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Richard Judd: Debt and taxes

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America is laden with massive debt and continues to pile up at incomprehensible levels, which is a major cause of our current economic crisis and a formidable barrier to any recovery. When our national debt is expressed as a percentage of gross domestic product, it shows our ability to pay off our debt.

In 1981, America's debt-to-GDP ratio was just over 33 percent. Now it is 69 percent and rising. In earlier times, America taxed itself to pay for government services it received. "Tax and spend" was the mantra. Gradually the mantra changed to "borrow and spend."

Taking on debt has siphoned away trillions of dollars from private investment and public expenditures like infrastructure improvements and education. Increasingly we have been financing our debt by selling assets and borrowing from the central banks of China and Japan, in particular. Foreign nations and firms held approximately $3.3 trillion of U.S. treasury securities in April 2009. This debt, and our continued dependence on these same sources to provide even more loans, give them a strong means of influencing American policies from global trade to national security and domestic policies.

The primary obstacles to solving America's debt crisis are political and ideological. What has happened since 1981 is that most federal administrations and Congress borrow and spend — not tax and spend at a level that achieves a balance between revenue and expenditure. Thus, we have this huge debt that, without change in ideology and political will to solve the problems, will continue until America is economically hollowed out and bankrupt. Watch the process unfolding in Greece today to see how the process might unfold in America tomorrow.

One of the few things most Americans agree upon is that the federal income tax system is terrible. In 1913 the tax code was established, was three pages in length, taxed income at 1 percent for people with incomes up to $20,000 and increased to 7 percent for incomes over $500,000. Today, the tax code is a 24 megabyte download, the core of which is about 7,500 pages at 60 lines per page. The administrative costs of compliance approximate 1 percent annually. Keeping up with changes in the tax code is difficult. Congress makes over 400 changes each year.

The complexity of the code is enormous. According to the Treasury Department, IRS assisted guidance provides incorrect answers about 33 percent of the time. The present code also has under-compliance and is vastly unfair. For example, Wall Street billion-dollar-a-year hedge fund owners pay only 15 percent of their profits, about half of what most Americans pay. Also, the code is open to widespread manipulation, long shaped and dominated by corporate and political insiders. The insiders, both public and private, have financial and professional interest in keeping the tax system as it is. They are among the few who can successfully — and profitably— gain from no change. The insiders are likely to fiercely oppose instituting a new, not yet corrupted tax system for corporate and individual income taxes. However, such a systemic change is essential if America is to avoid fiscal and societal ruin.

In testimony before the Senate Committee on Finance in 2006, David Walker, then comptroller of the U.S., identified five principles for guiding tax reform.

Any new system should raise sufficient revenue to fund America's current and future expected expenditures.

The tax base should be as broad as possible, which helps minimize overall tax rates.

All Americans gain from federal expenditure and all should pay into the system, having "skin in the game." Currently 47 percent of Americans pay no tax at all.

A proposed tax system should improve compliance rates , reduce tax preferences, reduce complexity and increase transparency.

To the extent equity and simplicity allow, the tax system should aim for neutrality, by not favoring some business activities over others.

Transition rules must be an integral part of any reform proposal, establishing interim steps to take place instead of "one giant leap."

A sixth principle could be added also. Any tax system should be global trade compatible to reduce or eliminate the global trade disadvantages that American business confronts in global competition.

The option for consideration as game changers are: a flat tax, a "fair tax," and a value-added tax. The tax systems described below are based on their central concepts to show primary components of the options available at this time for Congressional consideration.

The flat tax as defined by Richard Armey would eliminate the present tax code and treat all taxpayers the same. Everyone would pay the same rate such as 17 or 18 percent of what is left of their annual income from all sources after subtracting a personal allowance.

Social Security and Medicare payroll deductions would not be taxed. The Armey version of the flat tax would have four allowances: for married couples filing jointly; single heads of household; non-married individuals; and an amount for each dependent child. Taxes on business would be equally simple. A firm would subtract all expenses from all income, and if income exceeded expenses, it would pay a tax of 17 or 18 percent on that residual.

The fair tax, as proposed by Daniel Schaefer would be a 15 percent sales tax on the gross receipts from sales of any taxable property or service sold in the U.S. Income, estate, gift and dedicated excise taxes would be repealed. The IRS would be abolished. This "consumption tax" would be collected on all goods and services sold at retail. Utility, legal, accounting and other service-related activities would be taxed at the same rate. Federal taxes would not be withheld from paychecks and individuals would have no forms to fill out. Only Social Security deductions would remain based on income earned.

A value-added tax is a broad-based consumption tax. A VAT tax would be collected by businesses. Individuals are relieved of virtually all burdens including filing a tax return. Compliance cost of a VAT tax would be about one-third to 40 percent of the current tax code — about a $70 billion savings. Many countries using a VAT have eliminated potential inequities by imposing zero or very low rates of tax on food, health care, religious and cultural services. However, a VAT is susceptible to being manipulated because of the political ease that exclusions or the rate of taxation could be changed by Congress. Yet, a VAT is the most powerful and efficient way ever invented to raise government revenue. It is what America needs — as long as the present tax code is entirely eliminated.

Richard Judd is a National City Distinguished Professor Emeritus at the University of Illinois Springfield.