless it is heard early and often by its targeted audience. The President is a single individual elected by the whole nation while Congress is populated by 535 politicians, each of whom has different (and often conflicting) views from the others and each of whom is consumed with cultivating their own career. Congress speaks with many divergent voices, but the President speaks with a single, clear voice. Almost every voter knows who the President is, but few voters know who their Senator or Representative is.

With 535 members and complicated legislative procedures for members to hide behind, it is easy for a few members of Congress to protect certain special interests, including those allied to the low-tax policies favored by the top 1%. The President, unlike individual members of Congress, represents the whole nation and is far less susceptible to the influence of special interest groups. For most voters, the President has more credibility than Congress because for them it is much easier to identify with and believe the sole elected leader of the nation than to identify with and believe a remote institution which speaks through a babel of divergent voices. If there is to be a comprehensive and coherent taxing and spending plan which is focused, direct, simple, and tailored to appeal to the middle class, only the President can frame it and ensure that it is heard, loudly, clearly, and often by the middle class.

The President's message to the middle class in a time of crisis need be no more complicated than the following;

Now that America has been confronted with a worldwide calamity and the middle class is suffering unbearable hardships, its taxes must be cut and its Social Security, Medicare, Medicaid, and other social insurance programs must be protected at all costs.

As the largest and most powerful group of voters in the country, the middle class overwhelms all other interest groups when it is unified and mobilized. The President uniquely commands the power of the "bully pulpit," and as such has the power to mobilize public opinion behind a single, compelling message. More than any other politician, the President has both the best opportunity and greatest incentive to seize leadership of the middle class and champion its interests. Almost a century ago, the Depression thrust America into a severe crisis that threatened the existence of the middle class. When confronted with the choice of protecting the middle class or preserving the *status quo*, FDR chose the middle class and Herbert Hoover deferred to the *status quo*. History has smiled upon FDR and frowned upon Herbert Hoover. When finally forced to choose between the top 1% and keeping their taxes low or the middle class and expanding their social insurance, the President should and almost certainly will side with the middle class.

CONCLUSION

While the Ameri-Share Tax is designed to be an efficient, fair, and pro-growth tax plan for any time, it is especially designed for an America confronted by the following trends:

- A growing concentration in income and wealth in the top 1%;
- A growing debt-to-GDP ratio; and
- A growing shortfall in the market income of the middle class relative to their cost of living.

Each of these trends weakens America economically, socially, and politically, and taken together, they threaten America's continued greatness as the last best hope of the world. Sadly, America's politicians lack the will to reverse these trends until a calamity so bad that it cannot be ignored forces them to act. So, in the absence of political will, serious consideration of the Ameri-Share Tax awaits the next calamity.

For 40-plus years the very wealthiest capitalists and those with extraordinary skills have been huge winners in an economy overwhelmed by globalization and automation while most of those in the middle class have been losers. At the same time, the after-tax income of those in the top 1% in income and wealth, relative to their pre-tax income, has grown while that of most in the middle class has shrunk. The marketplace determines whose pre-tax income grows, but politics determines whose after-tax income grows. Anyone whose after-tax income grows more than their pre-tax income is a winner in the politics of the tax game. The fact that those very few voters in the top 1% of income and wealth, compared with the many, many voters in the middle class, control the politics of the tax game leaves in doubt the one-person, one-vote principle.

As perennial winners in both the economy and the tax game, America's wealthiest can easily afford the taxes essential to making the public investments that will revitalize and grow the middle class. No group has benefitted more from America's bounty than its wealthiest, and as such, it is in their interest to **PAYBACK** America by paying higher taxes to make the public investments essential to ensuring America's future. Imagine an America plagued by economic stagnation, and social and political unrest, a demoralized workforce, and a shrinking consuming and taxpaying base. This is what America will become if its middle class is left mired in stagnating and falling wages. Only public investments paid for by taxing the wealthiest can save America's middle class. While *noblesse oblige* has become *passé*, pure self-interest alone should be enough to motivate the wealthiest to pay the taxes necessary to assure a healthy and prosperous middle class. A thriving middle class means economic growth which in turn increases the return on capital which in turn makes the wealthiest wealthier. So, the wealthy should regard a thriving middle class as its goose that lays golden eggs and treat it with the tenderest loving care to assure that the golden eggs keep on coming.

Ultimately, however, individual Americans are responsible for their own fate. If middle- and low-income Americans want to keep the American Dream alive for themselves and their families, then they will have to inform themselves, organize, and work for it. To be successful, middle- and low-income Americans must come together to advance a new deal on taxes for the middle class as a cause, and if they attract enough voters to their cause, then politicians will pay attention. If enough politicians get interested, more than one presidential candidate will likely adopt their cause. Presidential candidates, and even Presidents, can be counted on to gravitate to causes where the votes are, particularly if a cause has merit.

So, for middle class voters who want to share in the American Dream, they should follow the admonition found in Luke 4:23, "Physician heal thyself." Take the time to learn what a better deal in taxes would be like, and then do something about it.

Finally, this book's purpose is to tell middle class voters—like Joe and Sue Middleton—that there is a better tax deal for them if they are willing to learn about it and work for it. A better tax deal for the middle class would be good not only for them but for America.

To all middle class hardworking Americans, **BEST OF LUCK, GO FOR IT!**