Fighting Fiscal Fantasies

By David Cay Johnston

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Taxes are about to start going up, and with that reality, three big lies are making the rounds, thanks in good part to the rise of sound-bite journalism.

Lie 1: The Coming Levies Are Obama Tax Increases

Actually, they are George W. Bush and Republican tax increases because, when it was in power the GOP did not make its tax cuts permanent, but instead voted to have them sunset next year. That is a point being made right now by Bruce Bartlett, a principled conservative who got fired in 2005 by a conservative think tank for writing a book about how the very unconservative spending policies of President Bush were propelling the nation toward insolvency.

Had the Republicans pushed for and won permanent tax cuts, any tax increases would indeed be President Obama's. But instead of principled tax reform, the Republicans and their ideological sales team led by Grover Norquist opted for temporary tax cuts for the rich — financed, it turns out, with borrowed money.

Lie 2: The Public Opposes Tax Increases

At least among the rich, support for tax increases appears to be about on par with support for the war in Iraq. But just turn on the local news across the country and you can watch more than a sprinkling of middle-income Americans who say that raising taxes on the rich would be a responsible move.

The latest evidence of broad public support for raising levies on the rich comes from a Quinnipiac University poll that found New Yorkers favor raising state income taxes for the rich.

The results were not even close. Asked about raising the rate paid by New Yorkers who make $1 million or more per year, 79 percent favored higher taxes, with just 19 percent opposed.

Lower the threshold to $500,000, and support for high tax rates remained overwhelming at 72 percent. Even at the quarter-million-dollar threshold, a solid majority — 56 percent — supported higher marginal state income tax rates.

The real shocker, however, is that Quinnipiac found that 62 percent of Republicans favor a higher tax rate on people who make $1 million or more annually. (Hello, Sen. Mitch McConnell, R-Ky., and Rush Limbaugh, have you held a wet finger up lately to see which way the political winds are blowing?)

Lie 3: The Rich Will Move if Their Taxes Increase

This is especially interesting because, as with Wall Street executives facing $500,000 salary caps, the obvious question is where would they go? Sure, a few might move to Dubai, which has its own fiscal problems and a culture that most residents of the Upper East Side, Georgetown, and Beverly Hills might find hard to adjust to. And a few might even be willing to give up the Metropolitan Opera, political salons, and the glitterati for life in, say, Jackson Hole, where the winter snows are deep and the culture rustic.

In New York, which faces budget shortfalls well into 10 figures every year for as far as budgeters' eyes can see, Gov. David Paterson (D) has opposed higher income tax rates on people who make $1 million or more annually, saying the rich would leave the Empire State.

The Manhattan Democrat wanted to keep the state's 6.85 percent top tax rate where it is, a levy that hits singles at $20,000 and married couples at twice that, but also applies to those making a billion dollars or more.

New York may be a deep blue state, but because its income tax is close to a flat tax and it has a host of regressive taxes, its tax structure is close to Alabama's. And in Alabama, the poorest fifth of families, who get by on less than $13,000 a year, pay about 11 percent of their income in state and local taxes, more than twice the burden on the top 1 percent of Alabamans.

A more likely outcome of Paterson's plans to slash spending on K-12 education (New York has many of the finest public schools in America), on higher education, on parks, on roads, and on services for the sick, disabled, and elderly is that the better educated, more skilled middle class would leave.

Indeed, when Jersey raised income taxes on those at the half-million-dollar-and-up level, a study by two Princeton economists found that the rich migrated into the Garden State. (For the study, see http://www.princeton.edu/prior/PRIOReconomy-Final-(2).pdf.) The reasons for that should be obvious:

First, America is more segregated economically than racially. Just like the poor and middle class, rich people like to live around their own economic kind. And a concentration of the affluent and rich makes it easier to get not just a Starbucks on every corner, but a choice of Dolce & Gabbana, Versace, and other brands within walking distance of one another.

Second, concentrations of people in any specific category create demand for more of them, hence ad agencies are known for Madison Avenue addresses and Detroit being synonymous with automaking. Not many of those in the top half of 1 percent (about $600,000 and up) or one-tenth of 1 percent (about $1.6 million and up) used to lush urban centers and tony suburbs will find bliss in

Beaver County, even though Pennsylvania applies only a flat 3.07 percent individual income tax.

Of course, time, trends, and bad policies can change where people gather, as we can see in the migration of the auto industry to places like Tennessee, where taxpayers instead of investors pay to build assembly plants, and Ontario, where healthcare is on the books of society, not employers.

Doubt things are changing? House Republicans just voted unanimously against tax cuts in the stimulus and in the Senate all but three Republicans voted against the same tax cuts. On the other hand, every Democrat in each chamber voted for the tax cuts.

It is in this changing milieu — this nascent era of real tax policies instead of fiscal phantoms — that Obama last week took one small step that will encourage one giant leap for official Washington toward fiscal responsibility.

For four decades Washington has produced federal budgets that were about as real as Peter Pan's island in the sky. That generations of seeming grownups voted for these budgets on Capitol Hill makes me think that being carded for beer when your hair has gone gray may not be such a bad idea, because children come in all ages.

The problem started with President Lyndon B. Johnson's moving us to a September 30 fiscal year-end and taking Social Security off budget. Johnson's budgets were delusional about the taxes needed for guns and butter. President Ronald Reagan cut taxes on the rich in 1981 and sold most Americans and Congress on the fantasy of denial about the huge budget deficits. Indeed, his act was so smooth that many Americans no longer seem to remember that Reagan signed laws to raise taxes, cleverly disguised as "revenue enhancers."

In his last two budgets President Bill Clinton actually produced modest surpluses.

But budgets were deliberately deceptive under President George W. Bush, who financed his tax cuts with borrowed money, using off-book spending, and fantasy revenues to hide the real size of his deficits and the failure to produce the promised economic growth.

One result of 40 years of overspending (except for the last two Clinton years) was that the economy became destabilized. And when the forces on Wall Street created a toxic mess, the federal government was in a precarious position to solve the problems through classic Keynesian economics, which would have worked just fine if those 38 past budgets had been balanced.

Obama's small step to end this era of delusion, denial, and deliberate deception leading to destabilization? Ending the phantom revenue game, at least as it applies to the alternative minimum tax.

His predecessor used projected revenue from the AMT to make future deficits appear smaller than they were. The Obama administration said it would count only the actual AMT revenues likely with a continuing patch. In other words, the 90 percent of AMT revenue that was illusory will now vanish.

Even so, the AMT is growing faster than any other federal levy.

In 1999 just 921,000 taxpayers paid $6 billion in AMT. By 2006 about 3.9 million taxpayers paid $21.6 billion. That the number being dinged has been growing faster than the total amount paid tells you that any notion that this is a levy on the rich is untrue. Indeed, the average AMT levy dropped over those seven years by $1,000 to $5,432 per affected taxpayer.

Persuading Congress that AMT revenues beyond these amounts — less than 3 percent of income taxes paid by less than 3 percent of taxpayers — are a fantasy will not be easy. Making red ink look black is a kind of modern alchemy, and Capitol Hill is full of politicians, and journalists, who want to believe.

Public perception of the AMT would change if reporters at the best news organizations, both print and electronic, would stop wrongly describing the AMT as a 1969 levy aimed at wealthy investors who paid little or no tax. The 1969 minimum tax was repealed in 1986 and replaced with the AMT, which falls not on investors who are aggressive purchasers of legal tax shelters, but on married couples with two or more children who own their own homes and on people who get gravely ill.

Obama also announced that he is determined by 2013, when his first term would end, to bring the current trillion-dollar-plus budget deficit down to about $500 billion. Doing that will mean cutting spending — the military is already getting ready for belt-tightening — and bringing in more taxes through explicit levies instead of gimmicks like phantom AMT revenues.

Getting from fiscal fantasy to fiscal responsibility will not be easy. Not getting there will be harder than anything we can imagine.

Your thoughts? E-mail me at *JohnstonsTake@tax.org*.