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U.S. DEBT CEILING DEADLOCK: TO TAX OR NOT TO TAX

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Congressional Republicans on one side and Democrats and President Obama on the other are deadlocked on raising the debt ceiling because any proposal to increase taxes, it is said, will be voted down in the Republican-held House of Representatives.

The Democrats insist on raising taxes because, they say, the burden of reducing the budget deficit and public debt requires sacrifices from all Americans. With the poor and the middle-class seeing their entitlements shrink in order to rollback spending, Democrats assert that it is only fair that marginal tax rates for the wealthy should be higher in order to boost tax revenues. Some of them are driven by an ideology that the upper-classes either inherited their wealth with little or no personal effort or accumulated it on the backs of the poor and middle-class.

Republicans resist higher tax rates for two principal reasons. First, higher rates permit Democrats to protect more of their favorite federal spending programs. In other words, higher tax rates translate into bigger government, and for many Republicans bigger government encroaches on individual freedom and personal responsibility. Second, higher tax rates are "job killers" because they reduce some of the income that private individuals are able to keep and thereby weaken the very incentive to grow their business enterprises and add to their payrolls.

Clearly, there is no middle ground, no room for compromise for Republicans who resist higher tax rates on grounds that it fosters big government. With sufficient numbers in the House of Representatives, these Republican ideologues could kill any deal struck by their leadership that includes higher rates. And the Democratic ideologues in the Senate could kill the deal if it doesn't include higher taxes.

Even so, there is a possible solution at hand for those Republicans who regard higher taxes in an economic downturn as "job killers." Why not impose a surtax to be triggered when the rate of unemployment drops to some acceptable level? Perhaps 5 percent or less. To illustrate, the surtax might be *fully* triggered at an annual unemployment rate of 5 percent or less. It could be *partially* triggered at an annual rate between 5.1 percent and 6.5 percent. The surtax would be lifted entirely at an annual rate above 6.5 percent. The trigger could be based on a 12-month moving average instead of an annual average.

The trigger mechanism could look like the following:

Jobless rate 5 percent or less ……………. ten percent surtax on taxes owed
Jobless rate 5.1 - 6.5 percent ……………. five percent surtax on taxes owed
Jobless rate more than 6.5 percent ……… no surtax

Consider the following information on the trigger mechanism using the annual rate of unemployment since 1980.

Full trigger on ………. 7 yrs: 1997 - 2001, 2006 - 2007
Partial trigger on ……12 yrs: 1987 - 1990, 1994 - 1996, 2002 - 2005, 2008
Trigger off…………...12 yrs: 1980 - 1986, 1991 - 1993, 2009, 2010

The surtax could be levied on all tax filers or only on those with incomes above some threshold level, perhaps $500,000 for individual filers and $1million for joint returns. The trigger could be based on different jobless rates. The partial trigger could be set at one-half of the full trigger, as we have done in our example, or at a higher or lower rate.

If the surtax were earmarked for debt reduction, it could not be used to justify more spending. If it were added to general tax revenues, the effect would be to reduce the deficit and reduce any increase in the public debt whenever a budget deficit occurs. Such a surtax scheme could be made part of any tax reform effort or dropped entirely.

By removing the narrow and divisive options to tax or not to tax our suggestion affords Congressional Republicans and Democrats multiple options for finding common ground for a compromise on the tax issue that would raise tax revenues over the long term without killing jobs and could clear the way for reaching agreement on the debt ceiling. The deadlock over the debt ceiling is more than just a fiscal challenge with powerful implications for global confidence in the U.S. government to manage it fiscal affairs. It is a crisis in self-governance.

Sometimes it takes great courage to set aside ideology for the good of the nation. This is one of those times.

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