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Ending the tax cuts, part of a sweeping package instituted by former president George W. Bush, probably won't be an easy sell with Americans, despite concerns about the national debt.

Reuters

Janet Whitman, Financial Post · Wednesday, Aug. 4, 2010

The Obama administration is stepping up its push to let tax cuts for the wealthiest Americans expire at the end of this year, drawing a line in the sand ahead of what is bound to be a heated political brawl before the U.S. elections in November.

Timothy Geithner, the U.S. Treasury Secretary, said in a speech Wednesday that tax breaks for those making more than US\$250,000 a year will only add to the country's ballooning deficit.

"Borrowing to finance tax cuts for the top 2% would be a US\$700-billion fiscal mistake," Mr. Geithner said in the speech in Washington, D.C. "It's not the prescription the economy needs right now, and the country can't afford it."

But ending the tax cuts, part of a sweeping package instituted by former president George W. Bush, probably won't be an easy sell with Americans.

Republicans are drumming up support by arguing that allowing the cuts to expire at the end of this year would put the brakes on the country's struggling economic recovery.

While the rhetoric is increasing from officials within President Barack Obama's administration, a growing list of congressional Democrats is coming out in support of an extension of the tax cuts.

"Democrats in Congress are extremely nervous about being seen to want to raise taxes," said Andrew Busch, public policy strategist for BMO Capital Markets. "To look like they're actually raising taxes and stalling the economic recovery is an anathema to them."

Against that backdrop, some political pundits expect that any decision on extending the tax cuts will simply be kicked ahead to next year, beyond the fall elections.

"It's still up in the air," said Chris Edwards, director of tax policy studies at the Cato Institute, a libertarian think tank headquartered in Washington. "But that's where I put my money. Democrats won't want to fight on this playing field because they fear it will work to

the advantage of Republicans. They're already saying the stimulus didn't work. If Democrats push to increase taxes it will just add more fuel to the fire."

Similarly, Republicans probably won't want to take a hit by urging all of the tax cuts be made permanent.

If U.S. lawmakers don't act, the sweeping tax cuts signed into law by President Bush will expire at the end of the year.

The Obama administration is in favour of keeping tax breaks for the middle class, but wants to wipe out tax benefits for the wealthiest 2% of Americans, such as a 15% tax rate on long-term capital gains from the sale of stocks held for more than a year.

Proponents of that plan argue that singling out the rich won't do much to improve Uncle Sam's coffers because the wealthiest simply find ways of not paying taxes.

Mr. Busch, who's in favour of extending the cuts, pointed to the example of John Kerry, the U.S. senator and former U.S. presidential hopeful, who docked his yacht out of his home state of Massachusetts to save on his tax bill.

Meanwhile, Warren Buffett, Bill Gates and a growing list of other billionaires are avoiding big tax hits by giving away half of their wealth to charities.

Critics of the proposed tax hikes say small business owners with wealth of US\$250,000 or more don't have that luxury.

In his speech, Mr. Geithner lauded the "sound fiscal policies" under U.S. President Bill Clinton that led to big surpluses and important investments in the middle class, which helped contribute to a period of strong growth and job creation.

"After that, Washington changed course, abandoned the basic disciplines of budgeting, and borrowed to finance expensive tax cuts skewed towards the most affluent, and a significant expansion of Medicare," the Treasury Secretary said. "The result was a huge increase in our debt burden, relatively slow job growth, and stagnation in incomes for the middle class. We are living today with the damage caused by those choices."

While lawmakers might end up extending the cuts and putting off any decision until next year, the future of the broad tax cuts is far from clear.

Lawmakers will be under increasing pressure to raise taxes and cut spending to grapple with the country's spiraling deficit.

"At this time if you raise taxes, it will probably be a drag on the economy," said Peter Morici, a business professor with the University of Maryland. "Obama's just getting by trying to raise taxes on upper income Americans because it fits his ideological view...But raising taxes on these people is not going to help at all."

Longer term, the United States will have to tackle the high cost of its healthcare system, which despite reforms passed by President Obama this year, remains the most expensive in the world, said Prof. Morici.

The United States spends 18% of its economic output on healthcare, compared to 12% for Canada, he said. "Sooner or later someone's going to have to do the math in the White House...If this country paid four times as much for electricity than other countries, we would have a problem. Paying 50% more for healthcare is the same problem."

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