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FACTS & OPINIONS

On Public Interest Issues

Quotes

The Constitution shall never be construed to prevent the people of the United States who are peaceable citizens from keeping their own arms.
—Samuel Adams

Death and taxes may be inevitable, but being taxed to death doesn't have to be.
—Howard Jarvis

Every child in America can hope to grow up to enjoy their own tax loopholes.
—Richard Strout

As surgeon general, I was called everything….I was called the "condom queen." But I don't mind putting that crown on my head and sleeping with it.
—Jocelyn Elders
Former Surgeon General

The Fundamental Problem with Social Security

Dennis E. Clayson

There is one question that most Americans refuse to think about. Pundits and commentators will take the logic of its premise up to a certain point and then go no further. Perhaps it is because of the almost universal lack of economic knowledge in our society, or because many do not want to face the implications of the answer. Whatever the reason, the answer relates to almost every discussion of federal taxation and is the key to the debate over Social Security.

The question can be stated simply. *What can the federal government do with a surplus to make that surplus available in subsequent years?*

If you think about it carefully, you will realize that there is nothing the federal government could do with a surplus that would result in its preservation and expansion. Consider the options. For example, you might suggest that the government could print money and store the money in large vaults somewhere. Yet printed money has no value except to facilitate exchanges. The longer you hold it, the more it depreciates. Even naive citizens will not invest wealth in this fashion.

Some have suggested that the government could take whatever surpluses it has and invest them in the marketplace. There are two reasons that the government can't do this. First, federal power is based on several sensitive balances. The trust between these constituencies is not sufficient for investments on this scale. Second, it would destroy the free marketplace. Normal fluctuations in the market would be seen as public threats and there would be tremendous political pressure for governmental control. Third, over time the government would end up owning the country, or at least all means of production, which is

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President
Dr. Don Racheter

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The Poor as First Victims of the Welfare State

Walter Williams

The most unique feature of the United States is that we are a nation of minorities. Virtually all of these minorities arrived penniless and uneducated. To add to our uniqueness, all of these immigrants faced varying degrees of hostility; none were welcomed to our shores with open arms, often not even by their own kind.

But these people were able to melt, *enmasse*, into the mainstream of American society. They worked in sweatshops; they were hucksters and peddlers; whole families, including children worked. Indeed, the conditions were rough — but they made it.

Today, through numerous so-called progressive laws, these harsh conditions have been removed. And, ironically, it turns out that the very people that we saved from the harsh conditions are having the greatest difficulty in entering the mainstream. The reason is that jobs for the lowest skilled person have all but been destroyed. In this sense, we have cut off the bottom rungs to the economic ladder.

What today's poor lack that yesterday's poor had is a free economic system. Today's poor have subsidies that flow from the welfare state; yesterday's poor had economic opportunity. Poor people today need just what the poor of yesterday had: a life with government off their backs.

The preceding is an excerpt from an address that Walter Williams gave at Hillsdale College in July 1990. Reprinted with permission from IMPRIMIS, the monthly speech digest of Hillsdale College. For more information contact Hillsdale College, 33 East College Street, Hillsdale, MI 49242, call 1-800-437-2268, or visit its Website at www.hillsdale.edu.

Privatizing Iowa's Prisons

A new POLICY STUDY from Public Interest Institute.

"As recent experience has shown, even under strong political pressures, the government simply has not been able to 'trim' the budget sufficiently to make any serious or substantial changes in Iowa's spending habits. What is needed is a fundamental change in a part of Iowa government. One fundamental change that has the potential to save the state millions of dollars is privatizing a portion of Iowa's prison system."

To read Privatizing Iowa's Prisons, visit Public Interest Institute's Website at ***www.limitedgovernment.org*** *or contact the Institute to request a copy.*

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Dennis E. Clayson

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close to the economic definition of socialism. The amounts of wealth confiscated by the government are too large to be invested in this fashion. Even if these problems could be overcome, the investments would only make sense if the government were willing to liquidate assets. This is problematic. History indicates that the federal government is unlikely to do this. Assets quickly build special interest groups, and they represent a type of power that is very difficult to relinquish.

Political leaders have suggested that a surplus could be used to reduce the size of the national debt. On the surface this appears to be a way of investing money for the future, while at the same time demonstrating a concern for fiscal responsibility. Unfortunately, this solution also fails. It is easy to explain why.

If you were to loan the government money by buying a government bond, you would make an agreement with the government that you would give them a certain amount of money, and after a specified period of time they would give you back an amount larger than what you invested. If the feds decided to "buy down" the national debt, they would have to come to you and do one of two things. They could retire debt prematurely by not paying off the full maturity value, or by paying it off earlier than initially agreed upon. In the first case they would say to you, "We want to retire our debt, therefore we will pay you the principal plus the amount of interest you have accrued up to this date." You would not be happy with this solution. The government would be essentially breaking its promise to you to pay you a larger amount in the future. You may be less likely to loan the government money again. Even more troubling, you may be less likely to trust the government as a stable instrument of investment. If your attitude became widespread, the feds would no longer be able to service their debt. The government is not going to put itself and the world's economic future into the jeopardy this policy could create.

The last fifty years have taught us that once a government program is in place, it hardly ever goes away. Not only that, but spending for these programs seldom declines.

Alternately, they could come to you and pay off the full amount before it is due. This makes you happy, but it makes the taxpayers very unhappy. To do this, the feds have to essentially increase the interest on the national debt and cheat taxpayers in the process. There are two reasons why the government will not do this. It would have a tendency to get people kicked out of office, and it would require the surplus to be utilized (albeit inappropriately) instead of being spent. Washington is about power, privilege, and influence. Money buys all three. If surplus money is used to pay you for a past debt, there is less for federal politicians to spend on other purposes.

The second major thing the feds could do to reduce the national debt is simply to issue less of it. Note, however, that issuing less debt has nothing to do with any surplus. All the government has to do to issue less debt is to balance the federal budget. Any money left over (i.e., a surplus) cannot be used to accelerate the process. So, a surplus cannot be used to buy down the national debt. It can be used on paper to make it appear that way, but essentially the government is still spending the surplus the same as any other income. The federal government can only do two things with a surplus, either send it back, or spend it.

This creates a very important question. If the government only has two options, which one would give the best results to the average taxpayer now and in the future? The last fifty years have taught us that once a government program is in place, it hardly ever goes away. Not only that, but spending for these programs seldom declines. Political battles over budgets have not been about spending reductions, but about the size of increases. Spending a surplus obligates the government to spend at least the same amount in the

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future. This requires that either surpluses will continue indefinitely, or that taxes and/or debt will have to be increased. Balancing the budget by returning surpluses does not obligate the government to future spending. It also allows the money to stimulate the free market, increasing the nation's wealth.

All of this brings us to a discussion of the Social Security surplus. What are the consequences of accepting the proposition that the federal government cannot maintain a surplus?

The first consequence is fundamental and is widely recognized. There is NO Social Security surplus. Yes, there is one on paper, but in the real world it does not exist. Furthermore, it has never existed and it never will. This fact is independent of party politics, shifty bureaucrats, or any election cycle revelations. It does not matter who is in power, or what their ideology is. There is no Social Security surplus because it cannot exist. The second consequence is actually more troubling. There is a basic problem with how the Social Security system has been unethically represented to the American people.

To put this into perspective, consider the following thought problem. Suppose the federal government wants to start a retirement program. It proposes that every worker make a contribution to the feds and then that worker would be sent a check every month by the government when he or she retires. For the sake of simplicity, we will say that the government agrees to issue a $400 per month check upon retirement. There are four workers for every beneficiary, so each worker is asked to pay $100 per month into the system. The workers agree, thinking that $100 per month will secure them a $400 per month retirement.

There is NO Social Security surplus. Yes, there is one on paper, but in the real world it does not exist.

The program is popular, especially with the retired, but the feds, looking into the future, realize that soon there will be only three workers for each beneficiary and soon thereafter, only two workers. This will mean that the two workers in the future will have to pay $200 per month into the system and will still only get $400 per month out of it. The future workers might not be happy about this. What to do?

A federal worker comes up with a solution. We could, he says, get the workers now to pay a surplus so that the future worker won't have to pay so much. This plan is deemed brilliant, so the feds ask the current workers to pay $130 per month. It is a small sacrifice, they say, to keep the system solvent and to make sure that the $400 per month is there for you when you retire. The feds are still paying out $400 per month, but are now bringing in $520 per month from the four workers. They now have a $120 per month surplus.

Here is where it begins to get interesting. The feds forgot to tell the workers that they can't invest the extra $120 per month. They can't put it into the bank, they can't buy wealth with it, and they can't even invest it in the stock market. They have to spend it, which they are delighted to do. The feds are getting the best of both worlds. They have extra money each month to spend on office buildings, B1 bombers, and political pork to keep their federal rears in Washington, and—this is the best of all—they don't have to raise any taxes to do it. The feds would be smart to say nothing about this, and they don't. But being compulsive, they write themselves out an IOU every time they spend the $120 dollars.

The current worker retires.

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The Fundamental Problem With Social Security

Dennis E. Clayson

He wants his $400 per month that he was promised and for which he paid. There are now only two workers to support him. Each worker must pay $200 per month to support the system, twice as much as the current retiree paid. The future worker is unhappy and asks the feds to cash in the IOUs to help him out. The feds say that they would be happy to do that, but that they spent the money and on paper bought a federal bond, which was secured by the future worker's taxes. If it weren't for the IOU (bond), maybe the future worker and the retiree could work out a different arrangement, but the feds' IOU has sealed the deal. So the future worker will have to pay $130 per month, plus all the IOUs. The total, as if by magic, comes up to over $200 per month.

Notice something interesting here. The future worker has to pay the same to keep the system solvent, irrespective of how much the current worker paid in surplus to "keep the system solvent." In other words, the future worker has been scammed because the promises made to him have been violated. The present worker has also been scammed because he was told that his sacrifice in paying more than the system needed would relieve the future worker and make the system secure. Neither of these happened. In between time, the feds had a party on the extra money, the so-called "Social Security surplus."

The ethical problem is actually worse than this little story illustrates. Who pays Social Security taxes? Who paid the surplus? Social Security charges are a flat tax on all persons with income. The teenager flipping hamburgers pays the tax, the working poor pay the tax, the part time worker pays the tax, and they all pay at the same rate. Making "the rich" or "big" businesses pay for redistribution of wealth by claims that you are helping the poor are common and accepted strategies, but robbing the working poor for more governmental pork is a very hard sell.

The amounts are enormous. Over the last five years, the surplus has been $100 to $170 billion a year. In 1999 there were approximately 111 million workers in the United States and $133.7 billion of Social Security surplus, or $1,205 per worker. This $100 per month tax is seldom acknowledged as money that will be spent as general revenue, and never, ever is the American worker informed that it will not make the system secure, or that he or she will have to pay it again when the Social Security IOUs become due.

Social Security is a pay-as-you-go system. It should never be presented as anything other than this. The increased costs per worker projected for the future of the system will have to be taken from the workers at that future time. If those workers refuse to pay the bill, or if paying it weakens the economy, the system will run head-on into a wall. There is no way to avoid this. It is essential for the economic well-being of the nation that Social Security reform be initiated, and initiated as soon as possible. If nothing else, for economic and ethical reasons, the surplus payments should be eliminated immediately.

Dennis E. Clayson is a Professor of Finance at the University of Northern Iowa. He also writes a weekly column for the Waterloo-Cedar Falls Courier.

The Tax That Wouldn't Die

Erik V. Schlecht

Like the Jason character from the "Friday the 13th" movies, Internet taxation is proving to be the boogieman you just can't kill. Once again it has reared its ugly head and is preparing to terrorize merchants, shoppers, and taxpayers throughout the nation.

The most recent unholy resurrection occurred at a meeting of lawmakers and tax officials in Chicago, where they endorsed a proposal to "simplify" tax laws and enter into a voluntary cartel to collect Internet sales taxes. The proposal, known as the "Streamlined Sales Tax Project," would require participating states to establish uniform definitions for taxable goods and services, while maintaining a single statewide tax rate for each good.

What evil talisman has raised Internet taxation from its temporary grave? Massive deficits accumulating in states across the country, brought on by a decade of decadent government spending. In fact, according to the Cato Institute's annual *Fiscal Policy Report Card on America's Governors: 2002*, states faced a combined budget gap of more than $40 billion in 2002. Rather than restraining their promiscuous spending, many Governors have instead decided to attempt to tax their way out of debt.

This, of course, ignores historical budgetary evidence and sound economic theory. No government in modern economic history has ever taxed its way out of deficits and most economists agree that tax increases during an economic slowdown are fiscal suicide.

The Michigan miracle is a prime example to the contrary. Rather than raise taxes in a vain effort to erase Michigan's growing deficits and turn around its economic woes, Governor John Engler cut taxes more than 30 times over the decade. As a result, the state's massive deficits disappeared and the state enjoyed one of the largest economic growth periods of Michigan's history.

When the economic evidence becomes too overwhelming to ignore, the Internet tax proponents usually turn to the "fairness" issue — even though it has been as thoroughly debunked as the economic argument.

That's right, our selfless Governors are simply attempting to level the playing field for small "Mom and Pop" and "brick-front" stores that must collect sales taxes while Internet companies currently do not.

No government in modern economic history has ever taxed its way out of deficits and most economists agree that tax increases during an economic slowdown are fiscal suicide.

This argument holds that small hardware stores across the nation will go under — thrusting their salt-of-the-earth proprietors into the cold — because the "Big Hardware" Internet site is not forced to collect taxes and therefore has an unfair competitive advantage. In this

Facts & Opinions

Question of the Quarter:

Should the sales tax be applied to Internet sales?

Send your thoughts on this issue to us at public.interest.institute@limitedgovernment.org.

We will publish some of your ideas in the next issue of *Facts & Opinions* in May 2003 and on our Website at www.limitedgovernment.org.

The Tax That Wouldn't Die

Eric V. Schlecht

case, class warfare is the last refuge of scoundrels.

This line of reasoning has been debunked numerous times, but for the sake of argument let's briefly review its more blatant fallacies:

- The same argument was made about catalogue sales with no such dire consequences for local merchants.

- In today's technological world anyone who can afford to operate a brick-front store can afford an Internet site to sell their goods "tax-free."

- Shipping and handling costs often offset any price advantage enjoyed by Internet retailers from the absence of sales taxes.

- Internet companies very often pay millions of dollars in telecommunications taxes that brick-front stores do not. Is that fair?

Furthermore, taxing Internet sales would place an enormous burden on Internet companies. Why should a company be forced by the government to become a tax collector for more than 30,000 tax jurisdictions across the country? How many "Mom and Pop" Internet sites will go out of business if that extraordinary expense is forced upon them? If that expense doesn't put them out of business, then the cost of defending themselves against countless lawsuits from state governments claiming they didn't collect a sufficient amount of taxes on their behalf surely will.

This is hardly an exhaustive list of why a "Streamlined Sales Tax Project" is a bad idea. Suffice it to say, the case against Internet sales taxes is solid and well known.

Eric V. Schlecht is Director of Congressional Relations for National Taxpayers Union (NTU), a non-profit, non-partisan organization founded in 1969 to work for lower taxes, less wasteful spending, and accountable government at all levels. Reprinted with permission from NTU. For more information, contact NTU at 108 North Alfred St., Alexandria, Virginia, 22314, call (703) 683-5700, or visit its Website at www.ntu.org.

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Whatever Happened to Free Enterprise?

Ronald Reagan

Beginning with the traumatic experience of the Great Depression, we the people have turned more and more to government for answers that government has neither the right nor the capacity to provide. Unfortunately, government as an institution always tends to increase in size and power, and so government attempted to provide the answers.

The result is a fourth branch of government added to the traditional three of executive, legislative, and judicial: a vast federal bureaucracy that's now being imitated in too many states and too many cities, a bureaucracy of enormous power which determines policy to a greater extent than our own elected representatives. And it can't be removed from office by our voters. . . .

More than anything else, a new political economic mythology, widely believed by too many people, has increased government's ability to interfere as it does in the marketplace. Profit is a dirty word, blamed for most of our social ills. In the interest of something called consumerism, free enterprise is becoming far less free. Property rights are being reduced, and even eliminated, in

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Whatever Happened to Free Enterprise?

Ronald Reagan
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the name of environmental protection. It is time that a voice be raised on behalf of 73 million independent wage earners in this country, pointing out that profit, property rights, and freedom are inseparable, and you cannot have the third unless you continue to be entitled to the first two.

Even many of us who believe in free enterprise have fallen into the habit of saying when something goes wrong: "There ought to be a law." Sometimes I think there ought to be a law against saying that there ought to be a law. . . . It is difficult to understand the ever-increasing number of intellectuals in the groves of academe, present company excepted, who contend that our system could be improved by the adoption of some of the features of socialism.

The preceding is an excerpt from an address that Ronald Reagan gave at Hillsdale College in January 1978. Reprinted with permission from IMPRIMIS, the monthly speech digest of Hillsdale College. For more information about Hillsdale College, see page 2.

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Check out our feature — **Question of the Quarter** — on page 6. We want to know your thoughts about the issues!