New American

Written by **Bob Adelmann** on July 13, 2012

Deficit Headed for $1.1 Trillion This Year

The U.S. Treasury Department announced on Thursday that the federal government's deficit for the first nine months of its 2012 fiscal year exceeded $900 billion and that the country is on target for another $1 trillion annual deficit for the fourth year in a row. And this was despite the fact that revenues for the same period actually increased by five percent.

In simple terms, government is growing more quickly than the economy can generate the revenues to feed it. And if the status remains quo, the economy will continue to stagnate. At present it is informally in recession, there is gridlock in Congress, elections are four months away, and Taxmageddon — the "fiscal cliff" — awaits taxpayers on January 1. All of this is sufficient to cause even the hardy to tremble.

What the president and a compliant Congress have managed to do over the last four years is to increase government spending, compared with what the economy generates — the gross domestic product, or GDP — to the highest level since WWII. James Glassman's study of deficit spending under the last five presidents shows that President Obama's ratio of deficit to GDP is 8.9 percent, compared to George Bush senior's 4.2 percent, Ronald Reagan's 4.2 percent, George Bush junior's 2.7 percent, and Bill Clinton's 0.5 percent. Putting that into perspective, Obama's deficits are running *between two and fifteen times greater than his predecessors,* with no end in sight.

In fact, if the economy's output declines as many economists are predicting, revenues will fall, resulting in even higher deficits. And yet there are voices of reason to be heard in the land. Anthony Gregory, a research editor at the *Independent Institute*, is persuaded that it's not too late to turn things around. Current calls to tax the rich — the one percent — are exactly the opposite of what is needed, he says. In fact, he points out that even if all the income — a 100-percent income tax rate — were applied to the one-million-plus households currently in that top one percent, it would generate scarcely $1.3 trillion, slightly more than this year's expected deficit. And that top one percent already pays 40 percent of the federal income tax!

There are two ways out of the mess, according to Gregory. One way is to increase taxes to a draconian level on the already suffering middle class:

> The only way to fix the deficits with tax increases is to terrorize the middle class, unleash the IRS to bloom into its full Nazi potential, and raise rates to the skies. Even this might not work…

The other approach is to implement serious, substantial, and immediate tax cuts for everyone, especially including the one percent. He describes taxation as "the violent confiscation of wealth

conducted by the most regressive of all institutions: the state. It destroys wealth and empowers the…ruling class. All taxes, including on the rich, should be slashed…"

How has that worked in the past? It certainly seems logical that taxes are inverse to incentive: The lower the tax, the higher the incentive, and vice versa. Peter Ferrara, best known for his membership in the Harvard *Libertarian* Association (!) while obtaining two degrees there, wrote in *Forbes* that

> if the tax rate is reduced from 50% to 25%, what producers are allowed to keep from their production increases from one-half to three-fourths, increasing the reward for production and output by one-half. That sharply increases incentives for all of the above productive activities, resulting in more of them, and more jobs, higher wages, and faster economic growth.

But how has that worked in the real world of politics, crony capitalism, and self-aggrandizement? In 1997 Congress was considering cutting the capital gains rate, then at 28 percent, to 20 percent, a slash of almost a third. The bill was analyzed by the Congressional Budget Office (CBO). which estimated that tax revenues would increase by $8 billion over the next three years, but would then go negative, "costing" the government $30 billion over the next seven years, for a net loss of $21 billion.

Congress went ahead and passed the tax cut anyway, and revenues increased by an astonishing $84 billion as the economy exploded in response to the cuts.

When Congress decided to cut the capital gains tax rate again in 2003 from 20 percent to the present 15 percent, the CBO estimated it would cost the treasury more than $5 billion over the next four years. Instead, revenues once again increased, this time by $133 billion over that period.

Perhaps the classic example of reducing taxes and increasing revenues occurred under the presidential administration of Democrat John F. Kennedy, who stated in 1963:

> It is a paradoxical truth that tax rates are too high today, and tax revenues are too low and the soundest way to raise the revenues in the long run is to cut the tax rates.…An economy constrained by high tax rates will never produce enough revenue to balance the budget, just as it will never create enough jobs or enough profits.

When his proposal was adopted by Congress in 1964, top income tax rates were reduced from 91 percent to 70 percent (with similar cuts in the lower brackets), and the economy soared by 50 percent the next year and revenues to the federal government increased by an astonishing 41 percent. Even *U.S. News and World Report* expressed surprise at the rebound:

> The unusual budget spectacle of sharply rising revenues following the biggest tax cut in history is beginning to astonish even those who pushed hardest for tax cuts in the first place.

In the current political environment the chances of adopting such measures are between slim and none. But it's nice to know that there are certain immutable, inexorable, inevitable results to be expected if they are implemented.

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