Armchair Economics

Perspectives from an economic everyman

Let’s Raise Taxes!

April 2013

Very few sentences are more divisive than this one. “Of course we should raise taxes…on the rich,” say liberals. Conservatives will say, “If everyone doesn’t contribute something, then what personal stake do they have in our economy?” And libertarians will probably fall out of their chairs by the mere suggestion of raising taxes. “More money for that massive inefficient bureaucracy we call government?!” Few things cause more consternation than the talk of taxes, especially raising them.

Raising taxes, and thus tax revenue, is one side of what seems to be the economic battle playing out in developed economies. The other side of this Maginot Line is cutting government spending. Raise taxes or cut government spending…What should we do?

For a few years now we’ve been at a logjam over this issue. The most obvious action would seem to do both – the grand compromise everyone in Washington is supposedly working towards. But only by deft maneuvering can politicians do either. Voters don’t like people messing with their cash, whether it’s being “doled out” by government or “hard earned” in the private sector. So we keep going back and forth over raising taxes and cutting government spending.

This debate frames our *fiscal policy*, one of the tools government uses to manage economy. The debate exists because, as is widely known, we have been running trillion dollar federal budget deficits for years now. Federal debt continues to grow, approaching 100% of GDP, which some folks suggest is where we meet a point of no return to a stable economy.

Fiscal policy is one of two ways government is currently trying to lift our economic ships. The other effort is *monetary policy*. Behind the great government curtain of Oz sits the Federal Reserve, pulling hard on the levers of monetary policy. Today, the Fed is aggressively managing these tools to sustain worthwhile economic activity.

It’s coming up on five years since our last recession yet headlines still regularly suggest economic concern and fragility. Nearly five years out, and we’re still trying to find a sustainable economic recovery. Are our fiscal and monetary policies working? It seems not very well. Are they the only arrows in our stimulus quiver? Not even.

How many times have each of us focused so much on a particular issue that we fail to see the bigger picture? They even have an old saying for that: can’t see the forest for the trees.

Increase tax collections or decrease government spending? Which should it be? Can we do both at the same time? Absolutely. All it takes is economic growth. The larger our economy grows, the more taxes we will collect. And the more robust our economic activity, the more employment will grow, causing social welfare costs to contract. How can we affect such a Cinderella economic story outside of using fiscal and monetary policy?

What about *industrial policy*? Can industrial policy have any meaningful influence over our economy? The answer should be obvious.

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When people talk about the Fed's monetary policy, they often focus on whether it is restrictive or accommodative. Theoretically, restrictive monetary policy is used to calm an overheated economy, while accommodative monetary policy is used as a catalyst for growth. Well, then what's our current industrial policy position? Is it restrictive or accommodative? To business owners and private sector company leaders, the answer is obvious: policy is restrictive.

The amount of effort needed to comply with government regulation is expanding, not contracting. Complying with growing government regulation requires the allocation of more resources to back office administration. The more resources devoted to the back office, the fewer resources available for the front office, which is the part of every company that designs, makes, sells, and executes its business. The front office generates sales, while the back office represents the cost of managing a business. Restrictive industrial policy increases back office costs, in turn limiting the amount of private sector economic activity that can take place.

Consider the Keystone Pipeline. Here's a private sector project, introduced in 2005, that requires zero government financial support, but enormous government regulatory support. The project would create thousands of private sector jobs in its construction. The economic waterfall of its construction and operation would create even more jobs. This pipeline would provide the US with more oil from a friendly neighbor. It makes our economy and country more secure, reducing our need to "support" what seem like black hole causes in global hot spots. And…it's been eight years in the approval process. Would we call this restrictive or accommodative industrial policy?

No government funds are needed for the Keystone Pipeline. Through it, we'd create thousands of jobs. We'd expand wealth. Tax collections would increase. Social safety net costs would decrease. Inefficient capital allocation to global hot spots would decrease.

There seems no better tool to unleash economic growth than industrial policy. Moving from restrictive to accommodative policy would be a huge win for the country. But of course, for a variety of reasons, we can't see the forest for the trees, so we remain fixated on fiscal and monetary policy, "tools" that only seem to be digging a deeper economic hole, ever harder to crawl out from.

Another tool that gets almost no attention when it comes to economic activity is *social policy*. While industrial policy is something more readily obvious, it seems almost impossible to find any discussion in politics, media or even amongst most voters about social policy's influence on economy.

In looking at the big picture, how would we describe our current social policy? Is it economically restrictive or is it accommodative?

Our current social policy seems totally focused on providing more and more financial support to the economically distressed. Are they economically distressed because we've removed incentive to take personal responsibility for their own welfare? Are we empowering people, or are we making it easier and easier for them to become and stay wards of the state? **Might they even be economically distressed because our industrial policy is restricting economic activity?**

A recent study suggested that the amount spent on federal means-tested welfare programs, if converted to cash payments and divided among households below the poverty line, would equal a daily income greater than the median household income in 2011. If this analysis is accurate, or even just close, it means the "poor" can "earn" as much as the median household without having to work. Policy that rewards not working equal to having a real job is obviously economically restrictive, not to mention the disincentive it creates for people to pursue productive activity.

Self-esteem ONLY comes from work and personal accomplishment. Keeping people on the dole decreases their self-esteem, pushing them further and further away from the ability to make responsible personal choices. Is this economically restrictive or accommodative? It mostly seems accommodative of turning people into wards of the state. Why do we not require every able-bodied adult receiving government assistance to perform something productive?

We have at least four tools with which government can inspire economic activity, yet we seem to believe the economy is managed purely by fiscal and monetary policy. While we've pushed those to the accommodative extreme, we have pushed industrial and social policy to the cripplingly restrictive. Move industrial and social policy to a more economically accommodative position, and we will naturally grow economy, raise revenue from taxes, reduce government spending and reduce our need for the fiscal and monetary policy that seem only to make matters worse. And any accommodative industrial and/or social policy that puts people to work and incentivizes people to do anything productive will result in a more confident and empowered society.

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