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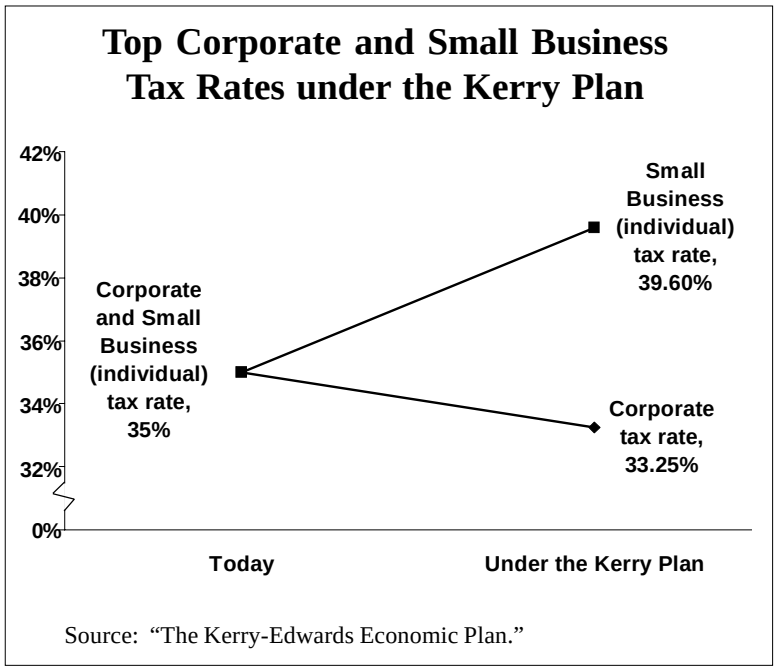
Kerry Tax Plan: "Them" versus "Us"

by Bruce Bartlett

A key element of the John Kerry-John Edwards campaign is an us-versus-them theme — where "us" are the poor and middle class and "them" are the greedy rich —famously characterized by Edwards as "Two Americas." The Democrats' message clearly implies that the rest of us would somehow be better off if the rich were worse off.

Kerry has proposed eliminating the 2003 tax cuts on "the rich," that is, everyone earning more than $200,000. The reality is that few Americans likely would classify those making $200,000 per year as "rich." For instance, with overtime, many police and fire-fighters make close to $100,000 per year. And if they have a working spouse, they are probably in the top five percent of earners and within shouting distance of the top two percent. Most Americans hope that even if they themselves never get to that income level, their children will.



Source: "The Kerry-Edwards Economic Plan."

Thus the basic problem with scapegoating the rich for every problem in society is that far more people identify with the rich than they imagine. As Bob Kuttner, editor of *American Prospect* magazine, recently wrote in the *Boston Globe*, "Because nearly everyone identifies upward, you don't gain traction in American progressive politics by baiting the rich."

Small Business Discrimination. While Kerry promotes his plan to eliminate tax cuts for everyone earning more than $200,000 as taxing those who can "afford it," these cuts will predominantly affect small businesses:

- Some 90 percent of businesses pay taxes through the individual income tax, not the corporate income tax.
- Under Sen. Kerry's plan, small businesses would pay a higher tax rate than corporations; the top tax rate for corporations would drop from 35 percent to 33.25 percent while the top rate for small businesses would increase from 35 percent to 39.6 percent. [See the figure.]

Small businesses create seven out of every 10 new jobs and account for more than half our economy's output. Kerry's plan to increase taxes on the "wealthy" would affect nearly 1 million small businesses and entrepreneurs who are in the top two individual income tax brackets.

Income Mobility. Kerry's plan will affect more people than he predicts due to income mobility. A recent study by the National Center for Policy Analysis and the Financial Services Roundtable shows there is considerable movement among income groups from year to year:

- The number of workers who remained in the same quintile (fifth) after one year was 60 percent; after 5 years, 43 percent; after 10 years, 33 percent; and after 15 years, 29 percent.
- Between 1988 and 1998, 47 percent of those in the lowest income quintile rose to a higher quintile, and 47 percent of those in the top quintile fell to a lower one, according to a recent study by the Federal Reserve Bank of Boston.

Joint Economic Committee research shows that far more than 400 people occupied the *Forbes* top 400 list during the last nine years — 2,218 taxpayers were on the list at some point during the period.

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- Amazingly, three-fourths were among the top 400 for just one year and 87 percent were on the list for 2 years or less.
- Less than 1 percent made the cut every year.

In short, there is substantial mobility in and out of the ranks of the very wealthy.

Two Strikes. "The rich" already have two strikes against them: Their total share of income taxes has risen over the past two decades — regardless of tax cuts — and the stock market collapse hit them the hardest. Do they deserve to have their taxes raised on top of that?

Although the average tax rate on the *Forbes* top 400 fell after the 2003 tax cuts, an Internal Revenue Service report shows that their share of total income taxes paid rose by 50 percent, from 1.04 percent in 1992 to 1.58 percent in 2000. In other words, the richest of the rich paid more and everyone else paid less.

The top 1 percent of taxpayers have increased their income tax share almost annually, from 19 percent in 1980 to 27 percent in 1988, despite the Reagan tax cuts, and to 37 percent in 2000. Interestingly, the same pattern holds in other countries.

- In the United Kingdom, the top 1 percent of taxpayers paid 23 percent of income taxes in 2003.
- In Canada, the top 1 percent paid 24 percent in 2001.
- In Australia, the top 5 percent of taxpayers paid 27 percents of income taxes in 2000.

In all countries for which data is accessible, the percentage of taxes paid by the rich is rising.

The Stock Market Collapse: Effect on the Rich. According to a July 29, 2004, *New York Times* report, the wealthy suffered greater income losses than any other income group from the stock market collapse that began in 2000.

- Every income class above $200,000 — the top 2 percent that Kerry and Edwards say must pay more taxes — suffered an income loss between 2000 and 2002 (in inflation-adjusted terms).
- The losses ranged from an average of 10.5 percent for those with incomes between $200,000 and $500,000, to an amazing 63.4 percent for those with incomes above $10 million.
- Between 2000 and 2002, one of every eight individuals with an income above $200,000 saw their income decrease.
- Finally, the ranks of those with incomes above $10 million fell by more than half, and their aggregate income felling nearly two-thirds — from $300 billion to $110 billion.

Although the vast bulk of high income earners are probably still doing very well compared to most Americans, there is no reason why they should be punished with higher taxes when they have just suffered staggering income losses.

Effects on the Nonrich. Interestingly, the data show that the bulk of the middle class did fairly well between 2000 and 2002. In fact, despite the recession and higher unemployment, every income class between $25,000 and $200,000 saw an income gain. Those with incomes below $25,000 saw a small income loss of 1.4 percent, which was probably compensated for in large part by the 2001 tax rebate and increase in the child tax credit. (The data are for before tax income and thus exclude the effect of tax cuts.)

Effects on the Deficit. Many would like us to believe the federal budget deficit is largely due to tax cuts for the rich. But even the *New York Times* disputes this idea, noting that those tax cuts mainly affecting the rich didn't take effect until 2003. "Falling incomes, rather than tax cuts, appear to count for the greatest share of the decline in income taxes paid," says the *Times*. "That is because the higher one stood on the income ladder the greater the impact was likely to be from the stock market crunch."

Conclusion. Elements of the 2003 tax cut legislation are due to expire over the next few years unless renewed by Congress. Sen. Kerry has called for early repeal of tax cuts on high income earners to pay for his health care plan. However, according to estimates by the Tax Policy Center (jointly operated by the Urban Institute and Brookings Institution), early repeal of those tax cuts would yield only about $278 billion. Since that is only a third to a fifth of the projected cost of the Kerry plan, one might wonder if the "rich" will be defined downward, and eventually include two-earner couples who consider themselves middle class.

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