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To Increase Federal Revenue, Taxes Must Go Up

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President-elect Obama recently put taxes in the forefront of economic discussion, with a proposal for some $300 billion in individual and business tax cuts.

Talk of tax cuts may be music to the ears of American taxpayers and a nod to satisfy Republicans but they make no sense in a time of soaring budget deficits and huge new government expenditures, including the probability of $1 trillion for Obama's proposed economic stimulus plan.

When the federal budget is so out of whack, and with so many pressing needs, taxes have to go up, not down.

The Bush administration managed to double the accumulated federal debt in its eight years. With the bailouts and stimulus plans, this year's federal deficit is expected to reach an eye-popping $1.2 trillion -- almost triple the size of last year's record deficit. This would be the largest deficit since World War II, both in absolute terms and as a percentage (8.3) of the gross domestic product.

Between this and the pressing need for an economic stimulus and recovery program, the solution is to increase federal revenue, and the best way to do so is through higher personal and corporate taxes. Despite the fact that Americans have grown accustomed to not having to pay for benefits, taxes have to be raised, and probably for almost everyone.

This was a need even before the current crisis. In 2004, the International Monetary Fund (IMF), normally concerned with debts and insolvency in poor countries, raised the alarm about US fiscal deficits and the "significant risk" these posed for the rest of the world. The IMF estimated that closing the deficit would require a 60 percent increase in federal tax revenues. Such a solution seemed politically unfeasible, even then. But it illustrates the extent of the problem.

In the short run, it is difficult to see how we can avoid increases in federal spending to stop the bleeding of the current economic meltdown. So tax cuts, by reducing federal revenue, would simply compound these long-term problems.

Some politicians and economists argue that tax cuts can be made up for by increased consumer spending and economic growth, which will in turn generate more tax revenue. But there is virtually no analysis that supports this theory. Even Federal Reserve Chairman Ben Bernanke acknowledged that tax cuts "usually do not pay for themselves." And former Secretary of Commerce Peter Peterson, a Republican, has observed that the tax cuts of the Bush administration were "an obligation driven by faith, not a policy guided by evidence."

Consider last year's $168 billion economic stimulus plan, the centerpiece of which was a tax rebate of $300 to $1200 for some 130 million US households. (Remember your $600 check? I don't either). At the time, Treasury Secretary Henry Paulson predicted that the plan would create "upwards of 500,000 jobs." But since then the economy has continued to tank, and last year the economy lost 2.6 million jobs -- the biggest annual drop since 1945.

Mr. Obama has emphasized that the US does need more jobs, but tax cuts simply will not contribute to that cause. About half a million jobs are being lost every month. The head of the Bureau of Labor Statistics said that their November jobs report was one of the worst since the Bureau's founding in 1884.

In my state of Indiana, the unemployment benefits fund has already gone insolvent, and the state had to borrow twice from Washington to pay benefits. Thirty other states are also at risk of exhausting their unemployment funds in the next few months, according to the National Association of State Workforce Agencies. Bailing out these state unemployment funds will pose yet another huge burden on the federal government.

Creating jobs, whether through government programs or incentives, will eventually lead to an increase in tax revenue and a revival of economic growth. The kinds of programs that Obama is discussing -- education, healthcare, infrastructure -- will pose huge drains on a government that is already bankrupt.

Obama should allow the Bush tax cuts to expire at the end of next year, for everyone except the very needy. He should also raise the marginal tax rates for the very wealthy. These rates are very low by both historical and international standards. Increased taxes will be unwelcome and painful, but the US is in a situation as unprecedented and dangerous as that of the Great Depression. Obama himself has called on Americans for sacrifice. And after two decades of bingeing, we can afford a little sacrifice.

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