

# The New York Times

OP-ED CONTRIBUTOR

## The Tax Cut We Can Afford

By MARK ZANDI

Published: August 14, 2010

UNLESS Congress and President Obama act soon, Americans' taxes will increase in 2011, when the cuts enacted under President George W. Bush are due to expire. Almost everyone agrees that this makes little sense given the economy's fragility. But consensus ends there. The president supports permanently extending the current tax rates for all except the highest-income households, while Congressional Republicans want the entire basket of cuts to be made permanent. The prudent middle ground would be to forestall any tax increases in 2011 and to phase in higher rates on upper-income households in 2012, when the economy will be on firmer ground.

The president's plan would be taking an unnecessary gamble with the struggling recovery. Businesses have only recently begun to add jobs, and they appear to be a long way from hiring fast enough to reduce unemployment. Even under the best of circumstances, the unemployment rate will remain near 10 percent well into next year. The high rate of joblessness has cast a shadow on the collective psyche that will only worsen with higher taxes, raising the already uncomfortably high odds that the economy will suffer a double-dip recession.

In most times, raising taxes on the wealthy by such a modest amount has had little impact on the economy. But these aren't most times. The well-to-do appear unusually sensitive to changes in their finances, probably because their nest eggs are significantly smaller with the drop in stock and housing prices. Only the top 3 percent of households [would have to pay higher taxes](#) if the president got his way, but this rarefied group currently accounts for a fourth of consumer spending. If they pull back, even a bit, the recovery could be derailed.

Successful small-business owners, who power the nation's job-creation machinery, make up one-third of these high-income taxpayers. They have set up their businesses so that their profits are taxed at personal rates. Raising marginal tax rates, even a little, on those who have suffered during the past several years would be a mistake.

Some people make a more nuanced argument that higher taxes on the wealthy could pay for additional economic stimulus — like a bigger job tax credit or resurrected 1930s-style work programs. This view has theoretical merit — some of my own analysis has been used to support it — but it is asking too much of our political system now to get it just right. I'm skeptical that a politicized Congress would be able to pull it off, and failure to do so would leave us next year with higher taxes and a hobbled recovery.

On the other hand, the Republican proposal to keep the current tax rates permanently in place even for the wealthy takes an unnecessary gamble with our long-term fiscal outlook. Tax cuts do not pay for themselves. Even when President Ronald Reagan slashed much higher tax rates in half, this argument failed; in the current tax debate, it is unsupportable. By definition, high-income households are where the money is; higher rates would raise substantial revenue for long-term deficit reduction.

Once the recovery is off and running, and stock and housing prices are consistently rising, allowing the Bush tax cuts for high-income households to expire — over, say, a three-year period — would not harm the economy. The overwhelming fear among high earners that their lifestyles will be forever diminished should have faded, and the tax increases would be small enough not to materially alter wealthy people's decisions about spending, working or investing.

Keep in mind that the economy performed admirably in the 1990s when high-income households paid the same higher tax rates. And the wealthy would benefit as much as anyone from reducing the federal deficit, because that would keep interest rates low, spurring investment and job creation.

Whatever policymakers decide regarding the tax code, they should take action, or agree not to, quickly. Not knowing what tax rates will be just a few months from now is adding to the collective nervousness, already high after the epic policy debates on health care, financial regulation, energy and immigration. All this anxiety is most likely affecting whether businesses hire.

None of this means the tax code should be off the table when President Obama's fiscal commission addresses how to fix our long-term problems. Past experience with fiscal austerity at home and overseas strongly suggests that it is best for the

economy's long-run performance to restrain government spending rather than raise taxes, but taxes must also be part of our national debate.

In this recession, the government has necessarily made a string of momentous economic policy decisions. Some have worked well; others have been a disaster. We can't afford any more mistakes.

*Mark Zandi is the chief economist of Moody's Analytics.*

A version of this op-ed appeared in print on August 15, 2010, on page WK10 of the New York edition.