Leaving a Big Nickel on the Table
By David Cay Johnston

Would you knowingly work for 95 cents on the dollar, especially if you were paying taxes on the full buck?

Right now the American economy is working at just 94.5 percent of its potential, according to the Congressional Budget Office. That means we are shorting ourselves almost $2,800 of annual economic output per person.

If our economic output were at its full potential, we could be enjoying an economy whose total output was $872 billion greater this year. That would be enough additional economic activity to restore full employment, which would mean much more tax revenue and an even faster shrinking of federal budget deficits.

All that extra output would also mean fewer demands for government services like jobless benefits and food stamps. Remember, one in every 52 Americans currently has no income except food stamps, and more than one in every five American children lives in poverty.

Potential GDP is not some pie-in-the-sky maximum output if everything worked perfectly. Rather, it is the sustainable output that is possible with our current base of people, plants, and equipment.

In its February 2013 economic outlook, the CBO took note of the sluggish economic recovery from the 2008 financial meltdown. The CBO said that actual GDP is expected to remain below potential GDP until 2017. The slowdown began in December 2007. That means we will spend at least a decade in the economic doldrums. Viewed another way, it means 10 years with the economic output that we could produce in only 9½ years.

Think of it as 26 weeks of the entire nation being idle.

So how do we get out of the economic doldrums? How do we get sailing to a prosperous future instead of languishing?

An answer lies in our tax system, both now and in the long run.

Long term, a key way to restore economic output is by encouraging more savings and less private debt, especially student loan debt, which acts to depress spending and, in turn, investment.

An excellent immediate technique would be to end corporate cash hoarding. Of the more than $5 trillion in liquid assets held by American corporations, the top 16,000 companies hold almost all of it, while millions of smaller enterprises struggle with cash flow problems. Much of the cash and near-cash held by the biggest firms consists of untaxed profits tied to subsidiaries offshore — money that could be used to pay dividends or worker bonuses or be invested in new plant and equipment, all of which would improve aggregate demand and could spark a cycle of growth (Tax Notes, Mar. 11, 2013, p. 1265).

Another way we can use our tax system to strengthen the economy, and the treasury, is to enact another stimulus package — one that invests in the future through infrastructure and research.

To those readers screaming right now that we have borrowed too much and that financial Armageddon lies just around the corner, consider this: The blended federal interest rate on borrowed money has fallen by more than half, while the debt has tripled in the last dozen years.

There is no immediate debt crisis, no matter how much the Beltway echo chamber repeats that claim. And borrowing for productive output is always smart. Even House Speaker John Boehner, R-Ohio, and House Budget Committee Chair Paul Ryan, R-Wis., said on March 18 there is no immediate debt crisis.

What we need to debate is how taxes can foster economic growth.

Using the 2009 President Obama stimulus money to keep teachers and police officers on the payroll had little effect, at least in the short run, according to Dartmouth economists James Feyrer and Bruce Sacerdote (http://www.dartmouth.edu/~bsacerdo
infrastructure spending was “highly expansionary,” their analysis of official data shows.

Washington remains fixated on tax rates (and for Republican leaders, tax cuts), even though we have plenty of real-world data showing tax cuts don’t work as promised. We know now that the George W. Bush tax cuts resulted in lower average incomes, less total income, and a sharp reduction in federal tax revenues during his terms and through Obama’s first term (Tax Notes, Sept. 27, 2010, p. 1409).

Unfortunately, a large number of Americans are unaware of that fact and instead believe the myth that the Bush tax cuts resulted in more tax revenue. That is just as bad as polls showing that more than 90 percent of Americans believe that the federal budget deficit is growing when the fact is that it has been contracting rapidly since the first full fiscal year under Obama. This fiscal year’s projected deficit is down 41 percent in real terms from fiscal 2009.

Asking which tax rate is best is the wrong question. We should be asking how we get the full potential out of our people, plants, and equipment, both now and in the long run.

We also need to ask how China can afford much better highways than the United States. Why do American trucks idle on pothole-riddled highways, wasting diesel fuel and throwing unnecessary volumes of minute particles into the air, instead of barreling along smoothly?

Why do we fail to repair or replace dams and bridges that we know are dangerous?

How much do we value the human lives that would be lost through the resulting preventable disasters?

How much would our economy grow, our tax revenues increase, our deficit shrink, and the efficiency of our economy improve if we undertook a multi-decade effort to rebuild our roads, bridges, dams, rails, pipelines, Internet, and electric grid to be the world’s best instead of what they are now?

How many of the 22 million-plus Americans who have no work or want more work could be usefully
employed if we had a serious program to improve and rebuild our infrastructure?

How many highly educated workers could be employed if we increased funding for basic research instead of cutting it? How much will the movements of key biological research scientists to China and India cost us in the long run? How much return on investment would we get by spending more tax dollars for research?

How can China, South Korea, and other countries afford to pay their best students to get advanced degrees while in America we cut tax dollars for higher education and raise tuition endlessly?

How much is aggregate demand for housing, automobiles, furniture, and everything else reduced by the incredibly high personal cost of a college education today?

How many great minds are being wasted because, as The New York Times reported March 17, hardly any poor but smart students even apply to our 238 most selective colleges and universities? (See http://www.nytimes.com/interactive/2013/03/17/education/How-Top-Students-of-Different-Incomes-Apply-for-College.html.)

Making those sorts of questions the topics we debate would allow us to focus on economic growth and social stability. It would open our eyes to how speculators and monopolists are polluting our economy even as they withdraw vast sums from it.

What we need to get out of the economic doldrums is a sustained government program to invest in America — not tax cuts or austerity budgets. That means more spending on infrastructure, paid higher education for top students who perform, and much more research, especially in biology, where the fortunes of this century will be much greater than the digital fortunes of the last.

Given the government’s ability to borrow at what Global Financial Data says are the lowest interest rates in seven centuries, when is a better time to take on debt to make up for the private sector’s reduction in spending? (See http://www.globalfinancialdata.com/News/Articles/Seven_Centuries_of_government_bond_yields.pdf.)

Relative to the economy, our federal debt burden is smaller than when the Constitution was adopted or at the end of World War II.

Borrowing, like taxing, is not without limits. But to put off until tomorrow, when interest rates will be higher, spending that today could be building a more prosperous future is as foolish as working for 95 cents on the dollar while paying taxes on the full buck.