Insight

Another Obama Tax Hike

DOUGLAS HOLTZ-EAKIN | FEBRUARY 3, 2010

Wall Street Journal Online

By: Douglas Holtz-Eakin and Alex Brill

The stunning victory of Scott Brown in Massachusetts may prove to be a game-changer for the President's health-care "reform" agenda. This is good news for the ability of lower-income families lacking insurance to climb up the ladder of American prosperity. His associated rhetoric notwithstanding, the President's policies in the stimulus bill a

nd health-care debate increase current barriers to the American dream. These legislative efforts (we use the Se

nate health-care bill for illustration) raise to shocking levels the effective marginal tax rates (EMTR) on lower and middle-income singles and families–with the government taking up to 41% of each additional dollar.

The mechanics are simple. The effective marginal tax rate is the answer to the question: "If I earn $1 more, how much less than $1 do I get to save or spend?" If you can keep that full dollar for your disposal, the effective marginal tax rate is zero. If earning another dollar does not raise your disposable income by even a penny, the effective marginal tax rate is 100 percent.

Obviously, neither extreme is realistic. But exactly where federal policies come down in between has dramatic implications for the ability of families to rise from the ranks of the poor, or to ascend toward the upper end of the middle class. This mobility is the heart of the American dream that has made the United States a beacon of economic light for centuries. Equal opportunity to achieve that dream – not equal paychecks or equal government handouts – is the real-world litmus test for fairness in government policy.

Consider, then, the figure below constructed for a two-earner family with two school-age children, one of whom is in college. The solid line shows the EMTR based on income tax law prior to the health-care bill (it excludes the impact of the payroll taxes). The dashed line displays the damaging increases in the EMTR assuming the health insurance premium subsidies contained in the Senate health-care bill and insurance cost estimates provided by the Kaiser Family Foundation. As a family's income rises above 133% of poverty, Medicaid eligibility will be eliminated but a family that does not receive health insurance from their employer will receive a subsidy to purchase health insurance in the "exchange." In turn, however, as their efforts yield higher income, subsidies are clawed back or effectively taxed away. The current law policies show that there are already some lower income families facing EMTRs above those in the middle class. But the barrier to success imposed by health-care reform is even more striking. According to the Congressional Budget Office, about 20 million people would receive a subsidy to purchase insurance through an exchange and thus face a higher EMTR.

How can a family be expected to get ahead when taking an extra shift, finding a way for a second parent to work, or investing in night school courses to qualify for a raise means handing the government as much as 41% of the additional income earned? Parents already juggle the tough trade-off between working more to build their family's future and spending time at home with their children. The bigger the EMTR, the tougher that tradeoff becomes.

How could this happen? In part, it may reveal ignorance about the long-term impacts of class warfare-based programs. For decades, both parties have employed refundable tax credits (i.e., disguised spending programs) as a way of providing benefits to low-income families while appearing to favor low taxes and small government. The class-conscious left has insisted that these benefits be "targeted" – i.e., that they disproportionately help those lower-income families that pay no taxes and be phased-out for the tax-paying middle class. The result fit their agenda of wealth redistribution. The right, eager to achieve any tax cuts they could muster, accepted the income limitations as the price of getting any tax relief. With progressives' hell-bent effort to soak the rich, the outlook for the poor and middle class quietly and steadily deteriorated to the condition we find it today.

Every "phase-out" of a tax credit or subsidy program is an EMTR in disguise. The cumulative impact is a cruel twist on "targeting," as families are anchored near the bottom of the income distribution by layers of fiscal cement. Ignorance is a dangerous animal in the hands of tax policymakers.

A second possibility is subtle paternalism toward the poor. Unlike the rich who are presumed to know what they want (which progressives are dead set on thwarting), it may be that poorer Americans are presumed to need guidance on how to live their lives (or a "nudge" in the parlance of the faddish behavioralists in the Obama Administration). They need to be told that it is a good idea to work, take care of your children, go to college and have health insurance, hence a tax credit for every virtue.

In the end it does not matter how we got here. Taxes interfere with the basic rewards for work, thrift, and saving. Excessive EMTRs damage these incentives, discourage the taxed, and threaten to rob America of a vitality that is its signature.

This year marks a crucial time in the future of tax policy. The tax laws enacted in 2001 and 2003 will sunset, along with the recent tax credits included in the so-called stimulus bill. As Congress thinks about the future, we hope it puts full weight on the importance of a tax code that supports the ability of the poor and middle-class to achieve their dreams.

The Massachusetts special election sends the strong message that voters want Washington to scale back its interference in their lives. Re-thinking the policies that get in the way of their pursuit of success is a good place to start.

http://online.wsj.com/article/SB10001424052748704259304575043302815479426.html?mod=googlenews_wsj