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Choosing fantasy or facts

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Have you noticed that many politicians who have trouble dealing with reality also seem to prefer fantasyland when dealing with budgets?

Those on the left never stop claiming that problems will be solved if only tax rates are increased. Why then does California, with its 10.6 percent state income tax rate, have a huge budget deficit and a 12.2 percent unemployment rate, while Texas, which does not have a state income tax, enjoys a budget surplus and a below average unemployment rate of 8.2 percent?

Why then does nearly bankrupt Rhode Island with the eighth-highest overall state tax burden in the United States, including a 7.75 percent income tax rate, have a 13 percent unemployment rate, while South Dakota with the fourth-lowest state tax burden and no state income tax, have virtually full employment with only 4.8 percent unemployment?

New York politicians have been living in political fantasyland for many years. Upper-income people living in New York City have faced the highest state and local income tax rates in the country (over 12 percent). Recent studies show high-income earners are in mass flight from New York to friendlier tax environments. The rational thing for New York politicians to do would be to cut tax rates to make New York more competitive; but no, they increased taxes on the top earners (many of whom continue to pack their bags).

It is not only politicians who live in fantasyland, but others as well, such as some labor leaders. The new (in office since January) Republican governor of Puerto Rico, Luis G. Fortuno, inherited a budget deficit of $3.2 billion, which is larger than any state budget in the United States on a per capita basis.

For many years, Puerto Rico has suffered from bloated government with five times as many government workers per capita than California. Seventy percent of the budget goes for government salaries and benefits.

Mr. Fortuno has had little choice but to take drastic action to keep the government from going bankrupt and losing its credit rating. He has already laid off 4,000 government employees, and he plans to lay off another 17,000 this week.

As would be expected, the Service Employees International Union (SEIU), who brought on a good part of the crisis through its excessive employment and wage demands, is now trying to prevent the governor from doing what is needed.

The SEIU has yet to learn that a parasite that kills its host soon finds it has no place to live (work) - just ask the auto union. Unlike the governor, the SEIU and the others continue to live in fantasyland, ignoring the fact that the cookie jar is empty.

Vice President Joseph R. Biden Jr., who has a long history of confusing facts with fiction, this past week added to the administration's claim that "nearly 650,000" jobs have been created or saved by the stimulus package. He said the recovery plan "is operating as advertised" and is on target to reach the president's goal.

In reply, the highly respected economist, Alan Meltzer, who has a long history of being able to distinguish between facts and fiction, said: "The administration can make up any number it pleases. The number has no meaning. The Council of Economic Advisers gets a number for jobs saved using the same model that Dr. Christina Romer and Jared Bernstein used when they forecast that the $787 billion stimulus program would keep the worst unemployment rate in this recession at about 8 percent. But as we all know, since that bill became law, our economy has shed some 3 million jobs and the unemployment rate is nearing double digits."

Ironically, the Obama administration and the politicians who run New York, California, etc., may ultimately help Mr. Fortuno by driving many of their highest-earning and most productive citizens to Puerto Rico.

Mr. Fortuno has made it clear that he believes the key to solving Puerto Rico's economic problems is to reduce the size of the government and take its foot off the windpipe of the private sector. He told me at a breakfast meeting last week that he wants to reform the tax system and reduce rates for everyone.

Any American citizen (which includes all native-born Puerto Ricans) who resides in Puerto Rico pays income taxes to the Puerto Rican, not to the U.S., government. The maximum income tax rate in Puerto Rico is now 33 percent, just a couple of points lower than the U.S. federal rate.

But if Mr. Obama succeeds in raising the maximum federal income tax rate up to the 50 percent range (by letting the Bush tax cuts expire and increasing "surtaxes" to fund his health care and energy schemes), and if the high-tax states continue to raise their rates so the total burden on upper-income people reaches 60 percent or more, Puerto Rican residency is going to become increasingly attractive.

At the moment, most who flee the high-tax states go to states without an income tax like Texas, Florida, and so on, but they still have to pay the federal income tax. Thus if Mr. Fortuno is able to reduce the maximum marginal tax rates in Puerto Rico to the mid-20s, many job-creating entrepreneurs are likely to make a beeline toward what will increasingly be an island paradise, where tax rates will be half of what they are on the mainland.

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