Economic Commentary

June 30, 2019

Tax Proposals

Samuel Gompers, the first president of the American Federation of Labor, was asked by a reporter in the 1880s, “What is it that labor unions want?” His concise answer was, “More.”

Today there are 24 candidates vying for the Presidential nomination from the Democratic Party. Each candidate’s stump speech includes promises of “free” things to targeted constituencies, with a different group footing the bill. In essence, some groups will get “more,” while other groups will “pay their fair share.” According to these Democratic candidates, this means that higher income individuals will pay higher taxes.

Some historical context is necessary to help evaluate these current proposals. In 1986, Congress passed, and President Reagan signed into law, the last Tax Reform Bill worthy of that name. In that Bill, top marginal income tax rates and long term capital gains rates were set at 28%. The credit for passing that legislation goes to former House Majority Leader Richard Gebhardt, Democrat of Missouri, and former Senator Bill Bradley, Democrat of New Jersey. Senator Bradley, in particular, made it his personal goal to get support from his fellow Democrats for this legislation.

This law controlled taxes until 1993 when the members of President Bill Clinton’s Administration claimed they needed “more” revenue to fund their initiatives. Not only did they increase income tax rates, they made 85% of Social Security payments taxable income in order to provide more funding to the Old Age, Survivors and Disability Insurance Fund. As this Fund increased, so did the number of dubious to invalid claims for disability payments, over the ensuing 25 years.

Former Vice President Joe Biden is now leading in the polls of the Democratic candidates. He has indicated that one “loophole” he believes should be closed, is the practice of providing a “step-up” in cost basis at the death of an owner of an appreciated asset. (This current “step-up” means that assets are valued at market value for estate tax purposes and no capital gains taxes are included in the estate tax calculation). The purpose of closing this loophole is to get “more” from the estate of someone who did not pay capital gains taxes during their lifetime on their appreciated assets.

If this proposal were to become law, the complexity of estate taxes would increase dramatically while tax revenue would be minimally affected. For example, a “step-up” in the cost basis only occurs when an estate goes through probate (a judicial process), and only 2% of estates go through probate each year. Those estates pay taxes on the market value of all the estate’s assets, including the appreciated assets, with a top marginal rate of 45%. If capital gains were assessed on appreciated assets, would they be in addition to the Estate taxes, or would they be a credit against estate taxes? If the former, then the top rate on appreciated assets in an estate would approach 70%, a rate last seen in the 1980s. If the latter, there would be no difference in overall taxes assessed, and the change in the tax law would be meaningless.

Another leading contender for the Democratic nomination is Senator Bernie Sanders of Vermont. He speaks passionately about the need for "Democratic Socialism" that cares for workers, and he admits that it will cost more to implement all his proposals, but insists that it will be worth it. His economic consultant Stephanie Kelton, an economics professor at New York's State University at Stony Brook and a proponent of "Modern Monetary Theory" was asked about the cost of "Medicare for All." She responded that the incremental cost of $3 trillion per year was not the right way to look at the proposal, but rather one should look at all the money that could be "saved" through government administration of the program. Count me among the skeptics of this idea, as we saw what happened to the Student Loan Program after the Federal Government took it over. (Democratic proponents of this idea claimed it would be profitable for the Government, and now many of the Democratic Presidential candidates are proposing that the Government write off $1.5 trillion of student loan debt).

Professor Kelton acknowledges that raising government revenue through taxes won't cover all the programs Senator Sanders favors, but any shortfall can be made whole through incremental Treasury borrowing. Her view of "Modern Monetary Theory" is that it doesn't matter how much we borrow presently until other economic indicators such as inflation, start increasing. I ask with skepticism, "What could possibly go wrong with that?"

Senator Elizabeth Warren of Massachusetts is also rising in the polls for the Democratic Party nomination. She has championed an annual wealth tax, making sure to start it at levels that are well beyond even the aspirations of her targeted voters. In my opinion, the costs and complexity of administering such a program are almost beyond imagining. Fortunately we have already seen such a program in France, which was so onerous that the French actor Gerard Depardieu, was offered Russian citizenship from his fiend President Vladimir Putin, so he could avoid the annual levy. Depardieu chose to relocate to Belgium instead. The wealth tax in France has since been rescinded.

The Tech Entrepreneur and Democratic Party presidential candidate Andrew Yang, has proposed a $1,000 per month grant from the Federal Government to every adult citizen of the United States. This program would continue on an annual basis. We know from past experience that this proposal may not help Mr. Yang. Former Senator from South Dakota George McGovern, proposed a one-time $1,000 grant to every adult American in 1972 during his presidential campaign against President Richard Nixon. He lost 48 states that year. Mr. Yang proposed paying for this program through the introduction of a Value Added Tax (VAT). I could be persuaded to support a VAT, but only on the condition that it be done via a Constitutional Amendment that eliminates the income tax and includes a ceiling rate such as the 20-25% rate commonly levied in Europe. Mr. Yang sees the VAT as a means of redistributing income, while I see it as a substitute for a complex, broken income tax system.

Now I would like to comment on the current status of the Social Security Disability Insurance Fund. In 2015 the actuaries employed by the Social Security Administration projected the Fund would be bankrupt in 2016. Their proposal was to siphon funds away from the main Social Security program (which was projected to go broke in 2032), so that both programs ran out of reserves at the same time in 2032. However, in 2019, these same actuaries projected that the main Social Security program would have reserves through 2034, while the Disability Fund was projected to remain solvent until 2052. Both programs have benefitted from much better employment data in both the number of people employed and their average wages. The Disability Fund program has been further helped by a much more stringent application of criteria on those applying for coverage. Consequently, I believe it is time to repeal the 1993 tax provision that made 85% of Social Security taxable and return it to the prior 50% taxable level.

While I believe repealing the onerous 1993 Social Security tax provision is arguably a much more equitable way of structuring our tax code than the ones put forth during this campaign season, I don't believe my proposal or their proposals will become law.

My bottom line on the current proposals put forth by the Democratic candidates for "more free things" is, "Please, no more!"

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