



## Would Higher Taxes Help Cash-Strapped States?

The dire economic straits of the nation have prompted progressives to call for increased taxes, a measure they believe can help offset the deficits at the state and national level. However, when one examines the fiscally troubled states of California and New Jersey, it becomes evident that higher taxes would do little to assuage the problem.



[Bloomberg News](#) reports, "States face deficits that may reach \$140 billion in the next fiscal year, according to the Center on Budget and Policy Priorities in Washington."



Despite the worsening economic situation, however, most governors publicly denounce the possibility of raising taxes, opting instead to cut programs and order layoffs.

One problem that progressives fail to address in their proposals to raise taxes is that high tax rates do not always translate to higher revenues. Andrew Mellon, Secretary of the Treasury under conservative Republican President Calvin Coolidge, alluded to this reality:

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It is incredible that a system of taxation which permits a man with an income of \$1,000,000 a year to pay not one cent to his Government should remain unaltered.

It is time to face the facts: merely having high tax rates on large incomes will not bring in more tax revenues to the treasury, because [of] the flight of capital away from taxable investments.

Economic expert and syndicated journalist [Thomas Sowell](#) has addressed the same issue in a number of his columns. For instance, on December 2, he observed:

Internal Revenue Service data show that there were 206 people who reported annual incomes of \$1 million or more in 1916. But, as the tax rate on high incomes skyrocketed under the Woodrow Wilson administration, that number plummeted to just 21 people reporting \$1 million a year in income five years later.

What happened to all those millionaires? Did they flee the country? Were they stricken with fatal diseases? Did they meet with foul play?

Not to worry. Right after Congress enacted the cuts in tax rates that Mellon had been urging, there were suddenly 207 people reporting taxable incomes of \$1 million or more in 1925. As Casey Stengel used to say, "You could look it up." It is on page 21 of an Internal Revenue publication titled "Statistics of Income from Returns of Net Income for 1925.

Where had all the income of those millionaires been hiding? In tax-exempt securities like state and local bonds, among other places.

For example, in 1920, those in the highest tax bracket paid 30 percent of all taxes. After alleged "tax



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cuts for the rich," those in the highest tax bracket were paying 65 percent of all taxes by 1929.

Sowell explains this confusing statistic: "High tax rates on paper, which many people avoid, often does not bring in as much tax revenue as lower tax rates that more people actually pay after it is safe to come out of tax shelters and earn higher rates of taxable income."

Today, some governors seem to understand these economic rules. Examples include Democrat Andrew Cuomo of New York and Republican Chris Christie of New Jersey, who have avoided tax increases and have instead implemented austerity measures.

For example, earlier this month, Christie joined 28 other Republican governors asking President Obama and congressional leaders for permission to reduce Medicaid outlays, though Christie has not yet indicated how much he hopes to cut from the program. Likewise, New York's Andrew Cuomo declared his intent to lower Medicaid spending by \$2.1 billion, while Florida's Rick Scott looks to trim \$1.8 billion.

In addition to program cuts, fiscally conservative governors seek cuts in employee benefits as a means to save. Christie has indicated that he will seek savings in contract talks with state workers' unions. He has announced,

I think collective bargaining is an important process and I want to participate in it fully with the workers of this state so they feel whatever deal they end up getting is a fair deal. If I have to resort to other tactics, I will, because I have to balance this budget.

In September, Christie proposed undoing a nine percent pension increase, raising the retirement age, and freezing cost of living raises for retirees. He also recommended raising employee contributions toward pensions from 5.5 percent to 8.5 percent.

Aware that his proposals might not be warmly received, Christie asserted,

We need to get at the benefits and we need to get realistic with folks and tell them the truth: promises were made that can't be kept. We need to go after the drivers of these costs.

Despite the positive example set by governors such as Christie, however, some of the more liberal governors have not been afraid to impose higher taxes. For example, Illinois Governor Pat Quinn signed a law that would increase income taxes to five percent. Minnesota Governor Mark Dayton and California Governor Jerry Brown have also indicated an interest in extending or implementing tax increases.

States such as California and New Jersey face such large deficits, however, that income tax increases would make only minor chips at the deficit. In California, increasing the state income tax by two percentage points would generate a \$13 billion increase in revenue, according to the *New York Times*. That would still leave California's deficit at \$12 billion. A similar income tax increase implemented in New Jersey would raise almost \$5 billion, leaving the state with a remaining \$4 to \$7 billion deficit.

The *New York Times* touts income tax increases as a viable means to reduce deficits, but contends that for states such as New York, New Jersey, and California, the increases must absolutely be paired with spending cuts.

However, in states that are less financially strapped, such as Arizona, the *Times* writes, "Such a tax increase would go much further in addressing at least the short-term problems."

Perhaps the writers at the *New York Times* should read Andrew Mellon's book, [Taxation: The People's](#)



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Whether income tax increases would truly help the cash-strapped states remains to be seen. According to the Tax Foundation, “2011 may be a year of dramatic tax increases.”

*Graphic: state flags of New Jersey (top) and California (bottom)*



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