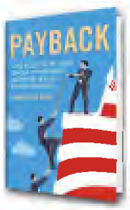
Payback Q&A



This Q&A offers readers a quick take on the issues raised and solutions proposed by the author (https://paybackproject.net/the-author/) of *Payback: Why the Top 1% Must Invest in the Rest and How It Can Renew America*. The questions and answers have been divided into sections for ease of use. Readers who find these issues relevant to their lives and the well-being of America can go deeper by reading the free online book from the founder of The Payback Project, available on this site.

Book Q&A

Part 1: An inescapable truth is most middle-class workers don't earn enough market income to maintain a middle-class standard of living.

Q: Why have you written *Payback: Why the Top 1% Must Invest in the Rest and How It Can Renew America*?

A: Because I believe the fate of the middle class – the foundation of America's greatness – depends on making fundamental changes in tax policy, and I don't see anyone else discussing this.

Q: Explain the issue that no one else is discussing that you think is so important?

A: Payback is premised on one big, inescapable truth. This truth is that the wages of millions of workers with ordinary skills are being suppressed by two inexorable forces, automation and globalization, which pose a grave threat to the continuation of the American Dream for these workers.

Q: What do you mean by the term "ordinary skills?"

A: The labor market is composed of many submarkets. The workers within each submarket can be divided into two categories, those with ordinary skills and those with extraordinary skills. Each submarket determines whether a skillset is ordinary or extraordinary, in that ordinary skills are paid below average and/or falling wages while extraordinary skills are paid above average and/or rising wages. I believe that an increasing number of skillsets in an increasing number of submarkets have been rendered ordinary by automation and globalization. This has made most middle-class workers subject to the Iron Law of Wages.

Q: What is the Iron Law of Wages?

A: The Iron Law of Wages is a term that was coined in the 19th Century during the industrial revolution to describe what happens to the wages of workers in a particular labor market when the number of workers in that market grows faster than the demand for their services. Capitalism demands that the wages of workers in such a market must fall. The Iron Law of Wages, therefore, poses a deadly threat to the wages of millions of middle-class workers. I believe that tax policy is the most practical and least disruptive way to cope with the suppression of the wages of middle-class workers. Acceptance of this premise forces a rethinking of many issues, such as the need to increase the progressivity of taxes, end taxation's corruption of capitalism, and raise the level of taxation.

Q: How is the Iron Law of Wages relevant to America in 2020?

A: The short answer is it will determine the fate of the middle class. For the last two generations, globalization and automation have been displacing workers with ordinary skills at an accelerating rate. In today's economy, workers with ordinary skills are vulnerable to displacement at any moment. As the word "ordinary" suggests, workers with ordinary skills make up most workers. So, a majority of workers are in a more precarious position than they may realize. In reality, globalization enables capitalists to roam the world to hire the cheapest labor, and automation enables capitalists to replace workers with less expensive computers and machines. As vulnerable workers are displaced, they join a growing labor pool composed of other such workers. A growing pool of displaced workers coupled with dwindling demand for them means the wages of these workers, as dictated by the Iron Law of Wages, must fall.

Q: Suppose you're right and the Iron Law of Wages will suppress the wages of millions of workers with ordinary skills. What are the implications?

A: Well, there are two sets of implications, one viewed from the standpoint of affected families, and one for America as a whole. As the Iron Law of Wages suppresses the wages of more and more workers, their families won't have enough income to lead a middle-class standard of living, much less save for their retirement and pay for their own health care and the post-secondary education of their children. As the financial stress on these families intensifies, so too will their sense of insecurity and anxiety. A society with millions of families ridden with insecurity and anxiety will inevitably lead to mass social and political unrest.

Q: Now, what are the effects of low wages on America as a whole?

A: On the surface, lowering labor costs helps capitalists increase their profits and allows consumers to buy cheaper goods and services. Beneath the surface, however, low wages for millions of workers endanger the economy and the middle class. Over time, more and more displaced workers will lose their purchasing power, will become part of a growing demoralized and under-skilled workforce, and, together with other disgruntled groups, will foment social and political unrest. A shrinking consumer base, a demoralized, under-skilled workforce, and a nation plagued by social and political unrest threatens America's political stability, which isn't good for business. Given the fundamentals of capitalism, the Iron Law of Wages will continue to work its will at a faster pace.

Part 2: Globalization and automation threaten the middle class, but they don't have to; capitalism can be made to work for everyone.

Q: Does this mean you want to change the fundamentals of capitalism?

A: Certainly not. I'm a firm believer in capitalism, but it must be an economic system that works for everyone. Before telling you how I think capitalism can be made to work for everyone, I want to tell you what shouldn't be done. Nothing must be done to either disrupt global markets for labor and capital or prevent technological innovation. Competition and innovation are the lifeblood of capitalism and anything that harms either weakens capitalism's ability to create prosperity. To the extent that capitalism is prevented from creating the maximum possible amount of income and wealth, everyone, rich and poor alike, suffers. For the economic pie to grow as big as possible, everyone must benefit, and for everyone to benefit, the pie must be properly sliced.

Q: To use your metaphor, what does the size of a pie's slices have to do with making it bigger?

A: This requires a quick explanation of what makes capitalism work, what prevents it from working, and what makes it work best. Capitalism creates more wealth than any other system because it naturally balances supply and demand, and, as a result, it allocates resources in the most efficient way. Open, honest, and competitive markets un-contaminated by non-economic factors are what make capitalism efficient.

Q: Now, what prevents it from working?

A: Markets become corrupted by restrictions on participation, fraudulent and anti-competitive practices, and non-economic factors interfering in their operation. Corrupted markets can't properly balance supply and demand and allocate resources efficiently, and, therefore, prevent capitalism from realizing its full potential.

Q: Finally, what makes it work best?

A: For capitalism to create the most wealth possible, consumers must have enough income to purchase the most goods that capitalists can produce, and capitalists must have enough capital to produce all the goods that consumers can afford to purchase. Workers, not capitalists, comprise most consumers. So, there's a delicate balance to be struck between how much of the economic pie should go to capitalists and how much to workers. Tax policy can slice the pie to make it bigger or smaller for either capitalists or workers, and how it's sliced will determine the size of the pie.

Q: You lost me when you said tax policy can slice the pie to make it either larger or smaller. Explain.

A: Economic reality confronts capitalists with a quandary. For any particular capitalist, low wages increase their profits, but if all capitalists pay low wages, then consumers won't have enough income to buy all that can be produced. So, here's the quandary: It's not in the interest of any particular capitalist to increase wages, but it's in the interest of all capitalists that workers have enough income to buy all that can be produced.

Part 3: Capitalism remains the best system for growing the economic pie. Tax reform can ensure the pie is sliced to meet social needs.

Q: I've got the quandary, but what does tax policy have to do with it?

A: Tax policy offers a solution. If, for the entire economy, income for workers is too low and income for capitalists is too high to maximize growth, then taxes can be increased on capitalists and lowered on workers to levels that do maximize growth. The goal of tax policy should be to ensure maximum growth by taxing at levels that enable both workers to have enough income to buy the most capitalists can produce and capitalists to have enough capital to produce it.

Q: So, you recommend using tax policy to make capitalism create the most wealth possible?

A: Exactly. I want capitalism to rip and roar, but to stay viable, it must enrich workers as well as capitalists. The goal of tax policy shouldn't be to punish success, but rather to create as much wealth as possible for both workers and capitalists.

Q: Essentially you are arguing for using tax policy to redistribute income. Is that right?

A: Yes. Capitalism creates prosperity far better than any other system, but it doesn't always distribute it well. Sometimes external forces such as globalization and technological innovation intervene to distribute income and wealth in ways that harm both economic growth and social equity. For the past two generations, these forces have been concentrating too much income and wealth in capitalists. Whenever the maldistribution of income and wealth threatens economic growth and/or social equity, tax policy should be used to correct it, not exacerbate it.

Q: Using tax policy to correct the maldistribution of income and wealth gets the government involved in redistribution, doesn't it?

A: No doubt about it. At the outset, I want to make clear that I don't welcome the idea of the government being involved in the redistribution of income and wealth more than is necessary to maintain the economic health and social equity of a society. If, and it's a huge if, income and wealth concentrate too much at the top for too long so that it threatens irreparable harm to the economy and the body politic, the risk of doing nothing outweighs the risk of acting. It should be remembered, however, that the government has substantial experience with the redistribution of income and wealth, and like most things, it's good if done well and bad if done poorly.

Q: What's your test for when redistribution is done well and when it's done poorly?

A: Redistribution is done well when it promotes economic growth and/or social equity, and it's done poorly when it frustrates either.

Q: That's fine in the abstract, now give me a specific example of redistribution done well.

A: Medicare is an example of redistribution done well. It disproportionately taxes those with the highest income to provide health care to those with the lowest income. It passes the social equity test because it provides an essential service to those in need. And it passes the economic growth test because it expands the health care industry by providing paying patients. Had an amount equal to the taxes paid by upper-income taxpayers to pay for health care for the needy been used to purchase luxury goods, then the luxury goods industry would have been expanded. I believe that growing the health care industry is better for the economy and society than growing the luxury goods industry.

Q: All right, now give me a specific example of redistribution done poorly.

A: Debt-financed tax cuts for the rich are examples of redistribution done poorly. Since 1981, there have been four major tax cuts, all of which both added to a bulging national debt and disproportionately benefitted taxpayers in the top 1%. These tax cuts flunk the social equity test because they unnecessarily increased the income and wealth of the top 1% at the expense of future generations of taxpayers. And they flunk the economic growth test because the small increases in current growth that these tax cuts sparked will be offset by lower growth when the added debt must be repaid. I believe that enriching the top 1% by increasing the national debt is bad for both economic growth and social equity.

Q: You said the government is experienced in redistributing income and wealth. Give some examples.

A: The income tax itself is an example of redistribution. It replaced tariffs as the primary source of revenue because it was many times more progressive than tariffs. Progressive is shorthand for the "ability to pay" principle which means that those with high income pay more taxes than those with low income. In addition to tax policy being progressive, so too are social insurance programs like Social Security, Medicare, Medicaid, the Affordable Care Act, student aid programs, unemployment insurance, food stamp programs, low-income housing programs, and other similar programs. These programs are all financed by taking more from those with high income and distributing more to those with low income in order to meet social needs.

Part 4: The top 1% has gotten too fat and the bottom 90% too thin. More progressive taxes can right-size the slices of the economic pie.

Q: Progressive is a big word and can mean different things to different people. Just how progressive should taxes and social insurance be?

A: This is the crux of the matter. Since the New Deal, there's been general agreement that both taxes and social insurance programs should be progressive, but there have also been ongoing disputes about the degree of progressivity. So, the issue in almost all instances isn't whether taxes and social insurance programs should be progressive but how progressive should they be. This is a big part of what my book Payback is about. Generally, the greater the concentration of income and wealth, the greater the need for progressivity.

Q: How do you know when too much income and wealth have concentrated for too long at the top?

A: Look at the trends in income and wealth concentration over a timespan. In 1986, the top 1% accounted for 23% of all wealth and the bottom 90% accounted for 39%. By 2014, the top 1% accounted for 37% of all wealth (an increase of 62%), and the bottom 90% accounted for 28% (a decrease of 29%). In 1986, the top 1% accounted for 12% of all income and the bottom 90% accounted for 64%, but in 2014, the top 1% accounted for 20% of all income (an increase of 82%), and the bottom 90% accounted for 53% (a decrease of 17%). During this same period, the median wage was flat and the gap between the median wage and the average wage grew. Compared with 1986, income and wealth have both intensely concentrated at the top.

Q: So, what's the problem if some Americans are much better off than others? Isn't that what happens in a capitalistic society?

A: Here's the problem. It's natural and good for some to have more than others based on ability, effort, and luck, but if it gets out of hand, capitalism can tear a society apart. Any time capitalism results in a growing number of able-bodied, full-time workers earning too little income to live a middle-class standard of living, save for their retirement, and pay for their health care and the post-secondary education of their children, then it's not working for everyone. The problem isn't that some have more than others; it's that many don't have enough.

Q: For capitalism to work for everyone, what must it do?

A: For capitalism to work for everyone, the private sector must create enough prosperity to meet the needs of the workers who contribute to the economy. It must also produce sufficient prosperity to satisfy the needs of society by raising enough taxes to finance the public sector. These jobs, moreover, should pay, at a minimum, enough for the worker and his or her family to have a decent standard of living. Beyond jobs, a capitalism that works for everyone should assure, regardless of income, all working Americans a decent retirement, adequate health care, and access to the post-secondary education they need to realize their potential.

Q: When you say a decent standard of living and a decent retirement, what do you mean?

A: I'll be precise and arbitrary. I believe that no adult, full-time worker who works at least 2,000 hours a year should earn poverty wages. So, I believe that no wages should be less than 125% of poverty, currently about $15 an hour. As to retirement, I believe that current Social Security benefits, with some added progressivity, guarantee a decent retirement for all workers.

Q: We've covered a lot of ground about what you think it takes for capitalism to work for everyone. Since your book is about tax policy, explain how it can make capitalism work for everyone.

A: I'm going to state the three principles that I believe will make tax policy enable capitalism to work for everyone:

First, tax policy must redistribute income in ways that promote both economic growth and social equity.

Second, tax policy must end its corruption of capitalism.

Third, taxation must raise sufficient revenue to maintain America's long-term financial security.

Q: Take the first principle and explain what redistribution can do to promote economic growth and social equity.

A: As I've already said, capitalism doesn't always distribute income and wealth in ways that promote maximum growth or social equity. From time to time, forces like globalization and automation intervene to concentrate too much income and wealth in too few and to upset a proper balance between the investment necessary for maximum production and the income necessary for maximum consumption. When that happens, tax policy should redistribute income to correct the imbalance.

Q: How do you know when there's an imbalance?

A: A key indicator is the unhealthy accumulation of surplus capital.

Q: Define "surplus capital."

A: Wealth is income that accumulates over time, and it has two components, investment capital, and surplus capital. Investment capital is that portion of wealth that is invested in businesses to earn a return, and surplus capital is that portion of wealth that can't be invested in businesses because there's no demand for the goods and services it would generate.

Q: Now that you've described surplus capital, what is its significance?

A: Investment capital as the source of funds for business investment is essential to making the economy work. Surplus capital supports philanthropy and the market for luxury goods and services. Because of the intense concentration of wealth, most surplus capital has concentrated in the top 1%. There is nothing wrong with the top 1% having more philanthropic dollars to spend or more access to luxury goods and services, but it involves a tradeoff.

Q: What's the tradeoff?

A: Tax cuts for the rich have been a leading cause of the accumulation of surplus capital in the top 1%. In tax policy, there's a choice. Taxes can be cut disproportionately for either the top 1% or the bottom 90%. Since the wealthy are financially able to save their tax cuts, tax savings for the top 1% result in increasing their surplus capital. But, since those who aren't wealthy spend most or all of their income on just getting by, tax savings for the bottom 90% result in increasing their consumption. Tax policy, then, involves a tradeoff. Cutting the top 1%'s taxes grows elite luxury markets and some philanthropy while cutting the bottom 90%'s taxes grows mass consumer markets.

Q: Explain how this tradeoff affects people.

A: Growing luxury markets means more income for high-end realtors, private jet and yacht salesmen, and art dealers while growing mass consumer markets means more jobs for Walmart employees, childcare workers, and fast-food workers. I believe that there will be more jobs and the economy will grow faster if tax cuts are used to increase the mass consumer market rather than elite luxury goods and services market. Increasing philanthropy enables wealthy donors to favor their pet charities, but at the cost of diverting tax revenue from unmet public needs.

Q: You've explained why you think redistribution that favors the bottom 90% promotes economic growth. Do you want to tax away all surplus capital?

A: No. The ability to accumulate surplus capital is an essential element of capitalism and should be encouraged as a just reward for success. My point, however, is that when its further accumulation threatens growth, it's time to rein it in.

Part 5: As the economy changes, the slicing process must adapt.

Q: You've explained how you think redistribution can promote economic growth. Do you think it can be overdone?

A: Sure, there's a risk, and I'll suggest some key trends to help measure the risks of an imbalance developing in either direction. Increases in the following trends indicate an imbalance in favor of excessive investment, and decreases indicate an imbalance in favor of excessive consumption:

• The top 1%'s share of income and/or wealth is rising and the bottom 90%'s is falling.
• The share of national income derived from the ownership of assets is growing while the share of national income derived from wages and salaries is falling.
• Per capita surplus capital is growing faster than per capita investment capital.
• Industrial capacity exceeds consumer demand and the excess is growing.
• The rate of inflation is below average and falling.
• The rate of increase in per capita GDP is below average and falling.
• The price of luxury goods and services is rising faster than that of non-luxury goods and services.

When these trends indicate that there is either excessive surplus capital or excessive consumption, income and wealth should be redistributed to redress the imbalance.

Q: You said that tax policy should be used to redistribute income to correct an imbalance. Why tax policy?

A: I believe tax policy is the simplest, most direct, and least disruptive means of redistributing income and wealth. Anytime excessive surplus capital exists, taxes can be made more progressive, and whenever excessive consumption occurs, taxes should be made less progressive.

Part 6: Since tax preferences are clumsy, corrupt capitalism, and contribute to social inequity, social needs should be addressed directly.

Q: We've covered your redistribution principle and how tax policy can be used to implement it. Let's turn to your second principle – the need to end tax policy's corruption of capitalism and contribution to social inequity.

A: As I've said, capitalism is easily corrupted, and tax policy is a leading cause of corruption. For markets to function efficiently, they must allocate resources based solely on economic factors. Tax policy, however, has become the plaything of politicians who systematically use politics to override market pricing in allocating resources.

Q: How does politics override markets in allocating resources?

A: The key to capitalism's efficiency is market pricing unfettered by non-economic factors. Tax policies that change the price of goods and services or the return on investments from what they would've been without such policies distort how markets allocate resources.

Q: How do tax policies change the price of goods and services and the return on investments?

A: There are over 200 tax preferences, which either lower the after-tax price of preferred goods and services or increase the after-tax return on preferred investments as compared with their pre-tax prices or returns.

Q: What's wrong with that?

A: Lowering prices and increasing returns by enacting tax preferences distorts markets and gives preferred goods and services and preferred investments an unearned advantage over their competitors.

Q: What do you mean by an unearned advantage?

A: I mean an advantage unearned in the marketplace. In the literal sense, however, the advantage is earned; it's just that it's earned by lobbying politicians to award them with the advantage. It's an example of politicians, not market forces, picking winners and losers.

Q: Do you think that politics plays too big a role in tax policy?

A: Most definitely. America pretends to have a capitalistic economy, but politics overriding natural market forces is what happens in socialistic societies. Since tax policy is the product of the political process, there's no way to keep politics out of it. But, whenever politicians enact tax preferences that pick winners and losers differently than natural market forces would have picked, they should be called out and held accountable.

Q: Explain what tax preferences are.

A: Tax preferences are those provisions buried in hundreds of pages of the tax laws that confer special benefits on preferred groups of taxpayers. What's common to almost all tax preferences is that they benefit a preferred group by causing the after-tax price of preferred goods and services to be cheaper than their pre-tax price, and the after-tax return on preferred investments to be higher than their pre-tax return. Who's preferred and what's preferred are the products of pure, raw politics. Each tax preference divides taxpayers into two categories: those preferred taxpayers who benefit from the preference, and all others who must pay for it.

Q: What do you mean when you say that non-preferred taxpayers pay for the benefits that preferred taxpayers get?

A: All tax preferences lose revenue. Since America taxes much less – about 6% of GDP – than it spends, all revenue losses add to the national debt. Someday the national debt will have to be repaid, and those who will have to pay it will be stuck with the tab for the cost of each tax preference.

Q: Now, explain how tax preferences work.

A: There are four major types of tax preferences: exclusions, deductions, credits, and preferential rates. Except for refundable credits, they all reduce the preferred taxpayers' tax liability if they spend their money on preferred goods and services or invest in preferred investments. Refundable credits are a means by which politicians use tax policy to redistribute income to preferred low- and middle-income taxpayers.

Q: That's awfully abstract. Can you give an example or two of each?

A: Sure. Let's take exclusions first. The most pervasive and costly tax preference of all is the employer-sponsored health insurance exclusion, which excludes from an employee's taxes the cost of their employer-sponsored health insurance. For employees to get a tax benefit, their employers must sponsor a health insurance plan in which they participate. If there were no tax benefit, there'd be no reason for employers to become involved in their employees' health insurance.

Q: What's so bad about employees getting a tax benefit because their employer provides their health insurance?

A: Bad isn't the right word. Discriminatory, costly, and distorting are better words. This tax preference discriminates against taxpayers who don't work for large employers, saddles employers who sponsor health care plans with a financial burden that makes them less competitive, and skews consumer spending.

Q: Let’s take these one by one. How does this tax preference discriminate against taxpayers who don’t work for large employers?

A: But for this tax preference, employers likely wouldn’t be involved in their employees’ health insurance, just as they aren’t involved in their auto insurance. Since most taxpayers are employed by private employers, millions of them get their health insurance through their employer. Millions of other taxpayers, whose employers don’t sponsor health care insurance or who are self-employed, buy their health insurance in the individual market. This tax preference causes many low-risk taxpayers who buy their insurance in the individual market to suffer price discrimination relative to many high-risk taxpayers who’re employed by large employers.

Q: Explain why this is happening.

A: Health insurance is priced based on risk, and risk falls as the size of the risk pool rises. The size of risk pools for employer-sponsored health plans is determined by the number of employees an employer has. Employees of large employers, as a result, have a competitive advantage over both employees of small employers and the self-employed because they can participate in larger risk pools. Since premiums on plans with small risk pools are higher than those on plans with large risk pools, employees of large employers get a better deal than others. If risk pools were formed independently of an insured’s employment, then the market would no longer discriminate against those who don’t work for a large employer and risks would be based on pure market factors.

Q: So, employees of large employers get a special discount. Isn’t that just the way of the world?

A: That is the way of the world if you believe that exercising political influence is the way to get ahead, and frankly lots of folks do. The only reason employers are involved in their employees’ health care is because of the tax preference, a product of politics, not economics. Absent this tax preference, market factors, not politics, would allocate risks.

Q: All right, now explain how this tax preference saddles employers with a burden that makes them less competitive.

A: Under free-market economics, an employer pays compensation to its employees, and the employees decide how to spend it with no involvement from the employer. Employers now compete in global markets, and in most markets, businesses aren't involved in their employees' health insurance. An employer who sponsors a health insurance plan incurs costs in connection with organizing, funding, and administering it. Since these costs have nothing to do with the employer's core business, they put these employers at a competitive disadvantage against competitors who aren't burdened by these costs.

Q: Finally, explain how this tax preference skews consumer spending.

A: This tax preference induces taxpayers to over-spend on health insurance coverage because it credits dollar for dollar whatever they spend against their taxes. As a result, many participants, particularly high-income taxpayers, choose gold-plated plans that include low deductibles and co-pays with the broadest coverage available, such as full dental and vision care. The net effect of this tax preference is to encourage the overuse of health care by high-income taxpayers who can afford health care without any taxpayer help.

Q: You've pointed out the discrimination against employees of small employers and the self-employed, the burdensome costs to employers, which make them less competitive, and the overuse of health care by high-income taxpayers caused by this tax preference — and yet, the Republic still stands. What's the big deal?

A: What makes it a big deal is it's the worst kind of problem. It's insidious. Coping with obvious problems is difficult enough but coping with an insidious problem is next to impossible.

Q: What do you mean by insidious?

A: It's like smoking. Some smokers, like my dear dad, smoked for years and enjoyed it without the slightest concern for their health. But then my dad died, in the prime of his life, of diseases directly related to smoking. This, together with other tax preferences, is like that in that their effects accumulate unnoticed over a long period of time — and then when it's too late, they inflict serious harm.

Q: Isn't that a little dramatic?

A: It would be if this tax preference were the only one, but it isn't. There are more than 200 and, taken together, they're like a ticking time bomb. Each tax preference has its own influential political constituency that protects it with the same ferocity of a lioness protecting her cubs. At some point, after it's too late, the danger that tax preferences pose to America's economy, financial security, and social and political stability will become all too obvious.

Q: Before getting into the danger tax preferences pose, give examples of the other types of tax preferences.

A: All right, let's take deductions. They differ from exclusions in two major ways. First, to qualify for deductions, a taxpayer must have total deductions in excess of the standard deduction. And second, deductions offset tax liability by the percentage of the amount of the deduction times the taxpayer's marginal tax rate. Leading deductions include medical costs, state and local taxes, home mortgage interest, and charitable contributions. In 2020, the standard deduction for a married couple filing jointly was $28,800, and tax rates ranged from a low of 10% to a high of 37%.

Q: Again, what's the big deal if taxpayers get a break for these types of expenditures?

A: It's a big deal for about 10% of taxpayers, almost exclusively high-income taxpayers, who qualify for deductions. But it's a raw deal for that 90% of taxpayers who don't, and for future generations of taxpayers who will someday have to pay higher taxes to make up for the revenue loss attributable to these deductions. It's worth asking what the justification is for giving a costly tax break for a few politically determined deductions to a few high-income taxpayers when millions of low- and middle-income taxpayers incur these same types of expenses and get no tax break. I can't think of any. This is a classic example of misplaced social engineering that helps the unneedy instead of the needy.

Q: What do you mean by social engineering?

A: Social engineering is where the politicians decide on a social problem that needs fixing and then enact a program to deal with it. For example, when the politicians determined that not enough retirees could save enough to pay for their retirement or health care, they enacted Social Security and Medicare. Similarly, programs have been enacted to provide student aid, unemployment insurance, health care, affordable housing, and food stamps, and other similar programs for those with low- and middle-income. Social engineering is what the politicians do when a social problem arises that capitalism cannot fix on its own.

Q: What do taxes have to do with social engineering?

A: The short answer should be first to provide the revenue to fund the social engineering that's enacted, and second to do no harm.

Q: What do you mean by "do no harm?"

A: Most social problems stem from those with low- and middle-income being unable to afford something that the society determines that they should have even if they can't afford it. Things like food stamps to avoid hunger, student aid for the next generation of workers to get a post-secondary education, health care, housing, and other similar needs. Taking less in taxes from the needy lessens the need to enact programs to provide them with what they can't afford.

Q: What do tax breaks for those with high-income have to do with harming those with low- and middle-income?

A: Quite a bit. Every tax break for the unneedy loses revenue. Lost revenue either adds to the national debt or reduces the funding for programs for the needy. Adding to the national debt squeezes funding for programs for the needy which invites social unrest and political instability.

Q: You seem skeptical of using tax policy to fix social problems.

A: You got that right. The purpose of taxation should be to raise revenue to pay for the cost of government and do it in a way that doesn't discourage economic growth or lead to social inequity. Social problems confronting America should be attacked directly, not by tinkering with tax policy.

Q: Give some examples of how the government should cope with the types of social problems addressed by the deductions you listed.

A: I'll take them one by one, starting with medical costs. Assuming it's the job of the government to soften the blow of medical costs, I believe that it should be done by using social insurance, programs like Medicare, Medicaid, or the Affordable Care Act to cover these costs directly. For the most part, social insurance programs are more thoroughly means-tested than deductions and, therefore, much less likely to help those who don't need it.

Q: Now what, if anything, should be done about state and local taxes?

A: The federal government funds a broad array of federal grant programs that provide hundreds of billions to the states to help pay for functions such as education, health care, transportation, low-income housing, environmental matters, and many others. These grants mitigate the wealth disparities among the states and help ensure that states have the resources necessary to meet their needs. If one or more states believe that they're not getting enough federal aid, they can lobby to increase their grants. Beyond that, if a taxpayer chooses to live in a high-tax state, that's their choice. I don't believe that it's the federal government's job to indemnify taxpayers for their state and local tax liability, particularly high-income taxpayers who choose to live in high-tax states.

Q: What about home mortgage interest?

A: This one is easy, at least in theory. It's a taxpayer's choice to rent or buy, and if they decide to buy, it's their choice about how expensive their home should be. The federal government has no business involving itself in that choice, and even if it did, it's a waste to make it easier for high-income taxpayers to buy expensive houses. In today's America, millions of low-income Americans, many of whom pay no income tax, need help paying for modest, decent housing. Federal grant programs targeted at the needy are better ways of meeting America's housing needs than providing a tax break to the unneedy to buy expensive houses.

Q: Finally, explain what's wrong with the charitable contribution deduction.

A: Almost 90% of taxpayers get no tax benefit from this deduction, and yet most of them make charitable contributions every time they give to their church or other local non-profit. This deduction benefits those with the highest income who can best afford to give and whose standard of living isn't cut by their philanthropic contributions. As with other deductions, every penny of revenue loss attributable to this deduction either deprives the government of funds necessary to meet unmet public needs or adds to the national debt.

Q: Does this mean you're against charitable giving?

A: Certainly not. However, I think that high-income taxpayers, just like the almost 90% of taxpayers who get no tax benefit for their giving, should give as much as they can after paying their taxes. Tax incentives aren't necessary to encourage giving, despite fundraisers' tendencies to use such incentives to build their cases to donors. In the late 19th century, for example, robber barons such as Rockefeller, Carnegie, Morgan, and others, donated huge amounts to charities when no tax benefits for giving existed. I believe the multi-millionaires and billionaires of today are no different. The likes of Jeff Bezos, Bill Gates, Warren Buffet, and others will continue to contribute to charities because even after giving billions to their heirs, paying taxes, and making investments, there billions will still be left to support charitable causes. Again, I'm in favor of giving, but I believe that it should be done independently of tax incentives, particularly in a time with an exploding national debt and trillions of unmet public needs.

Q: You've made your views on deductions clear. Now explain what you think about credits.

A: There are three major tax credits – the child credit, which helps taxpayers and non-taxpayers pay for the cost of child dependents; the earned income tax credit, which supplements the wages of low-and middle-income taxpayers and non-taxpayers; and the premium credit, which helps low- and middle-income taxpayers and non-taxpayers pay a part of the cost of health insurance under the Affordable Care Act. Unlike deductions, credits offset taxes dollar for dollar and don't have to exceed the standard deduction.

Q: I noticed that non-taxpayers are entitled to these credits. How can someone who doesn't pay taxes get a credit against their taxes?

A: There are two types of credits: refundable and non-refundable. Refundable credits offset a taxpayer's tax liability while non-refundable credits are paid even if the taxpayer doesn't owe any taxes. The explicit purpose of non-refundable credits is to redistribute income to non-taxpaying, low-wage workers who don't earn enough income to support their children, have a decent standard of living, or pay for their own health insurance. These types of credits are attempts to mitigate the economic reality that capitalism doesn't always result in employers paying their employees a living wage.

Q: Since non-refundable credits provide a cash equivalent payment to non-taxpayers, how are these payments funded?

A: Excellent point. Non-refundable credits are just a different name for government-issued and funded vouchers. Unlike refundable credits, which simply offset a taxpayer's income tax liability, non-refundable credits are funded through appropriations because the taxpayer doesn't have enough income to offset the cost of the credit.

Q: You expressed doubt about using tax policy for social engineering, which in this case means supplementing the after-tax income of low wage workers. What do you think about using credits for this purpose?

A: Capitalism's failure to assure that no able-bodied, full-time worker will earn less than a living wage is an economic, social, and political problem that demands governmental action. A society in which millions of able-bodied, full-time workers are mired in poverty is a drain on the economy, a social disgrace, and a political tinder box. Instead of using tax credits to raise the standard of living for low- and middle-income workers, I believe there are much better ways.

Part 7: Rather than tax the working poor with the payroll tax, finance Social Security and Medicare with the personal income tax.

Q: Are you suggesting that getting rid of the payroll tax and replacing its lost revenue with the personal income tax is a better way to engage in social engineering than using tax preferences and credits?

A: Tax policy shouldn't increase poverty by taxing low- and middle-income workers either nearer or deeper into poverty. The payroll tax taxes every dollar that low-wage workers earn at a rate of 15.3%, which plunges them deeper into poverty. By increasing the after-tax income of low-wage workers, the child credit, the earned income tax credit, or the EIC for short, and the premium credit all attempt to undo some of the harm done by the payroll tax to these workers. A simpler way to undo these harmful effects would be to repeal the payroll tax.

Q: Aren't Social Security and Medicare financed by the payroll tax?

A: Yes, but there's no reason why Social Security and Medicare couldn't be financed from the personal income tax. Nothing prevents the political process from repealing the payroll tax and replacing the lost revenue with an increase in the personal income tax. To secure permanently the financial security of both Social Security and Medicare, the government could pledge the first dollars that come into the general fund from the personal income tax to the payment of these programs. Not only would this relieve low- and middle-income taxpayers of a tax that forces them into poverty, but it would permanently guarantee the financial security of both Social Security and Medicare.

Q: Don't workers and others pay for their own Social Security and Medicare benefits from their payroll taxes?

A: That's a myth. No one contributes nearly enough payroll taxes to pay for their Social Security and Medicare benefits, even including what their employers contribute on their behalf and the interest that would accumulate on all such contributions. In 2011 the Brookings Institution published a study that established that beneficiaries of Social Security and Medicare get more in benefits than has been contributed on their behalf. This still holds true today.

Q: Is that true for everyone?

A: With very rare exceptions, yes. For anyone who doubts it, they should prove it for themselves, as I did, by adding up the total contributions made on their behalf and the interest that would have accrued on such contributions. Once they do, they'll find that this amount isn't nearly enough to buy a retirement income annuity equivalent to Social Security and a health insurance policy equivalent to Medicare. In Chapter 4 of my book, I invite readers to take the 'Libertarian Bargain' quiz to find out for themselves.

Q: How would low- and middle-income workers benefit from replacing the payroll tax with the personal income tax?

A: The personal income tax is much more progressive than the payroll tax. The payroll tax taxes every dollar of wage income from the first dollar up to the current cap of $137,700, while the personal income tax taxes only income above the standard deduction, taxes all forms of income, taxes income at graduated rates ranging from 10% to 37%, and has no cap on what is taxed. Replacing the payroll tax with the personal income tax would end taxing millions of low-wage workers into poverty and relieve the government of much of the need to use tax credits to supplement their income.

Part 8: If millions of low-wage workers are to pay for their healthcare, education, and retirement, their after-tax income must be increased.

Q: Suppose you're right and the payroll tax is replaced by the personal income tax. Would this solve the problem of low-wage workers not making enough to stay out of poverty?

A: It would go a long way, but more would have to be done — and not by using tax credits. For example, I believe that the politicians should mandate that all businesses, except for very small businesses and hobby businesses, pay all able-bodied, adult workers a living wage. Any business that can't pay a living wage isn't a viable business, and any business that can pay a living wage but doesn't is outsourcing to the taxpayers the need to provide financial help to its employees. Permitting businesses to pay less than a living wage enriches their owners at the expense of the taxpayers.

Q: You have pointed out ways that tax preferences and credits lead to a loss of revenue in the system. Let's take a closer look at some of the credits designed to help society. What's wrong with the child credit?

A: It wastes too much money on the unneedy. Couples with incomes of up to $400,000 qualify for a $2,000 tax credit for each dependent child aged 16 or under. Those whose income is above the median income of about $60,000 don't need taxpayer help to support their dependent children while those whose income is below the median wage need more help than the credit provides. As an example, the greatest unmet need for many low-wage workers is for childcare for preschoolers. Ending the child credit and using the revenue savings to expand and improve childcare for low-wage workers is a better use of public funds than increasing the after-tax income to high-income taxpayers, particularly at a time when the national debt is out of control.

Q: So much for the child credit. What's wrong with the EIC?

A: While it's better than nothing, the EIC is seriously flawed in that it corrupts both markets and politics.

Q: Corruption is a big word. Taking your charge one point at a time, explain how the EIC corrupts markets.

A: I believe that markets should determine the viability of both businesses and jobs. Neither a business that can't pay its cost of doing business without a taxpayer subsidy nor a job that isn't worth being paid a living wage is economically viable. By having the taxpayers supplement the wages of low-wage workers, the EIC encourages both businesses to pay less than a living wage to increase their profits and employees to work in dead-end jobs that can be lost at any moment. I don't think that the taxpayers should subsidize either increasing the profitability of businesses that don't pay a living wage or the prolonging of non-viable jobs.

Q: You've explained why you think the EIC corrupts markets. Why do you think it corrupts politics?

A: The EIC invites an unholy alliance between both the businesses that hire employees who lack the skills to merit a living wage and these employees to use their political influence to enrich themselves at the taxpayers' expense. Increasing the EIC enables businesses to increase their profits by keeping their employees' wages low while also enabling low-wage employees to increase their after-tax income. This results in politicians, not markets, determining both the profitability of businesses that hire low-wage employees and the after-tax income of these low-wage employees. This is a blatant example of a socialistic solution to a problem created by capitalism.

Q: You mentioned the "S" word, socialism. What does socialism have to do with this?

A: A lot more than most people think. Socialism can take many forms, but essentially it refers to a system that uses government intervention rather than market forces to achieve certain public policy goals. Socialism substitutes politicians for markets in determining what gets produced and who can afford to buy it. Substituting politics for markets isn't limited to socialists. It's a practice embraced by many fake capitalists who seek special benefits from politicians anytime they see an opportunity. Tax preferences in general – and the EIC in particular – are all examples of businessmen seeking an advantage from politicians that they can't get from markets. As for me, I trust markets more than politicians to determine what should be produced and who can afford to buy it.

Q: So, if you don't think the EIC is the best way to deal with the growing percentage of able-bodied, full-time workers who lack the skills earn a living wage, then what should be done?

A: Raising the wages of these workers can only be remedied by either upgrading their skills or providing them with public-sector jobs. The EIC does neither.

Q: You suggest two remedies. Explain what you think can be done to upgrade the skills of low-wage workers?

A: This a thorny issue that involves a harsh truth that few are willing to discuss. While I believe that education and retraining will work for some percentage of under-skilled workers, particularly the young, I'm doubtful that it will work for most workers 50 or older. The notion that a 55-year old laid-off assembly line worker living in rural Iowa can be retrained to work in information technology or become a successful entrepreneur strikes me as fanciful. Even as a skeptic, I would fund retraining programs and private-sector apprentice programs if they can show a track record of success. Given my doubts about retraining, I believe that most under-skilled workers will have to be placed in public-sector jobs.

Q: Public-sector jobs — does this mean hiring millions more government workers?

A: Yes, specifically this solution would involve hiring the structurally unemployed as public-sector workers to fill unmet needs at the local level. Millions of workers lack the skills to earn a living wage in the private sector and lack technical skills, making retraining unlikely. Yet, what many of these hardworking individuals lack in technical skills, they make up in their life skills and experiences, which could benefit our society if given an outlet. There is much worthwhile work to be done in the public sector in education, law enforcement, health care, child care, the environment, and other public functions, and these workers could both earn a living wage and contribute to improving the quality of life for everyone. I believe that this work would benefit America much more than using the EIC to keep workers in non-viable jobs that aren't worth a living wage.

A: Explain the kind of public-sector jobs you are suggesting.

A: I'm suggesting that community service jobs be created to improve the well-being of underserved communities throughout the nation. There are thousands of local governments and nonprofit organizations that could employ these workers to meet unmet public needs.

Q: Be more specific. What would these employees do?

A: These workers would be employed in education, law enforcement, health care, child care, parks and recreation, environmental matters, libraries, and other public functions to assist front line personnel and relieve them of routine and administrative tasks and to assist in providing maintenance and security for public facilities.

Q: Who would pay for and administer this program?

A: The federal government would provide funding for a grant program in which grants, based on need, would be made to local governments and nonprofits to hire these employees. Local governments would administer these programs consistent with federal guidelines.

Q: How costly would this program be?

A: It would depend on how many under-skilled workers are unemployable in the private sector. To the extent that the education system produces or retrains more workers able to earn a living wage in the private sector, the program would cost less, but if the education system fails, it would cost more. It's my hope that over time the educational system will respond and eliminate, or at least dramatically reduce, the need for this program.

Q: Do you worry that the cost of this program might get out of hand?

A: Yes, but I see no alternative. No matter what, something must be done with workers who are unemployable in the private sector. I believe that they and the nation are better off if these workers work in community service jobs rather than by enabling the likes of Amazon and Walmart to hire low-paid warehouse workers and greeters while expecting taxpayers to cover the costs of their unmet needs. Under a community-service jobs program, taxpayers, not low-wage employers, would get the benefit of the tax dollars expended on employing the otherwise unemployable to enhance the well-being of their own communities.

Q: I think that we now know why you don't think the EIC is the best way to deal with those who lack the skills to earn a living wage in the private sector. So, tell us what you think about the premium credit.

A: Of all the credits, this one makes the most sense because it's not really a tax credit. For all practical purposes, the premium credit is a government-funded voucher payable from appropriations whose purpose is to subsidize health insurance for those with low- and middle- income. I suspect that it's called a non-refundable tax credit because some politicians thought that it sounded better than calling it a government-funded health insurance voucher.

Q: So, you think that this credit is all right because it "isn't really a credit?"

A: Yes. The politicians identified affordable health insurance as a social problem, enacted the Affordable Care Act to address the need, appropriated funds to implement the program, and used taxpayer-subsidized vouchers to pay for the health insurance. That's how I think the system should work. The only involvement of the Affordable Care Act with tax policy is that the vouchers are labeled as tax credits.

Part 9: It's time to get rid of preferential rates and other tax preferences because they both corrupt markets and intensify social inequity.

Q: Having covered credits, let's move on to preferential tax rates. Tell us what they are.

A: Preferential rates means that different types of income are taxed at different rates. To better understand the significance of preferential rates, it's necessary to break income into two broad categories: capital income and labor income.

Q: Explain what each type includes, beginning with capital income.

A: As the name suggests, capital income includes various types of income derived from the ownership of capital. Examples include capital gains, dividends, interest, business income, rent, and royalties on oil and gas, software, books, and other tangible and intangible assets.

Q: Now explain labor income.

A: Labor income includes wages and salaries.

Q: What's the problem with preferential rates on various types of income?

A: Having preferential rates on different types of income corrupts capitalism.

Q: So, how do preferential rates corrupt capitalism?

A: Many types of capital income are taxed at different rates. Any type of capital income that's taxed at a lower rate than another gains an advantage over others because its after-tax return is higher. Again, this advantage substitutes a political decision for the market in allocating investment capital. Two major industries, real estate, and energy, illustrate what happens when politicians grant an advantage to a particular industry. Real estate investments have long been favored by taxing long-term capital gains at lower rates and having complementary provisions regarding rapid depreciation. Oil and gas investments have long been favored by the oil depletion allowance.

Q: So, what happens when an industry gets an advantage?

A: Starting with real estate, tax incentives have resulted periodically in over-building in commercial real estate and apartments. Half-empty office buildings, hotels, strip shopping centers, and apartments consume capital that could be better invested elsewhere. Moving on to energy, tax incentives for oil and gas have contributed to over-reliance on fossil fuels as an energy source with its accompanying harmful effects on the climate. Tax preferences that favor industries like these often breed other tax preferences.

Q: Give us an example of how the 'industry advantage' plays out.

A: The energy industry provides a classic example. Since tax preferences granted oil and gas an investment advantage, other sources of energy, such as solar and wind, have sought to level the playing field by seeking their own tax preferences. Both solar and wind businesses have each lobbied for and received tax credits, which have, to some extent, offset the advantage enjoyed by fossil fuels. As a believer in markets, I believe that instead of using one set of tax preferences to offset another, it would be better to get rid of all tax preferences and rely on markets to allocate investment capital.

Q: You've explained how you think that tax preferences corrupt capitalism. Now explain how you think they contribute to social inequity.

A: Let me explain what I mean by social inequity. It's not that some have more, even much more than others. Rather, it's that too many able-bodied, hardworking, full-time workers lack the income and wealth to live a middle-class standard of living, save for their retirement, pay for their health care, and pay for their children's post-secondary education while the wealthiest accumulate excessive amounts of surplus wealth. So, I believe that America now suffers from social inequity in that too many people have too little while a relative few have too much.

Q: Again, that's pretty abstract. What's your test for when too many have too little and too few have too much?

A: Before answering that directly, I'll provide some perspective. In 1980, the income threshold for poverty for an individual was $11,460 (in 2014 constant dollars), and in 2014 it was about the same, $12,071. In 1980, per capita national income (in 2014 constant dollars) was $27,403 (or 2.4 times the poverty threshold), and in 2014 it was $47,140 (or 3.9 times the poverty threshold). Over a 34-year period, the ratio of real per capita national income over the poverty threshold for an individual grew from 2.4 times in 1980 to 3.91 times in 2014, an increase of 63%. Overall, America was much, much richer in 2014 than in 1980.

Q: Whoa! These are a jumble of numbers, what do they mean?

A: Quite a bit. Assume that the poverty threshold number represents the income necessary to support a subsistence standard of living. The amount of income above the poverty threshold is the income that's available for increasing one's standard of living and paying for one's own health care, retirement, and post-secondary education as well as making the business investments necessary to grow the economy.

Q: I want to be sure that I understand what you're saying. In your previous answer, you stated that the ratio of America's real per capita national income to the individual poverty threshold was 63% higher in 2014 than in 1980. Does this mean that on average Americans were 63% richer in terms of the income available for improving their standard of living in 2014 than in 1980?

A: Yes, but — and it's a huge but —Americans on average appeared much richer in 2014 than in 1980. The problem with averages is that they belie the financial well-being of a large majority of Americans. For example, assume two individuals, one with an income of $1 million and the other with an income of $10,000. The fact that their "average income" is $505,000 offers little comfort to the individual who lives in poverty on an income of $10,000. Delving into how the distribution of national income changed from 1980 to 2014 reveals that America's increased riches became intensely concentrated at the top, and many Americans not only weren't richer but were poorer.

Q: What data proves your contention?

A: In 1980, the bottom 90%'s share of national income was 66%, but in 2014 it had shrunk to only 53% (a loss of 20%). And, in 1980, the top one percent's share was 11%, but in 2014, it had grown to 20% (a gain of 82%). Put simply, the 34 years from 1980 to 2014 were generous to the top 1% and stingy to the bottom 90%.

Q: How significant to everyday Americans was this loss of share of national income?

A: The best way I can illustrate what it meant to everyday Americans is to compare the income-to-poverty threshold ratios of three income groups over the period 1980 through 2014. In 1980, the income-to-poverty threshold ratio of those in the bottom 50% was 1.35 to 1, of those in the bottom 90% was 2.56 to 1, and of those in the top 1% was 37.42 to 1. In 2014 the income to poverty ratio of those in the bottom 50% was 1.34 to 1, of those in the bottom 90% was 3.15 to 1, and of those in the top 1% was 108.14 to 1. Comparing 2014 with 1980 reveals that those in the bottom 50% were no better off, those in the bottom 90% were only about 23% better off, and those in the top 1% were 288% better off. Since income above the poverty threshold rose in the top 1% by 288%, it was able to accumulate substantial wealth, most of which is surplus capital.

Q: Take a moment and compare the wealth of the three income groups – those in the bottom 50%, those in the bottom 90%, and those in the top 1% – in 1980 and 2014.

A: Okay but let me provide some background first. As I'll show, the intense concentration of income at the top inevitably leads to the intense concentration of wealth at the top. Since wealth is the accumulation of income not spent on consumption, it's easy to see how those whose income was well above the poverty threshold could save and invest while those whose income was close to the poverty threshold couldn't. Moreover, invested income compounds and income spent on consumption evaporates.

Q: You've made your general point. Now be specific in comparing wealth in 2014 with 1980.

A: In 1980, the bottom 50%'s wealth share was 1.4% (or $.26 trillion), the bottom 90%'s wealth share was 36% or ($6.89 trillion), and the top 1%'s wealth share was 23% (or $4.34 trillion). In 2014 the bottom 50%'s wealth share shrank 85% to .1% (or $.04 trillion), the bottom 90%'s wealth share shrank 22% to 28% (or $19 trillion), and the top 1%'s wealth share grew 61% to 37% (or $20.99 trillion). If social inequity means anything, it must mean having the wealth of the top 1% increase by almost six times (over 34 years) while the wealth of the bottom 50% falls.

Q: As a retired lawyer, you've put in evidence some compelling facts regarding just how much better off the top 1% is in income and wealth than everyone else. Now, present your argument as to why this rises to the level of social inequity.

A: As America has grown much richer, half of Americans, on average, live on the edge of poverty with no savings, while the top 1% has captured unprecedented shares of national income and wealth. Not only must half of Americans depend on taxpayer-subsided social insurance programs to gain access to adequate health care or the necessary post-secondary education, but they can fall into immediate poverty if they have a little bad luck. I believe that everyday Americans in the bottom half who fight America's wars, work in its factories and on its farms, run many of its small businesses, work in community service jobs such as law enforcement, education, and health care, make up its consumer base, and nurture the future generations who will keep America great deserve a bigger slice of America's prosperity than they're getting.

Q: What do you mean by a bigger slice of America's prosperity?

A: I mean that all able-bodied, full-time working Americans deserve a living wage and decent retirement, and all Americans, regardless of income, should be entitled to adequate health care and all the post-secondary education they need to be the best they can be in a highly competitive world. Instead of improving the lives of millions of low- and middle-income Americans, the politicians have adopted policies that have increased the surplus capital of the top 1%.

Q: I see that we're back to surplus capital. As I remember, you describe surplus capital as that portion of wealth that can't be profitably invested in productive assets because consumers can't afford to purchase its output. Tell us more about surplus capital.

A: I'll give you a few stats to illustrate what I mean by "surplus capital." Annually, business investments, labeled by the BEA as "Fixed Investment-Nonresidential," averages about 13% of GDP, most of which is financed from pre-tax business income. In 2014, the private wealth of the top 1% alone was almost $21 trillion, or about 119% of GDP, many times more than could be invested in productive assets. Almost all the $21 trillion of private wealth of the top 1%, therefore, would most likely qualify as surplus capital. While the accumulation of surplus capital is capitalism's just reward for business success, it can get out of hand. In 1980, the top 1%'s share of private wealth was 23%, but in 2014 it had grown to 37%. I believe that 23% was generous and 37% is obscene.

Q: I understand what you mean by social inequity, but what does that have to do with tax preferences?

A: The short answer is almost everything. Social inequity arises whenever too few have too much and too many have too little. That's where America is today. Tax preferences are the leading cause of tax policy hyping social inequity because they both erode much of the progressivity of the income tax and lose substantial revenue. The politicians have long known the dangers posed by tax preferences, and as a result, used the concept of the "normal income tax" to highlight them.

Part 10: The 'Normal Tax' is an old idea whose time has come.

Q: What is the normal income tax?

A: Congress created the term "normal income tax" in the Budget Control Act of 1974 to describe an ideal income tax—one that was simple, pure, and uncorrupted. The normal income tax was created as a benchmark in which the Treasury Department and its Joint Committee on Taxation, known as the JCT, could measure the economic and revenue effects of what it called "tax expenditures, " and report to Congress annually on its findings. Tax expenditures are just another name for what I call tax preferences; the two are the same.

Q: Stop a moment and explain why you used the term tax preferences instead of tax expenditures.

A: It's a matter of focus. Congress focused on the revenue lost by certain tax provisions while I focus on the fact that these provisions confer special benefits on preferred groups of taxpayers. My concern isn't just that these provisions lose revenue; they also divide taxpayers into two groups, winners and losers, with the winners and losers being chosen by politicians instead of markets.

Q: Now, please explain what the normal income tax is.

A: The normal income tax, as contemplated by Congress, taxes all income the same, has a progressive rate structure, and allows only a standard deduction applicable to all with no other offsets or deductions of any kind. The normal income tax regards all tax preferences as abnormal and doesn't allow any.

Q: You mentioned a requirement for annual reporting on the economic and revenue effects of tax preferences. Explain more about these reports.

A: The purpose of these reports is to determine in the case of each tax preference what its effects on the economy are, and how much revenue it loses compared to what would have happened under the normal income tax. It was hoped that this report would subject each tax preference to scrutiny by revealing the harm they do to markets and the revenue they lose. Even though the JCT and the Treasury annually report in detail the harmful effects of these tax preferences, only a few policy wonks outside of Congress pay any attention to them.

Q: You've explained what the normal income tax is. Now explain how tax preferences first erode the progressivity of the income tax and second lose revenue.

A: Since 1992, the IRS has published annually a report that details, initially concerning the top 400 taxpayers, and after 2014, for the top .001% of taxpayers, their sources of income, the tax preferences they used to reduce their taxes, and the taxes they paid. One big statistic in these reports proves my case, and many other statistics in these reports show how harmful these effects are in terms of relative equity among various groups of taxpayers.

Q: What data proves your case?

A: In 2017, the 1433 taxpayers in the top .001%, on average, had an adjusted gross income of $179 million and paid $43 million in taxes at an effective tax rate of 24.10%. Had these taxpayers paid taxes under the normal income tax, their tax rate would have been at least 36% which would have resulted in a tax of about $64 million, or $21 million more in taxes than they paid. No other taxpayer group benefits as much from tax preferences as those at the very, very top. In particular, no group benefits as much as the top .001%. Its effective tax rate of 24.10% on an average income of $179 million is almost two percentage points less than the 26.03% average effective tax rate applicable to those 1.4 million taxpayers in the top 99.001-99th percentile, whose average income is only $1.4 million. Taxpayers should ask themselves why a person whose income is $179 million should have a lower tax rate than one whose income is $1.4 million. Got time for another few stats?

Q: Have at it.

A: Proving that tax preferences take much of the progressivity out of the personal income tax, the top .001%'s effective tax rate was 24.10% on $179 million of income while those 7.2 million taxpayers in the 80th-75th percentile whose average income was only $90 thousand had an average effective tax rate of 18.63%, or 5.17 percentage points less. In 2017, the personal income tax rate schedule included rates ranging from 10% to 37%, giving the appearance of progressive rates. Tax preferences, however, make a mockery of the apparent progressivity of the rate schedule.

Most damnable of all is the comparison of the 15.3% payroll tax payable on every dollar of income earned by hamburger flippers versus the 24.10% tax payable on income by the top .001%. Americans should ask themselves if it's fair or wise to tax hamburger flippers, among the poorest of the poor, deeper into poverty while taxing the richest of the rich at a rate only 8.8 percentage points higher. Remember, there's a 27-percentage point spread in the rate schedule between the highest and lowest rates. Tax preferences enable the top .001% to add to its surplus capital while making hamburger flippers ever more dependent on taxpayer-subsidized social insurance programs like Medicaid and food stamps for survival.

Q: You've shown how tax preferences erode the progressivity of the personal income tax. What about its effects on revenue loss?

A: In 2019, the Congressional Budget Office (CBO) estimated, based on JCT reports, that the 200 plus tax preferences lost revenue in an amount roughly equal to 7.8% of GDP. That amount just about equals the amount of revenue raised by the personal income tax. Step back for a moment and think about the fact that tax preferences lose almost as much revenue as the personal income tax raises. If you'll indulge me, I'll show a few more stats that'll put in perspective the magnitude of revenue loss caused by tax preferences and who benefits from it. Let's start with the top 1%. Had the top 1% paid the normal income tax with a top rate of 37% instead of the current income tax, they most likely would have paid $212.7 billion more in taxes, or on average $148,000 more.

Since 1981, America has had four major tax cuts – in 1981, 2001. 2003, and 2017 – none of which were self-financing and all of which added to the national debt. When the practice of indulging in debt-financed tax cuts began in 1981, the national debt was less than 40% of GDP, now it's over 100%, and it's headed much, much higher. From 1980 through 2014 (in constant 2014 dollars), the top 1%'s household wealth grew by $21 trillion, and not so coincidentally, the national debt grew by $15.3 trillion. Tax preferences that especially benefitted the top 1% explain much of how both the top 1%'s surplus capital and the national debt simultaneously ballooned.

Part 11: The Ameri-Share Tax can promote economic growth, narrow income and wealth disparities, rein in the national debt, simplify taxation, and end corruption.

Q: Let's pause and take stock of where we are. You've explained how globalization and technology have resulted in the Iron Law of Wages suppressing the wages of millions of workers with ordinary skills and simultaneously over-concentrating income and wealth in the top 1%. These effects, you say, have prevented capitalism from working for everyone by slowing economic growth and fostering social and political unrest. You go on to assert that tax policy, most notably tax preferences, have intensified these effects. Given all of this, explain what changes you think should be made to tax policy to make capitalism work for everyone.

A: Fair enough. Criticism without offering a solution breeds cynicism. The harsh reality is that over-concentration of income and wealth threaten America's greatness and heighten the incidence of social and political unrest. This crisis has been brewing over the last 40-plus years. At first, only a trickle of Americans noticed that their jobs were becoming less secure and their incomes weren't keeping up with what was required to maintain their standard of living. With each passing year, however, it was becoming painfully obvious to more and more Americans that their incomes were lagging. Now, enraged voters know that their jobs are insecure and their incomes are, at best, stagnating. This realization has led to dangerous levels of social and political discontent. Deconcentrating the over-concentration of income and wealth is essential to coping with this crisis and fundamental changes in tax policy are the best way to do it.

Q: What social ills are you talking about?

A: With each passing year, fewer and fewer able-bodied, full-time workers are able to earn enough market income to take care of themselves financially by saving for their retirement and paying for their health care and the post-secondary education of their children. This growing financial insecurity has caused a dangerous increase in social and political unrest. The most effective and efficient way to ease this financial insecurity is to expand social insurance and make it more progressive.

Q: Explain what you mean by expanding social insurance and making it more progressive.

A: A growing number of workers need protection from job loss in light of automation, globalization and other forces at work in our current economy. That means unemployment insurance and food stamp programs will need to be expanded and their benefits increased. Additionally, relatively few workers have the means to save for their retirement, meaning Social Security, Medicare, and related programs will also need to be expanded and their benefits increased. The same goes for health care, meaning the Affordable Care Act, Medicaid, and related programs will need to be expanded and their benefits increased. Finally, few Americans can afford the cost of necessary post-secondary education, so student-aid programs should be expanded and their benefits increased. I believe those in the top 1% should contribute more to these programs to enable the bottom half to gain access to increased benefits.

Q: Are you saying that tax policy has a limited role in overcoming the challenge of coping with America's social and political unrest.

A: That's exactly what I'm saying. It's limited but crucial. Tax policy must end taxing low- and middle-income taxpayers either into or nearer poverty, and it must raise enough revenue to pay for the cost of expanded social insurance. In plain, simple language, this means that taxes must be raised substantially and made much more progressive.

Q: We've come a long way. I want you to lay out your plan for the kind of tax policy you think America needs, but before you do, please explain why you named your tax plan the Ameri-Share Tax.

A: For America to be the best it can be, it must make room for a shared experience in which all participate and respect the interests of those in the current generation as well as those in future generations. A splintered America with a myriad of interest groups ruthlessly pursuing their immediate self-interests, oblivious to the interests of others, will doom America's future. The Ameri-Share Tax raises the revenue necessary to meet the needs of all Americans in a way that respects the economic interests of all Americans. It's a tax whose purpose is to purge taxation of both political favoritism and policies that imperil the standard of living of future generations.

Q: Great. Now tell us how the Ameri-Share Tax does that.

A: I'll begin by laying out the principles that should govern tax policy. Taxes should raise sufficient revenue to pay the cost of government and pay down the national debt to a safe level; no person should be taxed so much that their after-tax income is less than 125% of poverty; no person should be taxed so much that they're unreasonably deterred from earning the next dollar; taxes should strike the right balance between investment and consumption; taxes shouldn't influence how markets allocate resources; the top tax rate should be as low as possible consistent with raising necessary revenue; the after-tax pecking order of taxpayers should not be different than the pre-tax pecking order; and taxes should be much simpler and fairer.

Q: So, what kind of taxes will satisfy these principles.

A: Conceptually, it's easier than you think, but politically, it's impossible under current circumstances. That said, history is full of examples of swift changes in public sentiment and leadership, particularly as social unrest mounts. In my book, I include some of these historical examples, and how they ignited transformative economic changes in their day. For the time being, I'll set politics aside and lay out my plan.

Q: Fine, but with the understanding that you're not going to dodge the political issue. Go ahead and lay out your plan.

A: The Ameri-Share Tax would junk the current personal income tax, payroll tax, corporate income tax, and estate tax and replace them all with a single tax on personal income. Congress itself, in the Congressional Budget Act of 1974, established the normal income tax as the ideal. I believe that the normal income tax – a tax in which all income is taxed the same, rates are progressive, and no offsets to tax liability are permitted – should be the primary source of taxation. The Ameri-Share Tax would also establish safeguards to assure that sufficient revenue is raised to keep the national debt to a safe level and tax business income in a fairer, less intrusive, and simpler way.

Q: Let's go back for a moment. You haven't said much about the payroll tax and nothing about the corporate income tax and the estate tax. Why are you recommending replacing these taxes with the normal income tax?

A: I'll start at 50,000 feet. Taxes on income, in one form or another, account for over 92% of total tax revenue. While the personal income tax, the payroll tax, the corporate income tax, and the estate tax all tax income in one way or another, each does it differently. In terms of revenue shares, the personal income tax and payroll tax are by far the major sources of total revenue, accounting for 48% and 34%, respectively. The corporate income tax accounts for only 9% of revenue and the estate tax less than 1%. Compared to the normal income tax, all existing taxes have major flaws. If you wish, I'll take each tax and explain why I think the normal income tax should replace it.

Q: Go ahead and start with the personal income tax.

A: I've already explained how the personal income tax is riddled with tax preferences that lose revenue, corrupt markets, and favor some taxpayers over others for political reasons. By ending all tax preferences, the normal income tax would cure these defects. For those who fret over socialism, they should abhor the fact that tax preferences enable politically adept taxpayers to enjoy more after-tax income than politically inept taxpayers who had more pre-tax income. The essence of socialism is for politicians, instead of markets, to pick winners and losers, and picking winners and losers is exactly what tax preferences do. Getting rid of tax preferences should be the goal of true capitalists while crony capitalists and socialists try to protect them.

Q: What's wrong with the payroll tax?

A: That's simple. The payroll tax is regressive in the extreme because it taxes only wages and salaries, taxes all income from the rich and poor alike at the same rates, and taxes every dollar earned by those in or near poverty. As I said earlier. It makes no sense to tax hamburger flippers deeper into poverty and then offset these taxes through the EIC and provide benefits under social insurance programs. The normal income tax is progressive and doesn't tax low- and middle-income workers into or closer to poverty. For those who will fuss about how Social Security and Medicare will be financed, under the Ameri-Share Tax they'd be fully financed from the normal income tax.

Q: What's wrong with taxing corporate income?

A: Nothing whatsoever. It's not whether but how best to tax not only corporate income but all business income. To get my full proposal, you can read my book, but I'll give you a quick take. Since I agree that businesses don't pay taxes, I'd tax business income by taxing business owners for all income they receive from their businesses. Generally, I think all business taxation is incurably distorted by political accounting. So, I'd cut the Gordian knot and tax all business income on a cash basis. Once a business owner has recovered the full amount of what they've invested in and contributed to the business, I'd tax all distributions from the business to its owner or owners as income.

Q: What's wrong with the estate tax?

A: Like the personal income tax and the corporate income tax, the estate tax is riddled with exemptions, exceptions, and deductions that simultaneously prevent it from raising significant revenue while enabling those who are politically favored to avoid taxation. The Ameri-Share Tax would treat all inheritances as income to the recipient, and tax it under the normal income tax. For those who think that individuals or non-profits should be able to inherit wealth without being taxed, I'd grant a lifetime exemption to each individual of $2.5 million, give or take a million or two. Of course I believe in charity, so I wouldn't tax bequests given to qualified non-profits. Over time, I believe that taxing inheritances as income, subject to a reasonable exemption, would go a long way to deconcentrating wealth without harming the economy.

Q: One quick follow-up on the estate tax. Wouldn't it force the breakup of family-owned businesses and farms?

A: I promise you that even if the Ameri-Share Tax were adopted, the estate planning industry has the imagination and legal tools to keep family-owned businesses and farms in the family if that's their wish.

Q: I think that we've covered what you don't like about existing tax policy. Now, tell us how the normal income tax, or the "Ameri-Share Tax" you propose, would satisfy each of the principles you laid out.

A: I'll start with how it would raise enough revenue to pay the cost of government including paying down the national debt to a safe level. Virtually all state and local governments are required by law to enact budgets in which there must be sufficient revenue to pay all costs of government. This means that taxes must be adjusted annually to reflect the needs of the time. I see no reason why the federal government shouldn't have a similar provision. Unlike state and local governments, however, the federal government is always at risk of having to cope with a national emergency that requires deficit spending. So, I believe that the president with the approval of a 3/5th majority of both houses of Congress should be able to declare a national emergency and spend whatever is necessary to meet the needs of the time.

Q: Why couldn't the national emergency exception become a loophole to enable continued deficit spending?

A: The honest answer is that it could. I'll admit that it's practically impossible to write a provision that guarantees no deficit spending ever because of the perennial danger of an unforeseeable national emergency. A national emergency exception would be a meaningful deterrent to ongoing deficit spending. Ultimately, however, it's up to the voters to determine if the president and Congress are using the exception to indulge in unnecessary spending. If the voters think that the president and Congress are abusing the exception, then they can vote them out, and if they don't, it's on them.

Q: You said that no person should be taxed if it would result in their after-tax income falling below 125% of poverty. How would this work under the normal income tax?

A: This one's simple. Each year the Department of Health and Human Services publishes a report that contains a poverty threshold amount for households of various sizes. For example, in 2017 the poverty threshold for a family of four was

$24,600. So, for that year, I'd set the standard deduction for a family of four at $30,750. No income would be taxed under the normal income tax for any family of four whose income was $30,750 or less.

Q: You said that no person should be taxed so much that it unreasonably deters them for earning the next dollar. How would this work under the normal income tax?

A: This one's more difficult because there are no hard and fast numbers that can definitively resolve it. Chasing the next dollar is important because it's in everyone's interest that everyone exerts maximum effort to generate as much income and wealth as possible. Since capital income and wage income are earned in different ways, the incentives to chase the next dollar for each are different.

Q: Let's break the question into two parts. Start with how to tax capital income so that it doesn't unreasonably deter a well-off investor from chasing the next dollar.

A: This one's the least difficult because of a lack of choice. A sure way to grow poorer over time is to liquidate your investments, buy a safe, and stash your cash in the safe. Over time, inflation will consume it. So, to preserve and grow capital it must be invested. Intelligent investing means considering all investment opportunities, evaluating all relevant facts, and making a judgment based on the investor's risk/reward analysis. If the income on all investments is taxed the same, it's difficult to imagine how tax rates – whether they're 10%, 20%, 30%, 40%, or 50% – would affect an investor's investment decision. So, I don't think that tax rates deter intelligent investments or discourage an investor from making the best of their investment capital that they can.

Q: How much can you tax wage income without deterring a taxpayer from working for the next dollar?

A: It depends on the personal finances and psychology of individuals. For example, poor individuals have no choice but to work for the next dollar regardless of tax rates just to survive while rich individuals don't have to work even if their next dollar isn't taxed. Lazy individuals, rich or poor, shun work as a way of life while industrious individuals, rich or poor, work as a way of life. My experience, based on 30 years of doing deals involving many wealthy businessmen and investors, has been that these individuals are driven and would work just as hard to make the next dollars even if it were taxed at a rate of 90%.

Historically, marginal tax rates have been as high as 90% in the 1950s and 1960s when annual growth rates were the highest in modern times. So, I don't think that taxing productive individuals at a 40%, or even 50% tax rate, would deter many from striving for the next dollar.

Q: Does this mean you're not concerned about how high tax rates may go?

A: Not at all. The Ameri-Share Tax calls for the lowest rates possible consistent with raising the necessary revenue. The only reason rates will have to be higher in the future is to pay for the sins of the past. The cost of government is exploding because of the need for more social insurance. Also, the size of the national debt is obscene because of debt-financed tax cuts for the rich. Given these realities, tax rates must be higher than is desirable. This leaves voters with the choice of either taxing those with low- and middle-income into or nearer to poverty or taxing the top 1% at rates of up to 50%.

Q: You said that taxes shouldn't create an imbalance between investment and consumption. How would your proposal avoid an imbalance?

A: Since it makes no sense for capitalists to produce more than consumers can afford to purchase or vice versa, and the economy is dynamic and changing from moment to moment, striking the right balance between investment and consumption poses quite a challenge. I believe that this challenge can be overcome only by identifying, tracking, and weighing the proper financial and economic indicators. This will require technical expertise uncontaminated by politics.

Q: Technical expertise uncontaminated by politics. What planet do you come from if you believe that Congress could manage such a task?

A: I'm an earthling who's read a little history, and I don't believe for a moment that Congress can be trusted with such a task. The Ameri-Share Tax includes establishing an independent board, similar to the Federal Reserve Board, commonly called the Fed, to oversee tax policy and set tax rates annually to assure that a proper investment/consumption balance will be struck, sufficient revenue will be raised, and there will be a fair allocation of the tax burden among the various income groups. The annual tax rates set by the tax board would be subject to being overridden by any alternative rates approved by Congress and the president.

Q: Despite your claim of being an earthling, I have my doubts if you believe that Congress and the president will ever turn over tax policy to an independent board, but you can make your case later. Now, explain why your tax won't influence markets in allocating resources.

A:As I've stated previously, the 200-plus tax preferences distort markets by changing the relative pre-tax and after-tax price of many goods and services and the returns on virtually all investments. Ridding taxes of all tax preferences would rid these distortions. Since the Ameri-Share Tax increases the progressivity of taxes, it would affect markets only by shifting consumption from elite luxury markets to mass consumer markets. This means that businesses like Walmart which serve mass consumer markets would capture a larger share of the market than businesses like Christy's Auction House, which serve the elite luxury market. Given the top 1%'s share of surplus wealth, I'm confident that the elite luxury market will remain robust.

Q: You also said that you want to keep the top rate as low as possible. How do you propose to do this?

A: Before I explain how the Ameri-Share Tax keeps the top rate as low as possible, I want to say why taxes, not just the top tax rate, should be kept as low as possible. I believe that money spent in the private economy increases real national income and wealth much better than money spent by the government. So, I believe that taxes should be no higher than necessary to pay the cost of government, and the cost of government should be no higher than necessary to keep America safe and strong.

Q: Stop for a moment and explain what you mean by keep America safe and strong.

A: Here are a few leading examples illustrating what I mean. America must always spend whatever it takes to protect its national security; develop and maintain world-class communication and transportation infrastructure to promote commerce; educate its future generations to assure that it has the world's best workforce; and provide sufficient social insurance to assure that all working Americans have a stake in America's success. These are all governmental responsibilities, and unless they are done well all Americans, rich and poor, will suffer. The unwillingness to spend what it takes for the government to successfully perform these responsibilities will end America's greatness.

Q: I understand your point. Now explain how the Ameri-Share Tax will keep the top rate as low as possible.

A: Under the Ameri-Share Tax, the Board of Taxation would set all tax rates annually, and the top rate would be the lowest rate possible depending on the following four factors:

• First, a tax rate that raises the necessary amount of revenue.
• Second, the amount of the standard deduction based on the level of poverty.
• Third, a tax rate that strikes the proper balance between investment and consumption.
• Fourth, a tax rate that doesn't unreasonably deter a taxpayer from earning the next dollar of income.

Under the current personal income tax, tax preferences are the primary culprits for the top rate being as high as it is. Getting rid of them is the key to keeping the top rate as low as possible.

One suggestion I have for reducing the top rate doesn't involve a change of law. As I see it, the best way to cut all tax rates is to work for economic policies that increase the market income of low- and middle-income individuals. Higher market incomes for these individuals would reduce their dependence on social insurance from the government and enable them to pay a much bigger share of their retirement, health care, and post-secondary education. There's no better way to reduce taxes than to raise the market incomes of millions of workers and small business owners so that they can fend for themselves.

Q: Now, explain how the Ameri-Share Tax results in the after-tax and pre-tax pecking order for taxpayers being the same.

A: Eliminating tax preferences eliminates changing the pecking order because with no tax preferences the pre-tax and after-tax prices of all goods and services and returns on all investments will be the same. The extent to which tax preferences change the pre-tax pecking order is an example of politicians picking winners and losers, which is the hallmark of socialism.

Q: How will the Ameri-Share Tax make taxation much simpler and fairer?

A: I believe that taxes should be fair, and complexity is the mortal enemy of fairness. Like other evils in taxation, tax preferences are the culprits; they make taxation both complex and unfair.

Q: Stop for a moment and clarify what you mean by fairness.

A: To me, fairness means treating all taxpayers the same, and complexity is the primary means by which the richest of taxpayers get a better deal than all others.

Q: How does complexity get the richest taxpayers a better deal than all others?

A: I'll give an example that I think fairly applies to most leading tax preferences. Capital income, in one form or another, comprises most of the income of the richest taxpayers while wage income is virtually the sole source of income for almost all others. All wage income is taxed at the highest possible rate, but tax preferences cause many types of capital income to be taxed at lower rates. Since all dollars, regardless of how they were earned, spend the same, I think they should be taxed the same. So, I suggest that wage earners – who earn their bread by the sweat of their brow – ask the politicians why it's fair to tax their wage income at higher tax rates than the investment income of the wealthiest of the wealthy.

Q: Hold on a moment. Get back to what this has to do with complexity.

A: A lot. A law that taxes all income the same is simple and fair, but a tax preference that carves out exceptions and taxes various types of income at preferential rates is complex and unfair. It's unfair because wage earners are taxed differently from investors.

Q: Explain to non-professionals what makes tax laws so complex.

A: As a former practitioner, creating exceptions to laws of general application is tricky and usually involves heaping one exception on top of another, sprinkling in a few intricate and arcane definitions, and finishing by tossing in a few cross-references to other laws. Preferred taxpayers pay huge amounts to smart tax lawyers and other professionals to tailor the tax preferences on which they rely to fit their special needs; it's both an art and a science. The accumulation of over 200 tax preferences explains the hundreds of pages of tax statutes, the thousands of pages of regulations, and the thousands of IRS revenue rulings, general counsel opinions and memoranda, private letter rulings, forms, guidelines, and miscellaneous explanatory materials.

Q: Let's agree that tax preferences seriously complicate taxation and make it awkward and hard to understand. Lots of things are awkward and hard to understand. How does this result in the richest of the rich getting a better deal than everyone else?

A: Here's how. Because tax preferences are awkward and hard to understand, they're expensive and difficult for the IRS to administer. Oftentimes, wealthy taxpayers make dubious, but plausible claims, under tax preferences which have been intentionally crafted to include vague and ambiguous language to disguise the scope of their effect. Once a plausible, even though dubious, the claim is asserted, the burden of denying the claim shifts to the IRS resulting in litigation. Not infrequently the IRS's attorneys are over-matched by the taxpayers' high-priced tax lawyers. Knowing that complex litigation can consume huge resources and ultimately be unsuccessful, the IRS frequently shies away from the contest. Unlike complex laws, simple laws are relatively easy and cheap to administer.

Q: Sounds like just another way of the world issue.

A: Yes. But before we leave complexity and fairness, I've got a couple more points I want to make. First, I want to explain how taxpayers with deep pockets have an advantage in taxation because of complexity, and second, how much revenue is lost due in large part to complexity.

Q: How does having deep pockets gives rich taxpayers an advantage?

A: The fact that a person has a right under the law doesn't guarantee that the right will be enforced. If a right is denied and the claimant is forced to litigate to enforce it, then enforcement of the right depends on winning it in court. Winning in court can take a long time and be very costly. Inevitably, litigation of anything of consequence greatly favors those with the deepest pockets. Not having deep pockets, few ordinary folks can afford to litigate, and, therefore, their rights exist only on paper. While this is true in most things, it's especially true in taxes. So, if ordinary taxpayers want a fair deal, they must demand that tax laws be made simple, clear, and unambiguous.

Q: Now, explain how much revenue is lost due to complexity.

A: The IRS tracks and reports periodically on the shortfall between what taxpayers owe under the law and what they pay, which the IRS calls the tax gap. For the years 2011 through 2013, according to IRS estimates, the tax gap averaged $441 billion or about 16% of total revenue or two-thirds of the $680 billion budget deficit in 2013. As the tax laws have become more complex, the politicians have stripped the IRS of the resources necessary to effectively enforce the tax laws. Increased complexity coupled with decreased enforcement explains much of the tax gap. Since most revenue lost from the tax gap stays in the pockets of high-income taxpayers, complexity and lax enforcement are the friends of high-income taxpayers and the enemy of almost everyone else.

Part 12: With the next calamity, the seemingly impossible will become possible.

Q: Now that you've explained how you think the Ameri-Share Tax will strengthen America, it's time for you to prove that it can be enacted.

A: I'm more than willing, but I'll warn you that the answer lies deep, deep in the weeds. Under current circumstances, it's folly to believe that the Ameri-Share Tax could be enacted. History teaches, however, that current circumstances change, often for the worse, and sometimes for much worse. I'll readily admit that for the Ameri-Share Tax to be enacted there must first be a change so earthshaking that it shocks a large majority of voters into believing that they can't keep a semblance of their standard of living unless there's a huge increase in taxes. Once a large majority of voters come to believe that, the politicians will soon follow.

Q: What kind of change are you talking about?

A: A cataclysmic change—one that cracks the foundation of the economy and forces ordinary Americans to worry about how they are going to put food on the table. As destructive as the current pandemic has been, many people are still hanging in there, unaware of how much it has weakened us. It's the next calamity that concerns me.

I believe that sometime in the next several years it's almost certain that America will be confronted with one or more calamities that will force it to incur massive amounts of new debt. In just the last 12 years, two calamities have struck America – the Great Recession of 2008/2009 and the Pandemic of 2020. Each of these calamities severely damaged the economy and added trillions to an already bulging national debt. Having been racked by two calamities in the last 12 years, I believe that America is now only a calamity away from being forced by market forces to put its financial house in order.

Q: Give some examples of what kind of calamities you're talking about.

A: I'll suggest just a few that readily come to mind: another pandemic, for which there's no ready vaccine and which carries a high mortality rate; natural disasters, such as earthquakes and volcanic eruptions, or global warming, which results in sharp temperature changes, an increase in sea levels, more frequent and destructive hurricanes, massive flooding in some areas, and droughts in other areas leading to the disruption of global markets, mass migration, and regional shooting wars; an international debt crisis ignited by one or more debtor countries defaulting on their debt and spooking creditors; a major shooting war resulting from a geopolitical miscalculation, such as China's adventurism in the South China Sea and America's reneging on the Iran nuclear deal; a cyber-attack which devastates America's economy by disrupting major industries, capital markets, and the banking system; or a biological attack that kills millions of Americans, inundates the health care delivery system, and wrecks the economy.

Q: Do you think that America is especially vulnerable now to these types of calamities?

A: Yes. We live in a time of excessive carbon emissions, which are endangering the climate, the fracturing of the international order that has kept the peace and created prosperity for most of the last 70-plus years, sluggish economic growth that's lead to increasing social and political unrest in many of the world's leading nations, and the inability of many governments to solve relatively simple problems. Avoiding or mitigating calamities requires swift and smart governmental action, not only by one nation but by the international community. Given the ineptitude of many of today's governments and their inability to work together in international organizations, it's doubtful that they would be willing or able to work together to avoid an oncoming calamity much less recover from one.

Q: What would be the economic effects of a calamity?

A: A calamity on the scale I'm talking about would destroy trillions of dollars of public and private infrastructure, put many businesses out of business, some permanently, throw millions out of work, and inflict grievous harm on millions more. The tens of millions of Americans thrown out of work would suddenly become dependent on government assistance to put food on the table. I believe that it would take many trillions to recover from such a calamity and the only source of funds for the recovery would be for America to incur trillions of new debt. To cope with a calamity, America would have no choice but to incur whatever debt was necessary on whatever terms were available.

Part 13: Two generations of over-spending and under-taxing have mired America in a swamp of debt.

Q: In such an emergency, could America raise trillions of dollars of new debt?

A: I do not doubt that it could, but I also believe that there'd be a steep price to pay. Anytime a debtor, regardless of whether they are nations, businesses, or individuals, must incur debt, they are at a disadvantage in dealing with creditors because of the Golden Rule – "He who has the gold rules." Since creditors can't be compelled to lend money, debtors must convince them that they're getting an interest rate proportionate to their risk. Never is a debtor more at the mercy of a creditor than when they're forced to incur a huge debt in an emergency, are already over-burdened with debt, and the debtor's creditworthiness has been severely damaged.

Q: Are you saying that America is over-burdened with debt?

A: Yes. Over-burdened with debt means America having so much existing debt that in an emergency it couldn't incur trillions of new debt without having to pay much higher interest rates. According to the International Monetary Fund, the IMF, as of the end of 2018 America's government, businesses, and people had accumulated a near-record level of public and private debt amounting to 318% of GDP. Both the national debt and business debt were at post-World War II highs, and personal debt was headed for a record high. Making things worse, the outbreak of the pandemic of 2020 forced a huge increase in the growth rate of both public and private debt.

Q: If the government is the debtor, why does private debt matter?

A: Public debt is paid from taxes paid by taxpayers from the income they have left after paying their private debts. As taxpayers pile up more private debt, it consumes more of their income and leaves them with less to pay the taxes necessary to pay the costs of government. With less income to pay taxes, it's more likely that taxpayers will insist on the government incurring more public debt as a means of lowering their taxes. So, this becomes a deadly cycle in which increases in private debt leads to increases in public debt.

Q: How serious a problem is it if America continues increasing its public debt?

A: It terrifies me to think about it. As more private and public debt accumulates, it will be increasingly hard to increase taxes to pay down the national debt. With America's debt-to-GDP ratio already at a dangerously high level, a calamity would explode at a time when taxpayers are already under intense stress.

Q: What's the debt-to-GDP ratio, and why does it matter?

A: Like a thermometer that measures your body's temperature, the debt-to-GDP ratio measures a nation's ability to pay its debt. America's debt-to-GDP ratio is its national debt divided by its GDP where its GDP closely approximates its national income. A rising debt-to-GDP ratio means that America's debt is growing faster than its income, which makes its debt more stressful to pay. It's like an individual incurring credit card debt faster than their income grows; as the debt grows, so too does the stress.

Q: Does a high debt-to-GDP ratio mean that there's an increased risk that America may default on its debt?

A: No. America can incur unlimited amounts of debt which, no matter what, won't default. America will never default on its debt for two reasons. First, as its debt comes due, it can issue rollover debt to replace the maturing debt, and second, one of its agencies, the Fed, is empowered to buy the new debt and pay for it with money that it creates.

Q: If America can't default on its debt, then what's to worry?

A: Plenty. While America won't default on its debt, the interest rate on its debt could explode if America issues too much debt.

Q: What's too much debt?

A: The debt market will tell us by upping interest rates.

Questioner: What could cause that?

A: Three major factors could give the debt market an excuse to increase, maybe dramatically, the interest rate on America's debt.

Q: Before we get into the three factors, what do you mean by the debt market?

A: Let me personalize it. Leading investors in the debt market include sophisticated financial institutions that do business worldwide, governments of all kinds from all over the world, and the wealthiest of the wealthy individuals. These types of investors are a mercenary bunch – knowledgeable about finance, devoid of sentimentality, and bent solely on getting the highest interest rate possible with the least risk. In a crisis, America could expect no mercy from these investors.

Q: Understood. Now, what about the three factors that could drive up the interest rate on America's public debt?

A: I'll list them. First, America's addiction to debt raises fears of inflation. Second, America loses its dominance of the high-end debt market. Third, the capital available to purchase America's public debt becomes scarce.

Q: We're getting deeper into the weeds but go ahead and explain what you mean by America's addiction to debt raising fears of inflation.

A: Since 1981, America has used debt-financed tax cuts to enable taxpayers to enjoy a dollar's worth of government for only about 70 to 80 cents in taxes. Just as an individual getting a $100 cash out of an ATM puts money in their pocket, so too does America incurring debt to avoid increasing taxes. In both cases, the money being created is unearned because it's the product of debt, not work. Putting too much unearned money in taxpayers' pockets leads to inflation.

Q: We're back to too much. What's too much money in taxpayers' pockets?

A: Inflation results from money being created faster than goods and services are produced and sold. With this in mind, think of there being two kinds of money, real money, which is created as goods and services are produced and sold, and magic money which is created out of nothing by government fiat. While there's little risk of real money creating inflation because it doesn't grow faster than the economy, there's a great risk of magic money creating inflation because it grows at the whim of self-interested politicians.

Q: Explain how politicians create magic money.

A: Debt-financed tax cuts magically put unearned money in taxpayers' pockets just like the genie magically grants the wishes of the owner of the lamp. In both instances, something of value is created out of nothing. For the last 40 years, politicians have sold debt-financed tax cuts on the magical thinking that they pay for themselves. Proving that they don't, the national debt, as a percentage of GDP, has grown from less than 40% in 1980 to over 100% now.

Q: Since magic money spends the same as real money and doesn't take much effort to make, I can see how the temptation to create it is irresistible. So, is there any limit to how much magic money can be created?

A: Sure. Eventually, no one knows when the creation of magic money will increase the prices of most things voters buy and the interest rates on their loans to an intolerable level. Only when a majority of voters feel that the pain inflicted by this inflation has become unbearable will they force the politicians to kick their addiction to creating magic money. Until then, there's no limit.

Q: You've made clear that you don't like debt-financed tax cuts. Do you think that they should be banned altogether?

A: No. To do so would invite economic disaster. In periods of slow or negative economic growth, it may be necessary to use debt-financed tax cuts to kickstart the economy, but they must be used sparingly and properly structured.

Q: What do you mean by used sparingly and properly structured?

A: Debt-financed tax cuts should be used when they're essential to increasing consumption to stimulate growth. And then, they should be structured to put money in the pockets of low-income taxpayers who are certain to spend it instead of high-income taxpayers who are likely to save it.

Q: You said that America's creating too much magic money can lead to inflation, but so far there's no sign of it. So, what's the problem?

A: Like a pandemic, inflation doesn't announce its arrival far enough in advance to avoid it. Generally, inflation sneaks up on an economy and by the time it becomes apparent, it's too late to avoid intense, long-term pain.

Q: You've explained why you think that America's addiction to debt-financed tax cuts invites inflation and higher interest rates. Now explain why you think that America's losing its dominance of the high-end debt market would increase interest rates on its debt.

A: First let me explain what I mean by the high-end debt market. It's that part of the overall debt market that includes only government-guaranteed debt of the highest credit quality as determined by internationally recognized credit-rating agencies such as Moody's, Standard & Poor's, Fitch, and others. Investors who buy debt in this market include many national governments, American state and local governments, global financial institutions such as banks, insurance companies, trust companies, and other similar organizations, all of whom are required by law to invest a certain percentage of their assets in this market. Also, wealthy individuals who want to protect their core wealth in the safest of all investments invest in this market.

Q: You said that America dominates this market. What did you mean by that?

A: Since the end of World War II, American debt has been regarded by the world's financial experts and rating agencies as the most creditworthy debt in the world. Key indicators of creditworthiness of a government's debt include a high per capita GDP, a high per capita GDP growth rate, a low debt-to-GDP ratio, a strong national currency relative to others, a monetary policy that controls inflation, and most importantly, political stability. Based on all of these indicators, America's debt has dominated the high-end debt market for the last 70 years and commands the lowest interest rate of any debt in the world.

Q: How does this domination affect the lives of ordinary Americans?

A: It's incalculable; it means a higher standard of living for all Americans because it means America can finance its national needs at the lowest interest rates possible. Low interest rates on America's debt means lower taxes because it takes less revenue to pay interest on the national debt. And, since the interest rate on most mortgage loans, auto loans, and consumer loans is priced off of the interest rate on 10-year treasuries, low interest rates on America's debt means a higher standard of living for home buyers, auto buyers, and consumers.

Q: What could happen if America loses its dominance of the high-end debt market?

A: As I've said, I'm a capitalist and believe in the power of markets. American debt's domination of the market means that investors know that there's no comparable debt in terms of creditworthiness and must bid accordingly. If other debt available is as good or better than American debt, our country's debt will lose its monopoly advantage and have to compete for a lower rate. With investors having a choice, the interest rates on American debt would almost certainly rise, maybe by a lot.

Q: What could cause American debt to lose its domination of the high-end debt market?

A: I'll start by again pointing out the indicators that determine which government's debt is considered most creditworthy. They include a high and growing per capita GDP, a low debt-to-GDP ratio, a strong national currency, a monetary policy that controls inflation, and political stability. America's advantage, as shown by these indicators, isn't preordained or immutable. If America loses its edge in these indicators to one or more other governments, it will also lose its dominance of the high-end debt market.

Q: You've covered how inflation fears and loss of dominance in the high-end debt market can cause higher interest rates. Now explain how capital becoming scarce could drive up interest rates.

A: First, let me explain why I believe that there's a danger that the capital available to finance debt could become scarce. The world is awash in debt as never before. According to the International Monetary Fund, at the end of 2018 both the world and America reached record levels of combined public and private debt; global debt topped $188 trillion, or 226% of global GDP, and America's debt topped $66 trillion, or 319% of America's GDP. Outstanding debt has sopped up a growing share of capital, leaving less capital to finance economic growth and the additional debt that would be necessary to finance a recovery from a calamity.

Q: I understand that there's lots more debt out there, but isn't America much wealthier than ever before and therefore better able to pay the new debt?

A: Yes, that's true. America is much wealthier than ever before, at least for now. The wealth study by Saez and Zucman found that America's per capita private wealth (in 2014 constant dollars) increased by 257% from $85 thousand in 1980 to $219 thousand in 2014. While it appears that there's plenty of wealth to provide the capital necessary to finance America's needs, all that glitters isn't gold.

Q: What do you mean by that?

A: Wealth is ephemeral; it comes and goes depending on the economic climate of the time. Most private wealth is composed of financial assets of one kind or another and commercial and residential real estate. The market value for all of these types of wealth is volatile and subject to sharp swings in value.

Q: What causes these swings?

A: At any moment, the market value of an asset is what a willing buyer will pay a willing seller for it. Since the purchase of most substantial assets is financed by debt, interest rates significantly affect asset prices. Generally, asset prices rise in an up economy in which there's a rising growth rate, full employment, and low interest rates. An up economy means fewer sellers selling under distress and more buyers with more resources to buy. Just as an up economy increases asset values, a down economy depresses asset values. So, wealth is in large part a function of the health of the economy at any given time.

Q: I understand your point, but how dramatic have swings in value been?

A: The value of stocks, bonds, and commercial real estate dramatically fluctuates in times of crisis as shown by Standard & Poor's market indices. According to these indices, in the three months following the outbreak of the coronavirus pandemic, the value of stocks fell by 34%, the value of bonds fell by 14%, and commercial real estate by 39% – a sudden huge loss of wealth.

Q: You've explained how wealth can evaporate in an economic downturn. Now explain how this would drive up interest rates.

A: Supply and demand and the power of markets will drive up interest rates. In a market in which the demand for capital to finance debt has suddenly surged and the supply of capital has suddenly shrunk, interest rates – the price of attracting scarce capital – are certain to rise.

Q: You've explained how fears of inflation, America's debt losing its dominance in the high-end debt market, and a scarcity of global capital can drive up interest rates. Now explain what you think would happen to interest rates on American debt if a calamity strikes.

A: I think America's debt would be hit with a triple whammy which would spark a sharp surge in interest rates. It would almost certainly simultaneously increase fears of inflation, threaten America's dominance of the high-end debt market, and intensify the scarcity of capital to finance a recovery.

Q: Let's take these whammies, as you call them, one by one. Start with why you think it would raise fears of inflation.

A: A calamity would force America to incur trillions in new debt to finance the recovery. Although this infusion of cash into a crippled economy wouldn't likely ignite inflation immediately, the debt market would be concerned about its effect over the long-term.

Q: What would cause long-term concerns?

A: When incurring trillions of debt to deal with a crisis, it's easy to make a mistake and overdo it. If too much money is thrown into the economy, signs of inflation appear, and the risk of inflation isn't immediately quelled, the debt market will demand higher interest rates to compensate for inflation risk. The debt market is keenly aware that putting money into an ailing economy is much easier politically than taking it out of an over-heated economy. Long-term debt, in particular, will be especially sensitive to signs of inflation that go unaddressed.

Q: Moving on to the next whammy, how will a calamity threaten American debt's domination of the high-end debt market?

A: Calamities don't affect all debtors equally. If a calamity were to inflict more harm to America than other nations, it could make America's debt less creditworthy relative to that of other nations, like China or Japan, or groups of nations that join together to create a single currency, like the European Union. Given America's dangerously growing debt burden and the risk of being damaged more than other nations, there's no assurance that America would emerge from a calamity with its dominance of the high-end debt market intact.

Q: Now to your final whammy. Explain why you think a calamity would create a scarcity of capital.

A: For at least the last two decades, public and private debt throughout the world has grown faster than the world's GDP and continues to do so. This means that the world's share of income available to accumulate as capital continues to dwindle. At some point, the demand for capital to finance debt will outstrip the supply and enable those who control capital to impose higher interest rates.

Q: You said "at some point" capital would become scarce. What is that point?

A: I believe that the next calamity will mark that point. Scarcity is the result of an increase in demand coupled with a shortage of supply. Since a calamity would simultaneously explode the demand for capital by trillions and wipe out trillions of capital, scarcity would be the inevitable result.

Q: I understand that America and the world would have to incur enormous debt to recover from another calamity, but you need to explain why you believe that a calamity would, as you put it, wipe out trillions of capital.

A: Laws throughout the world law require that financial institutions, including banks, insurance companies, and other financial intermediaries, maintain adequate reserves to protect the integrity of markets. A calamity would deplete the reserves of many of these financial institutions because many insured assets would be destroyed or seriously damaged, millions of business loans and commercial leases would be forced into default, and millions of mortgage loans, auto loans, consumer loans, student loans, and credit card loans would also be forced into default. It would take trillions to replace lost reserves.

Q: What do you think this would do to the debt market?

A: I think a calamity would set-off a worldwide stampede in which governments, financial institutions, businesses, and individuals alike would desperately compete for whatever capital they could find. Those who survived the calamity with the bulk of their capital in place would be perfectly positioned to dictate much higher interest rates. This danger of a sudden, stiff hike in interest rates reveals a looming vulnerability that America has long ignored; it's what I call rollover risk.

Q: Here we go again, getting even deeper into the weeds. What do you mean by rollover risk?

A: Rollover risk, in connection with the financing of the national debt, is America taking the same risk as a homeowner who takes out a short-term mortgage with a lower interest rate than a long-term mortgage. Short-term debt saves interest costs in the short run but leaves the debtor with the risk of an intolerable spike in interest rates when the short-term debt has to be rolled over.

Q: So, what is it that makes America vulnerable to rollover risk?

A: America has chosen to finance over 80% of its national debt in a combination of short-term debt with maturities of one year or less and floating rate debt whose interest rate rises with inflation. If there's a sudden jump in interest rates, the interest rate on this 80% of the national debt will quickly follow.

Q: Why has America left itself vulnerable to rollover risk?

A: It's pure expediency. Rollover risk can be substantially mitigated by financing most of the national debt with higher interest rate long-term debt. The politicians, however, have succumbed to the temptation to save a little on interest cost by financing most of the national debt with short-term and floating interest rate debt. While this expediency has worked most of the time, it hasn't always worked.

Q: When has it not worked?

A: I'll date myself. I vividly remember how in the early 1980s the interest rates on government-guaranteed debt suddenly shot up; short-term interest rates rose above 10%, and long-term interest rates rose above 14%.

Q: The early 1980s were a long time ago. What makes you think that interest rates could jump that high again?

A: I believe that that the next calamity will force America to borrow trillions to recover. Heaping trillions of new debt on a mountain of existing debt will, I believe, ignite fears of inflation, endanger America's domination of the high-end debt market, and create a scarcity of capital. The ultimate effect of this calamity, I believe, will be an extended period of crushing interest rates which will become intolerable to America's body politic.

Q: What do you mean by intolerable?

A: I mean a level that raises the cost of capital to a point that prevents most businesses from growing and expanding, prices many homebuyers out of the market, and significantly slows auto sales and consumer purchases. Over time these rising interest rates will change the lives of almost all Americans because they will be the direct cause of rising unemployment, falling standards of living, and social and political unrest – a toxic mix.

Q: Suppose you're right. What makes you think that a large majority of voters will come to believe that a huge tax increase is the answer?

A: I don't think that voters will come to this conclusion overnight. It will take the debt market sending a clear, loud, and consistent message that interest rates on America's debt won't go down until it puts its financial house in order and voters coming to realize what it takes for this to happen.

Q: What does it mean for America to put its financial house in order?

A: The debt market will be the judge of that. But it no doubt will start with requiring America to improve the creditworthiness of its debt. America's debt-to-GDP ratio is the single most important measure of its debt's creditworthiness. Lowering it will stop undisciplined borrowing, increase the percentage of income available to pay debt, reduce fears of inflation, and increase the value of its currency relative to others. I believe that interest rates won't go down until America adopts a long-term plan to lower its debt-to-GDP ratio.

Q: Most voters don't know what the debt-to-GDP ratio is much less how it affects them. What makes you think that voters can be made to understand its importance?

A: It'll take a while to seep in. But if nothing is done about getting the national debt under control, the debt market refuses to lower interest rates, unemployment continues to rise, and standards of living continue to fall, then I believe that the voters will eventually catch on.

Part 14: Fiscal responsibility means raising enough tax revenue to pay for what is spent.

Q: What will happen then?

A: Initially, I think that there'll be a lot of posturing by politicians about getting control over the national debt by cutting the waste, fraud, and abuse in spending. But when it comes time to be specific, like which programs are to be cut and by how much, it'll become obvious to all that the old adage about cutting Social Security, Medicare, and other similar programs being the third rail in politics – touch it and you die – is even more true today than in the past.

Q: Why do you say that?

A: Two reasons. First, the level of cuts is unprecedented, and second, more Americans are more dependent on social insurance than ever for their standard of living.

Q: Let's take these one by one. Explain what you mean by an unprecedented level of cuts.

A: Just to stop the hemorrhaging in the debt-to-GDP ratio, it'll take a combination of sustained cuts in spending and increases in taxes of at least 6% of GDP. This a huge amount relative to how much America spends. It's about one-half of what's spent on social insurance programs and about the same that's spent on the rest of government including national security. While no doubt some cuts can be made to general government spending and national security, I'm confident that these cuts will be trivial. Never has America had to simultaneously cut spending and/or increase taxes by anywhere near 6% of GDP.

Q: Now, explain what you mean by more Americans becoming more dependent on social insurance for their standard of living.

A: Over the last 40 years, retirement, health care, and post-secondary education have become less affordable to those households with incomes in the bottom 90% due to income stagnation. Nothing hints that this trend is lessening. Any significant cut in social insurance will be felt by tens of millions of those whose income is in the bottom 90%. Every dollar cut from Social Security will lower the standard of living of millions of retirees; every dollar cut from Medicare and the Affordable Care Act will deprive millions of Americans of adequate health care; and every dollar cut from student aid programs will deprive millions of students of the opportunity to get the post-secondary education they need to get a good job.

Q: Does this mean that you think that the politicians will be forced to lower America's debt-to-GDP ratio almost exclusively by raising taxes?

A: Yes. Again, I want to emphasize that this is the earthshaking moment I've been talking about when a large majority of voters come to believe that their standard of living depends on maintaining and expanding social insurance programs, and the only way to do that is by a huge tax increase.

Q: How certain are you that a large majority of voters will come to believe that a huge tax increase is necessary?

A: Quite certain. I believe that most thinking politicians – and believe me there are more than a few – have long known that someday America will have to enact a huge tax increase to make up for years of running up the national debt and to pay for the inevitable future increases in social insurance. With the choice of doing nothing taken off the table, I'm confident that fear of an aroused bottom 90% bent on keeping their social insurance will trump fears of a defensive top 1% bent on keeping their taxes low.

Part 15: The Ameri-Share Tax may be the last chance to salvage the American Dream.

Q: Suppose you're right. Why do you think that the politicians will turn to the policies advocated by the Ameri-Share Tax?

A: In a word, fear. I believe that all politicians, particularly the successful ones, respond to the fear of not getting re-elected, which means neither denying anything a majority of voters want nor doing anything a majority doesn't want. Since a majority of voters don't want to either cut social insurance programs or raise taxes, the politicians will face a Hobson's choice: Either get blamed for cutting social insurance and lose or get blamed for raising taxes and lose. Politicians, being a clever bunch, have an escape hatch that will enable them to avoid the Hobson's choice trap.

Q: So, what is it?

A: Over the years the president and Congress have escaped blame for unpopular actions by creating an independent bipartisan commission comprised of elder statesmen from both parties and leaders from all walks of life to absorb the blame for doing what must be done. I discuss this in some detail in Payback. For now, however, I'll cite the Simpson-Bowles Commission appointed by President Obama in 2009 to cope with the Great Recession as what I expect the politicians to do here.

Q: It's been a decade since the Simpson-Bowles Commission came and went, and nothing happened. What does that example have to do with enacting tax reform based on Ameri-Share Tax principles?

A: An awful lot. Simpson-Bowles developed a tax reform plan that both raised significant revenue and cut tax rates. It was a reform plan that closely approximated the ideal of the normal income tax, which I discussed earlier, because it purged the personal and corporate income taxes of almost all tax preferences. Simpson-Bowles made only one mistake; it was ahead of its time. Unlike 2009 when America could still borrow huge amounts at cheap rates without putting its financial house in order, it won't have the same luxury after the next calamity; the debt market will see to that. As the child of the Simpson-Bowles plan and the grandchild of the normal income tax, the Ameri-Share Tax's core principles – ending tax preferences and cutting rates – will be the blueprint for putting America's financial house in order.

Q: What makes you so sure that a commission modeled after Simpson-Bowles would propose a plan based on the principles of the Ameri-Share Tax?

A: Because virtually all experts on tax policy agree that if taxes have to be raised, the best way to do it is to get rid of tax preferences so that tax rates can be kept as low as possible and end the political practice of preferring politically favored taxpayers. Otherwise, tax rates would explode through the roof. Also, I think the necessity of lowering the debt-to-GDP ratio will force a change in the existing political dynamic that welcomes the use of tax preferences.

Q: Explain what lowering the debt-to-GDP ratio has to do with changing the political dynamic regarding the use of tax preferences?

A: Everything. Since I don't believe the politicians would dare to cut social insurance in the wake of a calamity, I believe that lowering the debt-to-GDP ratio would force a huge increase in taxes.

Q: All right. Explain why a huge increase in taxes changes the political dynamic regarding the use of tax preferences.

A: If there must be a huge tax increase, three facts would drive the political dynamic regarding the use of tax preferences:

• First, every tax preference loses revenue, whose loss must be made up by increasing tax rates on taxpayers who don't benefit from them.
• Second, hardly any bottom 90% taxpayers get any benefit from tax preferences.
• Third, the top 1% of taxpayers save billions in taxes because of tax preferences.
This means that tax preferences are the enemy of almost all bottom 90% taxpayers and the darling of only top 1% taxpayers.

Q: Stop for a moment. Why do you say that tax preferences are the enemy of almost all bottom 90% taxpayers?

A: It's simple arithmetic. Tax preferences lose revenue and force bottom 90% taxpayers to pay taxes at higher tax rates compared to what they would be if they didn't exist.

Q: Explain why you say that tax preferences are the darling of top 1% taxpayers.

A: Again, it's simple arithmetic. Tax preferences save billions for top 1% taxpayers compared to what they would pay if they didn't exist.

Q: Since tax preferences are the enemy of the bottom 90% taxpayers, how have they survived this long?

A: When almost everyone's taxes are cut, taxpayers don't fret too much about not getting the biggest cut. But when almost everyone's taxes are raised, particularly by a lot, taxpayers will raise hell if they think they're getting shafted. Since there's been no major tax increase in over 40 years, there's been little pressure to rein in tax preferences. A huge tax increase, however, would force the politicians to choose between a sharp increase in tax rates for almost everyone or a sharp curtailment of tax preferences that would primarily affect only the top 1% taxpayers.

Q: I understand your point. How do you think it would play out?

A: Given that tax preferences are the enemy of almost all bottom 90% taxpayers and the darling of top 1% taxpayers, I believe that the fear of riling up the bottom 90% taxpayers will trump the fear of riling up the top 1% taxpayers. Until it's possible to cut taxes, I believe that the political dynamic will favor dramatically limiting the use of tax preferences rather than increasing tax rates.

Q: So far, you've explained how you think that politicians will deflect the blame for raising taxes and why you think that almost all tax preferences will be ended. Now explain why you think that taxes will be made more progressive as proposed by the Ameri-Share Tax.

A: Because for the last 40-plus years, both income and wealth have so concentrated in the top 1% that it threatens the economic, social, and political fabric of America. The best and least disruptive way to deconcentrate income and wealth is to make taxes more progressive. I think that after the next calamity, the political dynamic will not only rid taxes of most tax preferences, but it will also force markedly more progressivity in taxes.

Q: How progressive?

A: It's easy to set the bottom and top thresholds and tax rates, but not so easy in between. I think that it will be difficult to argue with the top and bottom brackets included in the Ameri-Share Tax – the top being an effective tax rate of 55% for those with incomes above $100 million and zero for those whose income is less than 125% of poverty. In between, it gets harder because of the ongoing need to monitor several factors on an ongoing basis. If you want me to get deeper into the weeds, I'll lay them out.

Q: Do it.

A: Tax rates should be set annually based on:

• First, what the revenue needs for that year are.
• Second, what the relative growth rates of the income of taxpayers in each bracket are.
• Third, what the proper balance between the income available for consumption and investment should be.

Q: It's not clear why these factors are important, please spell it out.

A: As to the first, to keep interest rates down, America must keep its debt-to-GDP ratio under control. To do so, tax rates must be set each year at levels that will raise enough revenue to keep the debt-to-GDP ratio at levels acceptable to the debt market.

Q: Explain the need to monitor the relative growth rates of the income of taxpayers in the various brackets?

A: As the economy changes, those in some brackets may leap ahead in terms of income and others may fall behind. Tax rates should be set annually to assure the proper level of progressivity.

Q: Finally, explain what you mean by the proper balance between investment and consumption.

A: As I've said before, for the economy to grow as fast as possible, it must produce the maximum possible amount of goods and services for consumption, and to do this, there must be enough capital available to produce them. This means that there must be a proper balance between the income available for consumption and that for investment. To the extent that changes in the economy disrupt this balance, tax rates should be adjusted to correct it.

Q: You're suggesting that tax rates be set annually based on your three factors, each of which involves a great deal of complexity. How do you expect the politicians to contend with this?

A: I don't. That's why it's an important part of the Ameri-Share Tax for the president and Congress to set up an independent, non-partisan Tax Board, similar in structure to the Fed, to annually set tax rates and recommend policy changes to the president and Congress. Once a tax reform plan is put in place, annual adjustments to tax rates should be based on economic factors, not politics, and should be administered by experts. Modeling this Tax Board after the Fed makes sense because the Tax Board should set tax rates and make policy recommendations using the same type of expertise and analysis that the Fed uses in setting interest rates and controlling the money supply.

Q: Would Congress and the president cede all of their control over setting tax rates to the Tax Board?

A: No. Under the Ameri-Share Tax, Congress could override any action taken by the Tax Board by a 3/5th majority vote in both houses with the approval of the president. In effect, Congress and the president could let the Tax Board absorb any voter wrath resulting from setting tax rates, but they could override it if they both agreed.

Q: What makes you think that the politicians would ever turnover this much power to a bunch of intellectual policy wonks?

A: It's not as unthinkable as is appears. Again, I believe that it would be fear on the part of politicians that would motivate them to do this. For the last 40-plus years, politicians have enjoyed the luxury of doling out tax cuts to favored groups, which has enabled them to please many and anger few. After the next calamity, however, taxes will have to be substantially increased, and it'll likely be many years before the debt-to-GDP ratio will be low enough for there to be more tax cuts. While it's great to control tax rates in an era of tax cuts, it's dangerous to be in charge of tax rates in an era of tax increases. So, I think that there's a fair chance that the politicians will find it appealing to dump an unpleasant responsibility onto the policy wonks rather than accept responsibility themselves.

Q: Moving along. You've explained why you think that the political climate will grudgingly accept the need for a huge tax increase, will turn against tax preferences, will insist on greater progressivity in taxes, and will see the benefits of having a Tax Board make tough decisions and absorb the blame for doing so. Now explain why you think that the politicians will replace the existing payroll tax, corporate income tax, and estate tax with a single tax on personal income.

A: Okay. Starting with the payroll tax, it's horrendous because it harms social equity, unduly burdens social insurance, distorts the job market, and fails to finance Social Security and Medicare.

Q: If it's so bad, how has it lasted this long?

A: Inertia. The political climate that'll emerge from the next calamity will be much more hospitable to progressivity in taxes and expanded social insurance and less hostile to tax increases. In this new environment, replacing the payroll tax with the personal income tax will have a lot of appeal.

Q: Explain the arguments that you think will have political appeal.

A: The payroll tax taxes the poorest of the poor workers deeper into poverty. Unlike billionaires who can avoid millions in taxes because of their tax dodges, hamburger flippers, and nail salon workers' pay 15.3% on every dollar they earn. The payroll tax literally takes food off of the table and reduces tens of millions of full-time workers to a standard of living of bare subsistence. I find no justification for the payroll tax.

Q: Explain how it unduly burdens social insurance.

A: What the payroll tax taketh away, the politicians to some extent giveth back in the form of social insurance programs like Medicaid and food stamps and tax gimmicks like the earned income tax credit. Many social insurance programs could be scaled back and the EIC could be ended by replacing the payroll tax with an income tax and making targeted increases in social insurance. There's no easier way to provide cash assistance to those in poverty than letting them keep more of what they earn.

Q: Explain how it distorts the job market.

A: The payroll tax taxes work done by humans but not work done by computers and machines. The payroll tax is both a financial and administrative burden on employers, and as such, it provides an added incentive for employers to automate their businesses. Natural market forces are encouragement enough for employers to automate their businesses without having tax policy add to it.

Q: Finally, explain how the payroll tax fails to finance Social Security and Medicare.

A: Easy. All anyone needs to do to answer that question for themselves is to read the executive summary of the annual trustee reports for both Social Security and Medicare to see the shortfall in funding from the payroll tax. Because of the chronic underfunding of these programs, either benefit must be cut by somewhere around 30% or new taxes added. In the political environment of the future, I'm confident that it will be politically unthinkable to either cut benefits or increase the payroll tax. I believe that a consensus will emerge that Social Security and Medicare should be financed from the income tax.

Q: Now that we've finished with payroll tax, explain why you think that it's politically possible to replace business taxes with the personal income tax.

A: This one's easy from the standpoint of reason but almost impossible from the standpoint of emotion.

Q: Explain the reason part of your answer.

A: It's an indisputable fact that taxes paid by business entities like corporations, partnerships, LLCs, trusts, and other similar organizations aren't born by those business entities but by their owners. Those business entities don't eat, drink, and breathe; they're no more than dusty old legal documents languishing amongst business records. Taxing business entities for business profits, as opposed to taxing their owners, is an inefficient way to raise revenue. Thankfully, the corporate income tax, which now accounts for less than 7% of total revenue, has become a far less significant part of the revenue mix than it used to be. It's my hope, more than my expectation, that taxing business entities, will die along with tax preferences. Again, I want to emphasize that business income should be taxed once when received by the owners of the business.

Q: Sounds like you're not optimistic about ending taxes on business entities. Is that so?

A: Yes. Emotions, unfortunately, play an out-size role in politics and are almost impossible to overcome.

Q: What are the hot-button, emotional issues that make getting rid of taxing business entities so difficult?

A: Many voters believe that taxing business entities is a magic way to raise money without taxing people. The best analogy I can think of is the willingness of many people to tolerate insurance fraud on the belief that it's the insurance company, not the premium payers, who pay for fraudulent claims. Getting rid of the something-for-nothing mentality among voters is a tough sell, maybe too tough to sell.

Q: Does this mean that you've given up on junking taxing business entities?

A: Not entirely. It's my slender hope that in general tax reform when the whole system comes under scrutiny, the experts will decide efficiency and economic growth must overcome myth. Taxing the owners, instead of their businesses, would both enable businesses to grow without having to contend with tax policy and greatly simplify taxation. Since no business profits would escape taxation, it's possible, if not probable, that business taxes could be replaced by a reformed personal income tax. For those who want to know more about the best way to tax business profits, please read Payback.

Q: We're now down to replacing the estate tax with the personal income tax. Why do you think that it's politically salable?

A: I think that after the next calamity hits, the political climate will be more receptive than in the past to replacing the estate tax with the personal income tax. It's a virtual certainty that income and wealth will be even more concentrated in the top 1% then than now and that something should be done about it. I'm confident that if voters thought much about how the estate tax works and who it works for, public opinion would turn against it.

Q: So, what should voters be thinking about regarding how it works and who it works for?

A: As a revenue raiser, the estate tax is leakier than a colander, and instead of reducing the over-concentration of wealth, the estate tax actively aids and abets further concentration. It permits a few lucky individuals, who just happened to be born to the right parents, to inherit huge amounts of unearned income with relatively little tax liability. I believe most voters believe, and I believe, in two principles: First. all Americans should have an equal opportunity to become the best they can be, and second, those who accomplish the most should have more than others. The estate tax frustrates both principles by unduly favoring the wealthy.

Q: Explain why the estate tax frustrates both principles.

A: Taxes on the billions of unearned income that escape taxation because of the estate tax could be used to provide educational opportunities to those who can't otherwise afford it. In today's world, "opportunity" is an empty word for those who can't afford to get the education they need to compete. While those who accomplish the most should have more than others, inheriting unearned income isn't much of an accomplishment. I think most Americans believe, and I believe, that each generation should be able to give the next generation a leg up, but I don't think that this means that any generation should be able to transfer huge amounts of untaxed, unearned wealth to succeeding generations.

Q: What do you mean by a leg up?

A: The easiest and fairest way to enable each generation to give the next a leg up without contributing to the further over-concentration of wealth is to pick a number, probably somewhere between $2.5 million and $5 million, and permit individuals to inherit that amount exempt from taxation. Giving a leg up is one thing, but permitting the transfer of billions of unearned, inherited wealth with little taxation also forces other taxpayers to make up the difference. While the bottom 99%-plus of taxpayers who don't benefit from inheritances in excess of several million don't notice it, they are for all practical purposes subsidizing those few who do.

Q: Explain what you mean by other taxpayers subsidizing the transfer of wealth from one generation to the next.

A: Remember, what forced an increase in taxes was the demand by the debt market that the debt-to-GDP ratio be lowered. This means that for every dollar that escapes taxation, all other taxpayers must make up the difference. So, voters should think about whether they should pay higher taxes to enable the heirs of the wealthy to inherit vast sums with little tax liability. If they think much about it, I'm confident that most will say that the heirs of the wealthy should be able to inherit unlimited amounts but that they should pay income taxes on any amount in excess of the exempted amount. I believe that the more that's known about the estate tax the less popular it'll be. For those who want to know more about the estate tax, please read Payback; it's free.

Q: We've covered not only the waterfront but the entire coastline. Before we end this, are there any other topics you want to discuss?

A: Just one more, Payback includes chapters on tax myths, such as the ideas that upper-income Americans are the country's makers and everyone else is a taker; Americans are over-taxed; and low tax rates guarantee maximum economic growth; and the persistent, yet false, belief that increasing taxes on job creators will cost jobs. I think that Payback does a pretty good job of dispelling these myths. I invite readers to read them to see if they think I've made my case.

Q: One final question. The title of your book is "Payback: Why the Top 1% Must Invest in the Rest and How It Can Renew America." Why did you choose that title?

A: That's a good question to end on. Times have changed dramatically since when I came of age in 1966 and went into the world to chase the American Dream – that dream being the opportunity for all Americans to make their way in the world the best they can and live the lives of their choice. In the 1950s and 1960s, the market incomes for most Americans was enough for them to fend for themselves, without much help from the government, for their education, health care, and retirement. Today, globalization and automation have suppressed the incomes of most Americans and made it impossible for them to fend for themselves. This means that if millions of low- and middle-income Americans are to have a fair shot at living the American Dream, they'll need much more help from the government than my generation. Getting this help will mean expanding social insurance on the same scale as FDR's New Deal and LBJ's Great Society. Because of America's 40-plus years of financial irresponsibility, it'll take a huge tax increase to pay for this expansion. No one has benefitted economically more from America's success than its top 1%; never has the top 1% been as wealthy as they are now; and no one has a greater economic interest in America's continued success than its top 1%. So, I believe that for America to remain the world's last best hope, its top 1% must pay higher taxes as an investment in its middle class. Without a healthy and growing middle class, America will fall from greatness, and with that fall much of the wealth of the top 1% will also fall. Investing in the middle class will be the best investment the top 1% has ever made. That's why I chose that title.

Q: With that, I think we can now close.

A: Thanks for your time.

About The Payback Project

The Payback Project equips citizens with a working knowledge of the U.S. tax system, focusing on the implications of tax preferences on middle-class Americans and those who aspire to be. The independent educational initiative includes a digital book available to the public under a Creative Commons license, an extensive library of downloadable resources, and a toolkit for media advocacy.

(https://www.youtube.com/channel/UCBYopMbrYGExtQXNjXcTPVA)
(https://www.linkedin.com/in/thomas-allen-moon-ba688781/)