

Do Tax Cuts Increase Government Revenue?

Many (Arthur) Laffer curve proponents will argue until their last breath that the George W. Bush tax cuts have spurred the economy to such an extent we are now benefiting from this wonderful strategy by evidence the federal and most state tax receipts are at all time highs. What greater “stamp of approval” on a strategy is possible than witnessing the proof in the results?

The Truth?

Unbridled credit expansion can do wonders for the **perceived** economic health of an economy and the associated tax revenue collection! That credit expansion may come in the form of Federal tax cuts where our government is effectively extending illusory credit ⁽¹⁾ via issuing Treasury notes, bills, and bonds to bridge the gap between spending and taxes collected. It may also come in the form of our financial intermediary system credit expansion enabled by unlimited liquidity from our Central Bank due to “easy money” policies.

Imagine two families, the Smiths and the Jones, struggling week to week to make financial ends meet. Each family income is approx. \$60,000 per year. Smith fabricates and sells boats, and Jones fabricates and sells motor homes. In spite of their week-to-week income limitation the Smiths would love to enjoy a new \$40,000 motor home, and not to be outdone, the Jones would love a new \$40,000 boat. At this most fortuitist time along comes a creative financier, Mr. “BernanSpan”, who offers a clever solution. Simply cash one of the beckoning mortgage line-of-credit checks they receive in the mail each day for say \$50,000 and purchase the merchandise of their dreams. By borrowing the extra \$10,000 they would have plenty of extra cash to make the monthly payments until the next windfall comes along. That next windfall could very well come from the “JohnSnowman” credit card company encouraging you to tap the unsecured credit world when you run out of assets to borrow against, arguing we must expand our prolific consumption habits to “keep the economy strong”. Finally, you can likely depend upon George W. and company to provide some extra tax refund dollars, compliments of Treasury Security purchasers (mostly foreigners) who are optimistic enough (or stupid enough) to continue buying our Federal debt.

The headline “**\$80,000 GDP increase**” resulting from the boat and motor home sale is a newsworthy event! Politicians, banks, and Wall Street herald the success. Bonus checks rewarding this prosperous strategy set all-time records! Employment is increased and inflation remains “under control”...! Even government will collect more tax revenue from the wonderful increase in economic activity. But...

The charade of credit expansion beyond Gross Domestic Product (GDP) will end soon. On average, it is impossible for one to owe more than one can produce in a lifetime, assuming inventory is not depleted. i.e. the average individual Debt-to-GDP cannot be greater than ONE in real terms. Given that truism for an individual lifetime, then it must follow that as we move through time and all people on earth conduct millions of exchanges in aggregate daily, the sale of any good or service would establish precisely the same level of debt to the borrower (assuming a purchase on credit) as debt relief and recorded GDP for the seller. Thus, on a minute-by-minute basis real legitimate Debt cannot exceed GDP in aggregate. So.... How can the U.S. expand total credit market debt by \$3.34 trillion ⁽²⁾ and only record a nominal \$753 billion ⁽³⁾ in GDP during 2005? That leaves a \$2.58 trillion gap to explain... Well, our embarrassing Current Account Trade Deficit can explain \$805 billion ⁽⁴⁾ of the gap, which is effectively borrowed from our trading partners. That only leaves \$1.77 trillion to go...! The truth is that most of the remaining “gap” can physically never be repaid in real terms! Those holding this credit will be

very upset when the illusory valuation is discovered on a broad scale. They (again, largely foreigners) may even withhold credit by not purchasing our debt, pursue protectionist trade policies, and become motivated to fight us.

Conclusion:

As attractive and seemingly healthy tax cuts appear to be, they are nothing more than a credit expansion charade that will end very painfully. Yes, they can increase government tax revenue in the near term, but the hidden price we must pay later is yet to be discovered. “Real” tax cuts are only experienced when the direct or indirect actual allocation of labor and natural resources to a government purpose are reduced. Government spending is a high correlation to the noted allocations. Let’s focus upon the government spending side of the ledger rather than the loosely correlated tax revenue side for a change.

Ref:

- 1) “Federal Government Debt is Pure Bubble” by Russell Randall, 3-8-2005
<http://www.austrianenginomics.com/id7.html>
- 2) “Best of Bill Buckler” <http://www.investmentrarities.com/thebestofbb03-27-06.html>
- 3) U.S. Bureau of Economic Analysis (BEA)
- 4) U.S. Bureau of Economic Analysis (BEA)

By Russell Randall; 5-13-2006