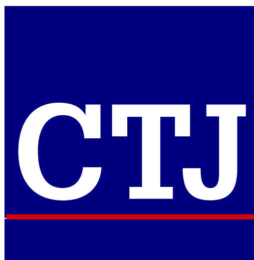

Citizens for Tax Justice

February 4, 2008

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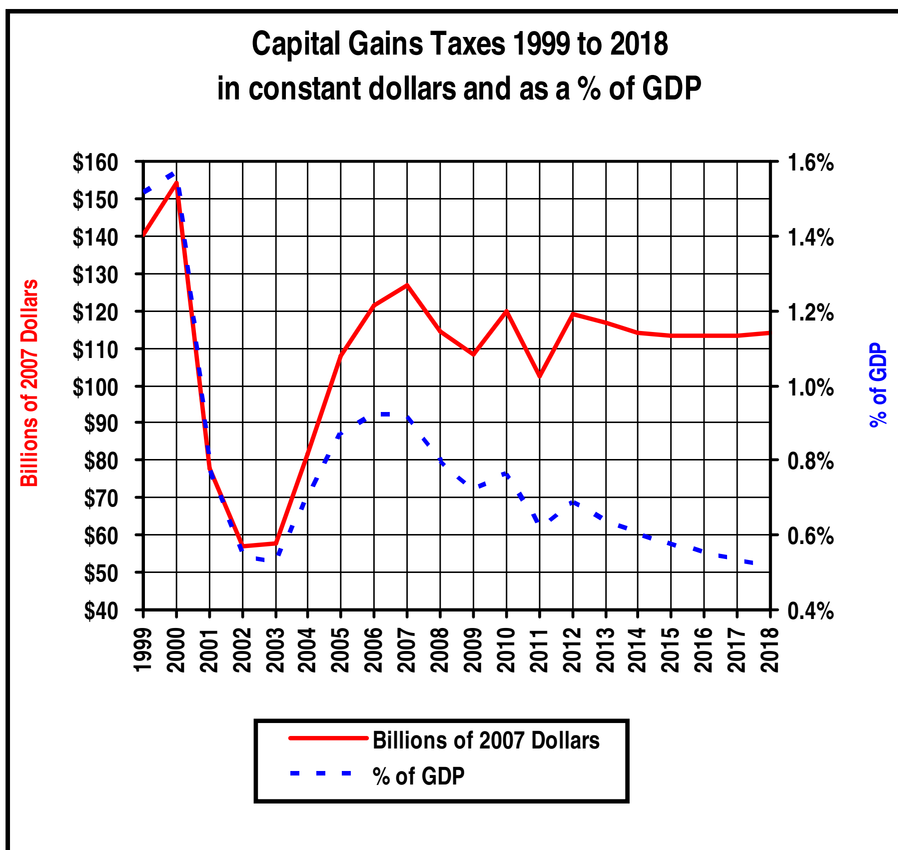
Wall Street Journal Ignores Facts in Its Crusade for High-Income Tax Cuts

> *"But if anyone still wants to reduce a tax that really would pay for itself, the Congressional Budget Office has the latest data on the revenue boom in the wake of the 2003 capital gains tax cut. Wow. The tax rate fell from 15% to 20%, yet revenue collections have climbed 152% in four years."* Wall Street Journal, January 29, 2008

The Wall Street Journal's editorial board is at it again. Their latest riposte in their ongoing duel with mainstream economics is an attempt to cast a normal upswing in a particular type of revenue, which always occurs in an economic cycle, as proof that cutting taxes actually increases revenues. The Journal ignores the fact that this revenue is well below the peak it reached during the Clinton era — when taxes were *higher*.

Someone not familiar with these debates over taxes might be wondering if the Journal's staff belongs to the generation that was taught "new" math. Actually, they just belong to a tiny group of eccentrics called "supply-siders" that has been preaching a "new" type of economics since the late 1970s.

They claim that if we lower capital gains taxes, there will be more capital gains realizations (meaning more people sell their property that has gone up in value) because the tax on that profit has been cut, and this will lead to revenue *increasing* overall.



The Journal now points to data from the Congressional Budget Office (CBO) showing that capital gains realizations and revenue from capital gains taxes increased since the recession that began in 2001. The supply-siders claim this proves that capital gains tax payments have increased *because* the tax rate on capital gains was cut in 2003 from 20 percent to 15 percent.

But the CBO points out that capital gains "plunged between 2000 and 2002" because of the economic downturn occurring at

the time. The implication is that we would expect capital gains to increase from that low point as the economy recovered even without a new capital gains tax break. In fact, it would be very unusual had they not increased from that very low point, regardless of whether the tax laws had changed.

The Journal also fails to notice that its source, the CBO, says that capital gains tax cuts do *not* pay for themselves. In discussing the possibility of letting the Bush capital gains tax cuts expire, CBO's report states that "CBO estimates that the effect of higher rates on realizations only partially offsets the increase in revenues from those higher rates. In other words, the estimated net effect of an increase in capital gains tax rates is an increase in revenues from that source despite a somewhat lower level of realizations."

Supply-siders have a tendency to take credit for the upswings (but not the downswings) that occur in every economic cycle. But they cannot deny the fact that we have collected less capital gains tax revenue during the last economic upswing than we did during the Clinton years — when taxes on capital gains were *higher*.

The nearby chart shows that revenues from capital gains taxes adjusted for inflation are well below their level at the end of the Clinton administration, and that capital gains tax revenues are not projected to come close to their Clinton-era levels at any time in the next decade.

Measured as a percentage of the economy (GDP), capital gains tax revenues have actually declined even more dramatically, as the chart shows.

There is one sense in which the supply-siders at the Journal are right. Yes, capital gains realizations might increase somewhat if taxes on capital gains are reduced. But one big reason for that is that wealthy people can convert ordinary income (which for them is taxed at a rate of 35 percent) into capital gains (which are only taxed at 15 percent) through various tax sheltering schemes.

After the Republicans took over Congress in the mid-1990s and proposed cuts in the capital gains tax, reporter Michael Kinsley and CTJ director Robert McIntyre argued that if we cut taxes in half for people named "Newt," then we surely would find that Newts reported much more income on tax returns.

The taxes paid by people named Newt might even go up, but that's just because a lot of people will have changed their names to Newt. The same can be said for cutting taxes for capital gains. People simply change their income into capital gains income (at least wealthy people, who have opportunities to use tax sheltering schemes). Think of, for example, "private equity" fund managers.

The Wall Street Journal continues to selectively read and interpret the facts to further its ideological goals. But the evidence is clear that we cannot raise revenues by cutting capital gains taxes or any other type of taxes.