

CURING THE TAX DISEASE

CHARLES SYKES

Almost lost in this Fall's debate over income tax cuts, property tax relief, tax rebates, and sales tax holidays, was the latest evidence of just how badly we have been losing the war against higher taxes.

Since 1980, state government alone saw its tax collections rise from \$2.98 billion to \$9.96 billion in 1999 — an increase of 234 percent.

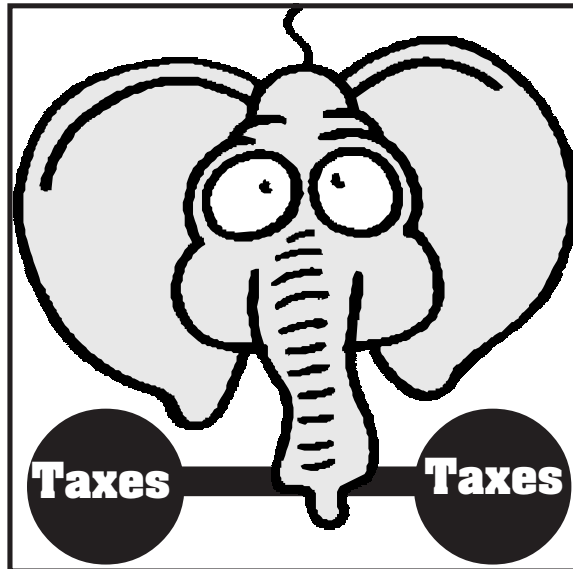
Despite Republican rule over the last two decades state taxes rose faster than the population.

Taxes rose faster than prices (inflation rose by 124%).

Taxes rose faster than incomes (which rose by 209%).

In fact, in the 1980s and 1990s, state tax revenues outpaced the growth of personal income by more than \$2.5 billion.

As tempting as this might be, we can't blame this on Tony Earl or Democratic Legislatures. In the 1990s, state taxes rose by 76%, at a time when personal income rose by 60% and inflation saw a mere 32% rise.



The numbers suggest that whatever victories have been won have been limited, temporary, and symbolic, and have done remarkably little to slow down Wisconsin's tax and spend machine. Indeed, we seem to have created a system in which few politicians vote for any overt tax increases — yet preside over dramatic increases in taxation.

The Tax and Spend Treadmill

All of this needs to be seen against the backdrop of the national debate over taxes. In the 1980s, cutting taxes (along with welfare reform, the Cold war, and crime) was a staple of conservative Republican politics. It also won elections.

But, clearly, both nationally and locally, the issue has lost some of its saliency. A healthy economy may have taken the edge off

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of the desire for tax reform, but the politics of taxation is also being shaped by other dynamics, as evidenced both in Washington and in Wisconsin.

Why has it become so hard to cut taxes?

With special attention to Wisconsin, here are four problems:

Class warfare. Only people who pay taxes tend to care about tax cuts. Over the last 15 years, especially at the federal level, the tax burden has been shifted onto an ever smaller proportion of the voting population. This has obvious and profound political consequences.

In 1998, a majority of personal federal income taxes were paid by just 5% of taxpayers. According to the Tax Foundation, 50.8 percent of all federal individual income taxes were paid by the top 5% of earners (people who had adjusted gross incomes of \$101,202 or above.)

The top 1% of earners paid nearly a third of all individual income taxes (32.3%).

This imbalance extends throughout the tax code:

The top tenth of earners foot 62.4% of the total individual income tax bill, while the top quarter of earners (who make \$45,833 or more) pay 81.3% of the total.

In contrast, the bottom 50% of earners together paid a mere 4.3% of individual income taxes.

Despite the rhetoric about the rich getting richer, these numbers reflect a major shift from 1980. For instance, the proportionate federal tax burden on the top 5% of earners has risen from 36.8% to 50.8%.

Because Wisconsin's tax rates are flatter than the federal taxes, the disparity is not as dramatic. But the imbalance continues to grow, especially as more and more voters are effectively exempted from the tax rolls. As a result, fewer and fewer voters have a vested interest in reducing a tax burden primarily borne by others. It won't be long before a majority of voters will be able to vote themselves the tax

dollars of others with absolute impunity. And, indeed, an ever growing number of voters find themselves on the receiving side of the politics of income redistribution.

Although Republicans continue to employ the rhetoric of tax cuts, they appear to have little stomach for actually cutting the burden of the most heavily taxed Americans. Fearful of being accused of cutting taxes "for the rich," Republicans have become complicit in the ongoing shift of the tax burden onto a handful of high earners. Not coincidentally, despite a Republican Congress, the overall level of federal taxation is now higher than any time since World War II.

Found money. Be careful what you wish for, you might get it. After decades of campaigning for a balanced budget, conservatives now have to deal with chronic budget surpluses. Ironically, the rhetoric about "paying your bills" has become a rallying cry for opponents of tax cuts. Belatedly, conservatives have also found that simply balancing the budget does nothing to actually reduce the overall size of government or its share of the economy.

At both the state and federal levels, politicians have tended to treat surpluses as found money. The result is that government is "locked in a spend-whatever-comes-in cycle" in which spending is driven to higher and higher levels even without increases in tax rates. Liberals no longer have to propose trillion dollar increases in taxes to support new entitlement programs — now they can simply pay for it out of surpluses.

Some of the tax and spend dynamics were evident in the debate over the state's budget surplus this year. Literally within days of state officials discovering that they had an additional surplus of \$568 million, coalitions of special interest groups were at the Legislature's doorstep with plans to spend most of it. Even though both houses of the legislature had already completed action on the state budget — the Republican Assembly increased spending by 10%, the Democratic senate by 12% — pressure to spend the surplus was so great that it brought the budget process to a halt for months.

Democrats tended to push for new “investments”, an increasingly shopworn euphemism for increased spending. But even Republicans had difficulty agreeing amongst themselves on whether to cut taxes permanently or temporarily; to focus on income or property or sales taxes; or whether to return the money through a rebate or a tax holiday.

The \$1.60 solution. In Wisconsin, as bad as the state tax picture seems, it gets even worse when property taxes — levied by local units of government — are factored in. Despite the infusion of billions of dollars into “property tax relief,” including more than \$4.6 billion this year alone to local schools, Wisconsinites continue to pay some of the highest rates in the nation. Worse yet, the level of property taxes has risen back to the level they were at before the state began funding two-thirds of the cost of public education — a massive undertaking designed to permanently reduce homeowners’ tax burdens.

Far from cutting taxes, the transfer of state money to local officials has in fact yielded ever higher levels of both spending and taxation. Just as higher tax revenues have encouraged state politicians to jack up spending, higher “property relief” has led to binge spending at the local level.

By creating a system where one set of politicians raises taxes and another set spends them, Wisconsin has put in motion a perpetual tax and spend machine. According to the Wisconsin Taxpayers Alliance, state and local taxes actually rise \$1.60 for every dollar in “property tax relief” sent to local governments by the state.

Ironically, that means that the very politicians who promise tax relief are actively fueling ever higher state taxes, which in turn spark

ever higher local levels of taxation. If by chance a future governor and legislature lift the modest cost controls on local school districts, Wisconsin is poised for a full scale tax-and-spend conflagration.

Invisible taxes. The real father of the modern welfare state was the man who came up with the idea of the withholding tax. Almost all of the growth in taxes has come about silently, automatically, and painlessly through payroll withholding. A basic fact of political life is that most Americans are paying more in taxes without really noticing it. Instead, a remarkable number of Americans are under the impression that the government is actually giving them money when it sends them their tax refunds.

As Amity Shlaes points out in her book, *The Greedy Hand*, it was an official at the retailing giant, R.H. Macy & Company who came up with the idea of withholding income taxes from workers’ paychecks as a way to finance the war machine during World War II. “Without withholding,” notes Shlaes, “it would be difficult to envision this scale of taxation

in a land born of a tax revolt. Indeed without withholding the outsized government we have today would be hard to imagine.”

Reclaiming the Tax Issue

How can conservatives recapture the tax issue?

Yes, cut taxes for the rich. Republicans need to face squarely the dilemma that if you cut taxes you must cut the taxes of those who pay taxes. Yes, this opens conservatives to the Democratic demagoguery that they are backing “giveaways” to the “rich.” But Republicans need to get over it. The alternative is surrendering the entire issue permanently.

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To begin with, conservatives need to continue to emphasize that people have an inherent right to the fruit of their own labors. It is not greedy to want to be able to decide how to spend your own money. What is greedy is the appetite for other people's cash.

It's the size of government, stupid. It's time to put away the green eyeshades. It is not enough just to balance the government's books; we need to limit the size of government. When Milton Friedman suggested a constitutional amendment limiting the size of government to a percentage of the economy, few conservatives paid much attention, because they were focused single-mindedly on a balanced budget. But, as they discovered belatedly, a budget can be balanced with lavish spending and confiscatory taxes.

Conservatives now need to shift the debate from balancing the ledger sheet to controlling the size of government. Government should not grow faster than our ability to pay. Nor should it be larger than, say, a fifth of the GNP.

In Wisconsin, all budgets are balanced. But legislators should consider strictly limiting the growth in state spending to the growth in personal income. If taxpayers cannot afford it, neither can government.

Give it back. The government does not run surpluses. It overtaxes its citizens. Not only should Republicans push for giving back surpluses, they should create automatic triggers to return excess taxation to taxpayers. Far from being a negative, the surpluses can be turned into an opportunity to educate the public about the need to put government on a diet.

End the shell game. Wisconsin's vast experiment with "property tax relief" has failed. The only way to engage in a "property tax relief" bidding war with Democrats is by accepting the premise that we can cut one tax by raising another tax. We can't. And it's time to be honest with voters. They might actually like it.

The only way to cut taxes is to cut spending. And the only way to cut spending is to hold the same politicians accountable for both spending and taxing. If legislators want to cut property tax bills they must make sure the money goes directly to taxpayers, without the local government skim.

Put the teeth back into the tax bite. All right, this is admittedly a long shot. But if we want to raise tax consciousness, we should change the way people give the government their money. Most people can tell you exactly how much they pay in property taxes. Almost no one has any clue how much they pay in federal or state income taxes — unless they are self-employed, or pay estimated taxes. And therein lies the clue: people who actually have to write out a check to the government tend to know how much of a bite the state is taking out of their wallets. The political dynamic in Wisconsin would change overnight if state residents were given an option of either making quarterly tax payments or having the government pay them interest on overwithholding.

When it comes to taxes, an informed electorate is an annoyed electorate.