# Behind Privatization Door Lurks A Killer: 'Tax Simplification'

by Richard Freeman

President George W. Bush and radical Republicans in the House and Senate are planning to roll out a "total overhaul" of the U.S. tax code, and perhaps use the "Social Security debate" to ram it through Congress. According to those involved, the reforms are designed to massively reduce taxes on the upper 20% of America's families by income—especially the super-wealthy upper 5%—while steeply increasing the tax burden on the lower 80% of families. But they would also cause sharp drops in government revenues, forcing deep cuts in vital Federal social and infrastructure programs.

Radical tax reformers such as Grover Norquist of the Mont Pelerin Society's satellite, Americans for Tax Reform (ATR), say the purpose of the current reforms is to reduce the role of government, towards providing police and national defense functions, and little else. Norquist would privatize just about everything, from education to infrastructure. On Pat Roberston's "700 Club," he proclaimed "My goal is to cut government in half in 25 years, to get it down to the size where we can drown it in the bathtub."

In his Feb. 2 State of the Union address, the President ranted, "Americans are burdened by an archaic, incoherent tax code. I've appointed a bipartisan panel to examine the tax code from top to bottom." Bush demands reform and "simplification" of this "archaic, incoherent" tax code, exactly as he uses the non-existent financial crisis of Social Security to demand its "reform." The tax code is indeed too complex, and could benefit from *positive* changes; but what Bush means is only that taxes on the speculative flow of the capital gains and dividends of the wealthiest families are allegedly "too complex." Bush's proposed means of simplification: Eliminate those taxes!

On Jan. 7, Bush appointed the Commission on Tax Reform. The political network run by George Shultz, leading Wall Street banks, and the financier oligarchy's Mont Pelerin Society—with its interconnected circle of think-tanks like the Cato Institute, FreedomWorks, Americans for Tax Reform, etc.—is both directing the push for Social Security privatization, and and shaping the work of this Commission to push for radical tax reform. The Commission's two co-chairmen, former Senators Connie Mack (R-Fla.) and John Breaux (D-La.) are hard-wired into this operation. This Commission's final report is due July 31.

The heart of the matter, in the fight over tax reform—whether rational, or, as Bush recommends, dangerous—is the General Welfare Clause of the U.S. Constitution, which foresees need of the sovereign nation-state to advance the common good in the interest of past, present, and future generations. This formed the wellspring for Alexander Hamilton's highly successful American System of economics. Drawing upon this, President Franklin Roosevelt made remarkable accomplishments in the period of 1933-45, defeating the Great Depression; doubling the output and employment of the U.S. productive economy; establishing the pro-development, fixed-exchange-rate Bretton Woods monetary system; etc.

Despising the General Welfare clause, banking forces behind Bush are moving to "reform the tax laws" in order to expand speculative financial flows at the expense of the productive economy, and try to save their dying financial system.

## Consumption-Based Taxes

The leading tax-reform forces in the Bush Administration advocate a "consumption-based tax," whose meaning will become clear. They would abolish the income tax now in force. The principal consumption-based taxes these groups are promoting are a national sales tax and a "flat tax." (There exists a third consumption-based tax, the Value-Added Tax—VAT. Each country in Europe has a VAT, sometimes in combination with an income tax. While some who are shaping Bush tax reform policy would consider a VAT, the overwhelming majority reject, and often ridicule it, because it would not fully allow the austerity measures they have in mind.)

The tax cut package—the so-called Economic Growth and Tax Relief Reconciliation Act—that Bush jammed through Congress in 2001, is a significant step down the path towards either a national sales tax or a flat tax.

The advocates of these new taxes make the following distinction, which is key to their approach. They call wages and salaries "consumption," because a worker consumes his or her wages or salary in the purchase and consumption of goods, like a home, food, and clothing. They then call a whole other category of income "investment or savings." In this category they include: a) dividends from stocks; b) interest from bonds or bank accounts; c) income from rental properties; d) capital gains from the sale of a stock or asset that has appreciated in price; and e) inherited money from a parent or other relative. This they call "income," and say the government *should not ever be permitted to tax it,* because if it did so, it would be taxing savings or the investment funds needed to make America grow. A government so petulant as to tax these sources of income (a through e), is hindering growth. This is their main line of attack on the income tax.

In the U.S. economy as presently functioning, the income from the above-mentioned sources derives increasingly from speculation, and is concentrated to an unprecedented degree among the wealthiest 10% of the population. Bankers and financial operatives themselves could not write a better argument. In fact, bankers wrote the tax reform, and adding some mumbo-jumbo, intend to sell it to workers making less than $30,000 a year, as if it benefitted the whole economy, which it does not.

President Bush has already bought into the argument. Speaking in Niceville, Florida in August 2004, he told a carefully orchestrated "Ask George Bush" campaign forum, "You know, I'm not exactly sure how big the national sales tax is going to have to be, but it's the kind of interesting idea that we ought to explore seriously." Already by that point in 2004, Rep. John Linder (R-Ga.) had introduced H.R. 25, a model bill to create a national sales tax system (NST). Its promoters say that it will be applied, at the sales level, on all the consumption purchases that every individual makes. The hucksters selling the NST make a long Boy Scout-like list of pledges about it—that it will be simple (not complex), modern (not archaic), equitable, etc.—and end with their pitch that, of course, the NST will lower tax rates. But that is simply not true.

To determine what the NST will charge on every purchase, let us look at Linder's H.R. 25, which is already marked up. The Washington, D.C.-based Institute on Taxation and Economic Policy did an assessment of the National Sales Tax in September, 2004. It reported:

> H.R.25 confusingly advertises its sales tax rate as 23%, but that's rather disingenuous. On a $100 purchase, for example, sales-tax proponents tell us that the tax would be $30, which most people would accurately call a 30% tax rate. The so-called 23% figure comes from dividing the sales tax by *the cost of purchases plus the tax.* To be sure, $30 divided by $130 does equal 23%, but no ordinary person would think of computing a sales tax that way [emphasis in original].

But this is only the beginning of the problem. The Institute's study also reported: "Allegedly, almost a third of the projected sales-tax revenues are supposed to come from taxes that the government will pay to itself. Build a road, pay yourself a tax. Buy some planes from the Air Force, pay yourself some more. And so on. . . . Without these phantom governmental tax payments, the sales tax would have to jump to 42% to break even." Nor does that end it. "In addition," the study concluded, "a quarter of the remaining sales taxes are supposed to be paid on things like church services, free care at veterans hospitals and a variety of hard-to-tax financial services like free checking accounts. If we disregard the supposed taxes on these items, the sales tax rate would have to climb to 50% or more."

That is stunning. Let us assume, that with give and take, in actuality, the national sales tax rate comes out to 40%. Many state and local governments also have sales taxes, ranging from 2%, up to 7%. Examine a purchase in America's largest city, New York. An individual making a $100 purchase would have to pay $40 in NST, and $7 in state and local government sales taxes, for a total tax of $47: half the value of the purchase.

The national sales tax is regressive, because it hits those with the lowest incomes the hardest. A worker making $30,000 or less per year must spend almost all of that on purchases of goods and services for his family; they can save very little, if anything. But for a person earning $200,000 or more per year, the total purchase of goods and services, even including luxury items, will be a much smaller percentage-share of total income than for the worker earning $30,000. The wealthier individual will be able to save or invest some of that $200,000 earnings, which portion should be *untaxed,* say NST advocates.

The Institute on Taxation and Economic Policy's brief found that there is a great disparity in the level of tax paid

TABLE 1
**Shares of Taxes on Long-Term Capital Gains**

| | 2004-08 | 2009-14 | 10-Year Average 2005-14 |
|---|---|---|---|
| Lower 20% | 0.0% | 0.0% | 0.0% |
| 2nd 20% | 0.0% | 0.2% | 0.1% |
| Mid 20% | 0.2% | 0.6% | 0.5% |
| 4th 20% | 2.3% | 3.2% | 2.8% |
| Next 10% | 3.4% | 4.5% | 4.1% |
| Next 5% | 4.8% | 5.6% | 5.3% |
| Next 4% | 17.4% | 18.8% | 18.2% |
| Top 1% | 71.9% | 67.0% | 69.0% |
| Top 5% | 89.3% | 85.8% | 87.2% |
| **All** | 100.0% | 100.0% | 100.0% |

Source: Americans for Tax Justice.

under a national sales tax:

- In virtually every U.S. state, the lower 80% of Americans by income bracket would pay much higher taxes. Nationwide, these tax *increases* would average $3,200 per year. The lower 80% would end up paying 51% more in sales tax than they now pay in Federal taxes.
- The highest-income 1% of taxpayers would get average tax reductions of about $225,000 per year.

## Coming In Short on Revenues

The United States could not function with a national sales tax of 40% or higher (and then with a state and local government sales tax on top of that). What some NST promoters intimate they will do, is set the NST at a lower level—a still exorbitant 30-35% effective rate—that would bring in far less revenue than the current income tax does, or than is necessary for the U.S. budget to break even. This would create a large revenue shortfall, seting the conditions to force fierce budget-cutting.

The flat tax idea was developed by Robert Hall and Alvin Rabushka of the monetarist nest, the Hoover Institution for War and Peace at Stanford University. In the 1980s, a version of it was introduced into the Congress. Its most noted proponent is former House Majority Leader Dick Armey (R-Tex.), who, along with Sen. Richard Shelby (R-Ala.), introduced this into Congress in 1995, as part of the Contract on America. (Billionaire publisher Steve Forbes ran on the flat tax in his 1996 Republican Presidential campaign.) Armey is sporting the flat tax about, as the founder and head of the Institute for Policy Innovation, and also as co-chairman of the Mont Pelerin Society-run FreedomWorks (another of whose co-chairmen is R.J. Reynolds heir C. Boyden Gray).

Armey's flat tax would assess a uniform 20% rate of taxation on everyone, which, he says, would be reduced, after two years, to 17%. We will see that this 17% tax rate, by design, would not adequately replace the revenue generated by the current U.S. tax code, nor permit the U.S. budget to break even.

There are two phases to this tax cut. For populist purposes, Armey claims that his flat tax would help the lower-income population, by offering a personal allowance deduction of $32,000 to a family of four; below that, such a family allegedly would not pay taxes. But there is a glaring hole: Armey's flat tax deliberately does not generate the same level of revenue as does the current tax code; either government programs would be massively slashed, or he would have to lower the tax allowance deduction to $20,000 or less.

Armey vigorously directs his tax-cutting to the wealthiest 20% of the population. Currently, the top U.S. marginal tax rates, depending on level of income, are 37.6%, 34%, 29%, and 26%. Armey would slash all these rates to 17%, and would *exempt from taxation entirely, all of our "a to e" forms of unearned income listed above.*

To see how this benefits coupon-clippers, bankers, etc., examine **Table 1.** Under continuation of current law, the lower 80% of the population by income is projected to pay only 3.4% of long-term capital gains taxes, because 96.6% of the profit from sale of stocks, art work, etc., goes to the upper 20% of families. It is even more concentrated than that: The upper 5% of households, by themselves, garner 87.2% of all long-term capital gains and pay 87.2% of capital gains tax. The upper 20% of families also earn more than half of all interest income, more than half of all dividends, inherit more than half of all assets and property, and so forth. The flat tax wipes out all imposts on this, offering them the greatest tax bonanza in history.

Who will pay the flat tax? The answer is that the middle class will pay a much greater tax. One reason is that it would eliminate the most common itemized deductions of the middle class, such as interest on home mortgages, health-care expenditures, and charitable contributions.

But Armey's proposal really aims for deep budget cuts.

A tax proposal that brings in the same revenue as the current system, is called revenue neutral. The Texas-based pro-flat tax National Center for Policy Analysis, in its "Tax Briefing Book," states, "If the Armey plan for tax simplification were completely revenue neutral, it would require a tax rate in the range of 19-20%." (In reality, analysts point out it would actually require a tax rate of 25% or more to be revenue neutral.) The briefing continues, "Establishing a rate of 17%, therefore, constitutes a tax cut. *The loss of revenue is paid for by capping government spending, including so-called entitlements*" (emphasis added). In fact, the loss of revenue could cripple the functions of government—Grover Norquist's ideal. The progressive nature of the tax system would be destroyed; one final tax bonanza for the wealthy would bring government to its knees.