



Obama's Odd Sense of Fairness

by Richard W. Rahn

IGNORING INDIVIDUALS AND COUNTING CLASSES IS UN-AMERICAN

President Obama keeps demanding that the rich pay more because “it is only fair.” In his State of Union address, he said millionaires should pay a minimum of 30 percent of their income in taxes. The 30 percent number seems to have come from divine inspiration rather than an exercise in logic.

In fact, the very rich pay far more in taxes than the relatively low nominal numbers they report on their tax returns. Many very wealthy people obtain most of their income from dividends, capital gains and interest on tax-free state and municipal bonds. The actual tax rate Mitt Romney, Warren Buffet and most other wealthy people pay on dividends, when correctly calculated, is about 52 percent, as reported by the Organization for Economic Cooperation and Development (OECD), which includes the federal and state corporate-level-profits tax burden, plus federal and state taxes on dividends. My Cato colleague, Chris Edwards, who prepared the accompanying chart, notes: “Just about every industrial country provides relief for the double taxation of corporate equity, either by having a lower personal

rate on dividends, a personal tax credit for dividends or a lower corporate-level tax. Despite the 2003 dividend tax cut, the overall U.S. rate of dividends ... is still the fourth-highest among the 34 high-income nations of the OECD.”

Mr. Obama seems to think it is “fair” to tax the same income multiple times, at a total effective rate of more than 50 percent.

Capital gains are taxed at 15 percent but will be subject to a higher rate as a result of revenue provisions in Obamacare. Now the president seems to be proposing that the rate be doubled to 30 percent, given his comments in his State of the Union address. Over the past half-century, the United States has raised and lowered the capital-gains tax rate many times. When rates went up, revenues went down and vice versa, because for the most part, people can choose when to take their capital gains or losses. Virtually all independent economic studies and even a U.S. Treasury study show that a capital-gains tax-rate increase will almost certainly be a big revenue loser and job killer and will depress economic growth. When Mr. Obama was asked about this during his first presidential campaign, he acknowledged that a capital-gains tax increase might lose revenue, but he wanted it anyway because of “fairness.”

So, according to the president, it is “fair” that everyone has to pay higher taxes or have fewer government services in order to make sure that high-income earners pay an increased rate of tax for risking their capital and creating jobs. This is perhaps the best description of “Alice in Wonderland” economics.

As with dividends and capital gains, interest is also subject to multiple levels of taxation, and so the nominal tax rate on it is far lower than the properly measured real rate. Many wealthy people buy state and local government bonds, which are tax free but normally have a lower rate of interest. The reason state and local governments are allowed to issue tax-free bonds is to enable them to have access to low-rate capital for building schools, roads, bridges, etc. To force high-income people to pay higher tax rates, this “tax preference” would need to be abolished, resulting in much higher interest-rate costs for state and local governments, which, in turn, would mean fewer new schools and highway improvements. I expect that many in the president’s political base who want more schools would not view this required tax change as being “fair.”

The federal government admits that hundreds of billions of taxpayer dollars are wasted through fraud and mismanagement. Medicare fraud alone costs tens of billions of dollars each year. Nevertheless, somehow the president thinks it is more “fair” to enact job-destroying tax increases rather than insisting that officials in his own administration clean up the fraud and waste or lose their jobs, as would happen in any private company.

Much of the president’s mental confusion about what is “fair” seems to stem from viewing people as “classes” rather than individuals. The American Constitution is all about protecting individual (not class) liberties and rights. If you think the “rich should pay more,” then you are thinking in class terms. Assume for the moment there are two individuals, each 45 years old with the same IQ, who went to the same college and dental school and are equally skilled dentists in private practice. However, one is married with four children in expensive colleges, and thus chooses to work 60 hours per week. The other dentist has no children and chooses to work just 30 hours per week and thus makes half as much. The president thinks it is “fair” to tax the industrious dentist at a higher tax rate. (Note: the bottom 50 percent of taxpayers pay just 2.3 percent of federal income tax, and the top 1 percent of taxpayers pay 36.7 percent, more than twice their share of earning.)

Those who are mentally mature enough to understand that people change their behavior in response to economic incentives and penalties and who view their fellow citizens as individuals rather than impersonal members of a class will have a very different notion of what “tax fairness” means than those who are not so mentally mature. By the way, did you see the report from the University of Minnesota’s Smart Politics that “President Obama’s 2012 State of the Union address rated at an 8th-grade comprehension level using the Flesch-Kincaid readability test, the third-lowest score of any State of the Union address since 1934”?

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