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LIMITS

On Power and the Use of Coercion

Where Your Taxes Will Go in 2011

by Brian Riedl

Taxpayers frantically filing their 1040s — as well as anyone following the spending and deficit debate in Washington — may be asking where exactly their tax dollars are going.

Some believe most spending goes to welfare and foreign aid. Others believe defense and corporate welfare dominate the budget. In reality, Social Security and Medicare are the largest programs, and are set to nearly double over the next decade.

Overall, Washington will spend $32,137 per household in 2011— the highest level in American history (adjusted for inflation). It will collect $18,295 per household in taxes. The remaining $13,841 represents this year's staggering budget deficit per household, which, along with all prior government debt, will be dumped in the laps of our children.

Government spending has increased by $5,000 per household since 2008, and nearly $10,000 per household over the past decade. Yet there is no free lunch: If spending is not reined in, then eventually taxes must also rise by $10,000 per household.

Washington will spend this $32,137 per household as follows (all numbers adjusted for inflation): Social Security/ Medicare: $10,458. The 15.3 percent payroll tax, split evenly between the employer and employee, covers most of Social Security's and some of Medicare's costs. This system can remain sustainable only if there are enough workers to support all retirees, which is why it risks collapsing under the weight of 77 million retiring baby boomers. Unless these programs are reformed, paying all promised benefits would eventually require doubling all income tax rates.

Defense: $6,465. The defense budget covers everything from military paychecks, to operations in Iraq and Afghanistan, to the research, development, and acquisition of new technologies and equipment. Lawmakers drastically reduced defense spending following the collapse of communism in the early 1990s. The 9/11 attacks reversed this trend, and the $2,800 per household increase since 2000 has returned defense spending closer to its historical levels (but still lower than during previous wars).

Anti-poverty programs:

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$5,374. Nearly half of this spending subsidizes state Medicaid programs that provide health services to poor families.

Other low-income spending includes: Temporary Assistance for Needy Families, food stamps, housing subsidies, child-care subsidies, Supplemental Security Income, and low-income tax credits. President George W. Bush increased anti-poverty spending to record levels, and it has grown an additional 29 percent since the end of 2008 under President Barack Obama.

Interest on the federal debt: $1,739. The federal government is $14 trillion in debt. It owes $10 trillion to public bond owners, and the rest to other federal agencies (mostly to repay the Social Security trust fund, which lawmakers raided annually before the program fell into permanent deficit last year). Record-low interest rates have recently held down these costs. However, the national debt is set to double by 2020, which will combine with higher interest rates to raise annual interest costs to nearly $6,000 per household.

Veterans' benefits: $1,190. The federal government provides income and health benefits to war veterans. Spending has leaped 147 percent over the past decade.

Unemployment benefits: $1,135. Unemployment costs have nearly tripled since the recession began.

Education: $698. Education spending is primarily a state and local function; 9 percent of the total comes from Washington. The federal education budget has jumped 83 percent since 2000. Most federal dollars are spent on low-income school districts, special education, and college student financial aid.

Health research/regulation: $552. This spending is up 56 percent over the decade, and much of this growth is concentrated in the National Institute of Health. The category also includes the Food and Drug Administration and dozens of grant programs for health providers.

Highways/mass transit: $522. Most highway and mass-transit spending is financed by the 18.4 cent per gallon federal gas tax. Washington subtracts an administrative cost and sends this money back to the states with numerous strings attached.

Justice administration: $510. Justice spending includes federal attorneys and prisons, as well as law-enforcement grant programs. New homeland security costs have added $100 per household to justice spending.

The programs listed above cover $28,643 per household. The remaining

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We Don't Need a Tax Increase

by Richard W. Rahn

President Obama and many other Democrats — and even a few Republicans — claim that the huge deficits the United States is experiencing result from the George W. Bush-era tax rate cuts. Is this true, and must we have a tax rate increase? The short answer is no.

First, a little budget history. In the 40 years prior to the 2007-09 Great Recession, tax revenues as a percentage of gross domestic product (GDP) were remarkably constant, never varying more than 2.3 percent above or below 18.3 percent of GDP. This fact is all the more remarkable given that the maximum individual income tax rate during this period varied from a low of 28 percent to a high of 70 percent. Federal government expenditures also were remarkably constant during this same 40-year period, never lower than 18.2 percent or higher than 23.5 percent of GDP, and deficits averaged about 2.5 percent. The debt-to-GDP ratio rose and fell during this period and was a manageable 36 percent as late as 2007. Yet, in the past four years, the debt-to-GDP ratio has almost doubled.

In 1986 (under President Reagan), there was a tax reform, which by 1988 had a maximum individual tax rate of only 28 percent. The maximum rate was raised to 39.6 percent under President Clinton in 1993 and reduced to 35 percent under President Bush in 2003. Although tax rates went down in the 1980s, up in the 1990s, and down again in the first decade of this century, each decade had some normal years (neither bust nor boom) that produced the 40-year average tax revenue of 18.3 percent of GDP. These "average" periods also had close to average deficits, but in each period, the deficit was less than the rate of economic growth, so the debt-to-GDP ratio fell.

What all these numbers show us is that the current tax regime, in normal times (with normal economic growth rates — approximately 3 percent), will produce enough tax revenue to cover the historical rate of spending with only a small and manageable deficit. The current long-term deficit and GDP-to-debt problem was caused by a big jump in federal "stimulus" spending over the past three years — not the Bush tax cuts. This has caused federal spending to rise from its historic 20 percent to up to 25 percent of GDP.

In essence, Mr. Obama and the others who are advocating tax increases — either enthusiastically or reluctantly — are saying that they want or expect the federal government to be bigger as a share of the national economy than it has been in the past and this bigger government should be financed through higher taxes. Wanting a bigger government is a value judgment. Saying a bigger government is a necessary evil because of the rising cost of "entitlements" misses the point that under present law and practice, the costs of the entitlements never stop rising as a percentage of GDP until they consume the whole pie, which obviously will not happen.

The real question is what percentage of our incomes do we divert to pay for entitlements and how best should this be financed. House Budget Committee Chairman Paul Ryan has set forth a plan to finance entitlement spending without increasing taxes, and he has challenged others to come up with alternative plans that can be debated.

Medicare is the single biggest problem in that it is and will continue to be a rapidly rising share of GDP under current policy. But if it is decided not to allow Medicare to increase as a share of GDP, it could be accomplished immediately by some combination of increasing co-payments, deductibles, means testing, etc. None of the entitlements is "uncontrollable" as is often alleged. The only thing lacking is the political will to make hard decisions.

Mr. Obama has made it clear in his statements and in his proposed budgets that he wants a bigger government. Yet he has proposed the most inefficient and destructive way of trying to

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We Don't Need a Tax Increase by Richard Rahn

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finance this bigger government. His proposals involve increasing taxes on the rich (i.e., those earning more than $200,000 a year, which is a rather loose definition of rich). If he had even a most basic understanding of economics and public finance, he would know that there is insufficient income among this group to pay for the programs he wants. The chances of getting them to pay much more is close to zero because increases in some tax rates do not necessarily result in more tax revenue. The United States already has one of the most progressive income tax systems in the world. Thus, the only way for the government to obtain significantly more revenue is to increase taxes greatly on the lower- and middle-income groups who now pay very little. But increasing tax rates on the upper-, middle-, or lower-income groups will have the nasty side effects of further slowing economic growth and increasing unemployment.

One of the first things that economic students learn is if you tax something, you get less of it, and if you subsidize something, you get more of it. Mr. Obama, in his radio address Saturday, said his solution to high gasoline prices is to increase taxes on oil companies, which produce the gasoline. Reagan understood the importance of economic growth and was the last president to have a degree in economics — and it showed. Mr. Obama wants wealth redistribution and appears never to have read a basic economics book — and it shows.

Richard W. Rahn is a senior fellow at the Cato Institute and chairman of the Institute for Global Economic Growth.

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Are Public Schools Underfunded? No

by

Michael Van Beek

A common claim by Michigan's public school establishment and its political allies is that, despite spending $20 billion annually on education, our schools are "underfunded." Comparisons to other states and to historical funding levels show that the claim is unsubstantiated and misleading.

The underfunding myth rests on an assumption that there exists some known "price" for a public school education that taxpayers are failing to meet. In fact, no such figure exists. All we have are the amounts actually spent on schools and the knowledge that they have consistently increased each year for at least the last five decades.

According to the National Center for Education Statistics, the per-student operating cost of Michigan's public schools nearly quadrupled from 1960 to 2007, from $2,991 in 1960 to $11,337 in 2007, as measured in 2007 dollars. Therefore, insinuations by the school establishment that its funding has undergone some dramatic decline in recent years should be taken with a large grain of salt. (These per-pupil opera-

rt of individuals like you who believe in individual liberty and free-market
e-paid envelope to make your tax-deductible contribution to this effort today.

tional expenses do not include school buildings and other capital spending.)

In addition, Michigan taxpayers transfer a greater proportion of their income to public schools than those in all but two states (Wyoming and Vermont). Figures from the Bureau of Economic Analysis (and reported by the National Education Association) show that some $55 out of every $1,000 in state personal income is consumed by our public school establishment. Vermont residents pay $56 per $1,000, and the national average is around $43 per $1,000. Residents in Nevada pay the least, $32 per $1,000 of personal income.

There are other ways of comparing public school price and value. Some types of tax-supported schools cost much less to operate than others. Michigan's public charter schools cost on average $2,200 less per pupil in 2007 than conventional schools. Put another way, public charter schools provide essentially the same service at a 25 percent "discount." Rather than accepting the "underfunding" myth, perhaps taxpayers should complain about being overcharged.

Confusion also surrounds the state School Aid Fund, over which the Legislature exercises control. Since Michigan's economy and tax base have shrunk over the last decade, the amount of state revenue flowing into this particular funding source has declined as well. However, that decline has been offset by a huge increase in the amount of federal money being funneled through the School Aid Fund. These revenues grew from $122 million in 2000 to more than $2 billion in 2009.

Also, the number of students statewide has declined 6 percent over the last decade. After adjusting for inflation, districts on average get $450 more School Aid Fund revenue per student than they did in 2000.

Other reasons for what may seem to be perpetual school money troubles are merely circumstantial. By law, Michigan school districts must adopt a balanced budget by the end of June. However, the state's fiscal year doesn't begin until Oct. 1, and the Legislature rarely finalizes its budget before July. This unquestionably generates uncertainty for school boards, which among other things contributes to the "underfunding" myth.

Finally, union contracts dictate that school districts notify employees of potential layoffs prior to the end of the school year. As a result, many more "just in case" pink slips are issued than the actual number of layoffs. Not surprisingly, the warnings get more attention than their later non-execution. In fact, the actual student-to-employee ratio of 8-to-1 has remained unchanged over the last 10 years.

The real reason for school money troubles is not "underfunding," but a failure to contain employee costs that comprise about 80 percent of operational budgets. As long as school boards continue to agree to contracts that grant school employees, particularly teachers, automatic pay increases and lavish benefits packages that outpace comparable private-sector averages and the ability of taxpayers to support, schools will never have "adequate" funding.

The beneficiaries of those unsustainable benefits have a strong incentive to promote the "underfunding" myth, but taxpayers should exercise a healthy measure of skepticism. On the whole, Michigan schools have more resources available than ever before, and receive a larger portion of state and local tax revenues than almost any other state.

Michael Van Beek is director of education policy at the Mackinac Center for Public Policy, a research and educational institute headquartered in Midland, Mich.

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The Growth of the Administrative State

by John Hendrickson

The Competitive Enterprise Institute has issued its 2011 report, *Ten Thousand Commandments: An Annual Snapshot of the Federal Regulatory State*, which examines the growth and impact of regulations on the economy. The administrative state has grown tremendously since the beginning of the 20th century, which has contributed to the federal government becoming the leviathan it is today. Clyde Wayne Crews Jr., who serves as Vice President for Policy and Director of Technology Studies, and is the author of *Ten Thousand Commandments*, describes regulation as an additional hidden tax on the economy.[1]

"Federal environmental, safety and health, and economic regulations cost hundreds of billions — perhaps trillions — of dollars every year over and above the costs of the official federal outlays that now dominate the policy debate," wrote Crews.[2] In addition, regulatory burden placed on businesses often gets pushed onto the consumer.[3] "Precise regulatory costs can never be fully known, because unlike taxes, they are unbudgeted and often indirect," wrote Crews.[4]

The current expansion of the regulatory state by President Barack Obama and the Democrats in Congress has caused much uncertainty over the economy. Growing concern over the impact of the Patient Protection and Affordable Care Act (Obamacare) and the increase in financial regulation has caused business uncertainty.

The Business Roundtable, for example, has been one of many voices calling for regulatory reform. The increase in regulatory activity is not helping in job creation or in economic growth. As the Business Roundtable states:

> Taken individually, a regulation — or even several— may appear to be cost-effective and manageable. However, the cumulative impact of literally dozens of new major regulatory requirements facing all sectors of the economy over the next several years is something entirely different. That is why an evaluation of the total regulatory burden is essential to understanding the magnitude of the problem U.S. businesses face. The costs of regulation stifle productivity, wages, and economic growth. By diverting capital away from more productive uses, poorly designed regulations undermine job retention and creation.[5]

"The dramatic reality that regulations and deficits now each greatly exceed $1 trillion a year is an unsettling new development for the United States," noted Crews.[6] In addition, "of the 4,255 regulations now in the pipeline, 224 are 'economically significant' rules wielding at least $100 million in economic impact."[7]

The administrative state not only brings economic concerns, but also constitutional concerns. Congress, especially in the post-New Deal era, has increasingly abdicated more of its authority to the Executive branch, which includes the President and the numerous agencies that make up the federal bureaucracy or the "fourth branch" of government. As Robert Moffit, a Senior Fellow at The Heritage Foundation wrote:

> Increasingly, Congress writes sweeping, big-picture legislation (think Obamacare) and gives regulatory agencies a free hand to fill in the details. Meanwhile, it's the agency-written rules and regulations that determine how the law gets implemented and how it will affect the everyday lives of our people.
> This is the last thing the Founders wanted. They created three distinct and

> independent branches of government — legislative, executive, and judicial — to safeguard Americans' personal, political, and economic liberty. Yet over the course of the 20th century, Congress habitually delegated its legislative/rule-making authority to executive branch departments and independent agencies.[8]

Congress must reassert more of its constitutional authority, while pursuing an agenda that will restore the federal government to its traditional limited bounds, which can be said for all of the branches of government.

Regulation does have a purpose, but regulations must be clearly defined and not burdensome. The best path for economic prosperity is to eliminate unnecessary regulations, while cutting tax rates and reducing spending. This solution, which is rooted in constitutional limited government, is needed to restore the economy and solve the fiscal crisis. The best economic stimulus can be found in following these three policies. Perhaps it is time to follow the advice of President Warren Harding who stated, "we need vastly more freedom than we do regulation," and that "a closer understanding between American government and American businesses" is especially needed in today's economy.[9]

Endnotes:

[1]Clyde Wayne Crews, Jr., *Ten Thousand Commandments: An Annual Snapshot of the Federal Regulatory State*, Competitive Enterprise Institute, Washington, D.C., 2011, p. 1 <http://cei.org/sites/default/files/Wayne%20Crews%20-%2010,000%20Commandments%202011.pdf> accessed on May 5, 2011.
[2]Ibid.
[3]Ibid., p. 2.
[4]Ibid., p. 2.
[5]"Position on Regulatory Reform," Business Roundtable, Washington, D.C., February 11, 2011, <http://businessroundtable.org/news-center/business-roundtable-position-on-regulatory-reform/> accessed on May 5, 2011.
[6]Crews, p. 2.
[7]Ibid.
[8]Robert Moffit, "Reining in the Administrative State," The Heritage Foundation, Washington, D.C., February 16, 2011, <http://www.heritage.org/Research/Commentary/2011/02/Reining-in-the-Administrative-State> accessed on May 5, 2011.
[9]Robert K. Murray, *The Harding Era: Warren G. Harding and His Administration*, American Political Biography Press, Newton, Connecticut, 1969, p. 171.

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Question of the Quarter: Should taxes be raised in order to pay off the national debt?

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$3,494 is allocated to all other federal programs, including international affairs, natural resources, the environment, regional development, farm subsidies, social services, space exploration, air transportation, and energy.

Taxpayers — and the next generation that will be paying nearly half of the bill — must decide for themselves if they're getting their money's worth.

Brian Riedl is the Grover M. Hermann Fellow in federal budgetary affairs at The Heritage Foundation.

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