

Cover Story · Vol 26 · [Issue 1260](#) · PUBLISHED 1/26/2005
URL: www.citypages.com/databank/26/1260/article12879.asp
HOME: www.citypages.com

Everything You Know About Taxes is Wrong

Pulitzer Prize-winning reporter David Cay Johnston talks about the retooling of the tax code to serve the very rich at the expense of the middle

by Beth Hawkins

Investigative reporter David Cay Johnston has spent his entire, storied career trying to prove that there's a better way to write about topics most reporters find too tricky or complex or too dull to interest readers. As a reporter for the Los Angeles Times, he was among the first to expose mismanagement, inefficiency, and brutality in the Los Angeles Police Department. He went on to rout out the misuse of charitable funds at the United Way in Los Angeles and Washington, D.C., and to document New Jersey's fraudulent system of casino regulation, among other stories.

In 1995, tired of reading stories by other reporters who covered the U.S. tax system by writing about what politicians said instead of how the system actually operates, he talked the *New York Times* into hiring him. In the 10 years since, Johnston has demonstrated, amply and relentlessly, that there is indeed a better way to cover taxes. His stories have forced the closing of so many dodges and loopholes and the creation of so many new laws and regulations that he's been nicknamed "the de facto chief tax enforcement officer of the United States." He won the 2001 Pulitzer Prize for beat reporting, and has been a Pulitzer finalist three other times since 2000.

Last year, Johnston published the fruits of all that prize-winning reporting in his book *Perfectly Legal: The Covert Campaign to Rig Our Tax System to Benefit the Super Rich--and Cheat Everybody Else*. A bestseller and the winner of a 2004 Investigative Reporters and Editors award, the book documents how, over the last three decades, the tax system has been twisted to subsidize the wealthiest 1 percent of the country. Johnston recently talked to *City Pages* about the book, the damage this reverse Robin Hood scheme is doing to the other 99 percent of Americans, and about the perils posed to democracy by the growing inequalities of the system.

City Pages: *Since the publication of "Perfectly Legal," you've been talking to people throughout the country about taxes, a notoriously complex topic. Do people understand what you have to say?*

David Cay Johnston: They grasp the principles of it, yes, and the fundamental point that we are shifting the burden of taxes. People bring their own lens to these things, and a great deal of what people think about taxes, whether they are right, left, populist, reactionary, radical, is based on their viewpoint. And one of the clearest effects is that I've had people of all different political views, after reading the book, write to me and say that that caused them to open their eyes and see things in a new way, which is what I set out to do.

And because the book is not ideological, it is factual, different people come to different interpretations of the book, of what it means to them. Not everyone agrees, for example, that it's a bad thing to shift the burden of taxes. And that's why in the paperback I emphasize something I should have in the hardback, and that's that the most conservative principle in western civilization is taxation based on the ability to pay. Because that is the principle that led to the creation of Athenian democracy. Plato, Aristotle, Adam Smith, the father of capitalism, David Ricardo, John Locke, John Stuart Mill--every single one of the worldly philosophers has concluded over 2,500 years that taxes should be based on the ability to pay. I meet all sorts of people who think that Marx thought this up, or FDR, and they are very ahistorical about it.

CP: *You cite a number of the super-rich who agree that taxes should be based on one's ability to pay.*

Johnston: Sure. Lots of very wealthy people understand. I mean, the stuff I have about Warren Buffett [saying] nobody in their right mind would pick our Olympic teams based on the sons of gold medal winners in previous Olympics. But without an estate tax, we're saying we're going to have control of our economic resources determined by who your parents were.

Now, there are also a significant number of wealthy people who either don't want to pay taxes, want to pay a lot less, and who are promoting an agenda that is entirely self-interested. And I don't have any problem with self-interest. I think that self-interest is a very motivating force. But that's why you have social controls on self-interest. The model of the cancer cell is growth for growth's sake, no matter what. And you don't want growth for growth's sake, you want growth for society's sake.

CP: *It would seem that at a certain point, impoverishing the middle class would begin to backfire, to work against the super rich. How far do you think our political leaders and the politically active super rich you describe as the donor class can go with this shift of wealth?*

Johnston: I argue at the very end of the book that in the long run, the super-rich, top one-hundredth of one percent, will be poorer if everybody else is. Because the value of your assets is going to be less if the society around you is not healthy and is not able to buy your products. Just look at the amount of money we're spending on security in all different forms, not just federal spending, but police departments, building security, etc. that's dead weight. It's a kind of tax on the economy. And in a healthier society you would have a lot less crime, a lot less money spent on security, and you'd be a lot better off.

So there is an interrelationship here and, you know, we are a society. You know this faux libertarianism? "I did it all by myself." No you didn't, the public educated you, the taxpayers built roads and highways and a court system and a structure of laws and then you, through your initiative, did very well for yourself within that context. But you didn't do it all by yourself.

And the idea that you don't have any moral obligation? In ancient Athens there was a flat tax, and when the Athenians had a flat tax, Athens was a tyranny. That's where we get the word from. When the moral philosophers of Athens reasoned that those people who got the greatest economic benefit from living in Athens had the moral obligation to bear the greatest burden of maintaining the society that made them rich. That is, when they invented taxation based on ability to pay, they also invented democracy. The two ideas are totally intertwined. And we are not the United States of Me or the United States of You. We are the United States of America, we are a society.

CP: *This same shift of the tax burden is occurring in Minnesota, too, and one effect critics are predicting is that the resulting budget crunch is simply shifting many costs onto the residents of central cities. Slashing public health spending, for instance, has propelled more uninsured people to public hospitals. Do people catch on to this eventually or do the architects of the shift just continue to get away with it?*

Johnston: I want to challenge the assumption behind your question. You know that there have been very good mapping studies done about the cost and benefits of, say, extending water lines from St. Paul to the suburbs, and they show how the inner city in effect subsidizes the outer rings. I think I read them 15 years ago. They were the first really good mapping studies using graphical mapping technologies and they were about, as I recall, St. Paul. They might have been about Minneapolis and St. Paul, but St. Paul anyhow. They showed without question that in the area of water and sewer the inner city residents were subsidizing the new suburbanites.

Economic shifts, whether they are people gathering in the central cities or moving to the suburbs, the exurbs, are driven by the rules the government sets, and people's view of their self-interest under those rules. And so it is not writ in stone that inner cities have to be loaded up with poverty and taxes, and suburbs can have affluent people and lower taxes. It's just the way we've organized the rules. Maybe that's the most efficient way to organize the rules and maybe it's really a very inefficient way to do it.

We have a tax system right now that rewards certain kinds of behavior and not others, and guess what? We get certain kinds of behavior and not others. For example, if you are the CEO of a multinational company if you're not moving jobs off shore you ought to be fired because you are not doing what the government's rules are telling you to do. Now, nobody announced that. No member of congress got up and said we have adopted laws and rules the net effect of which is you should be getting rid of American jobs and creating jobs offshore and taking profits offshore and disinvesting in America. But that is the net effect of what those rules amount to.

And that's where journalism is important. In identifying what isn't announced and in telling you what's really going

on. And some people call these ooze stories. Nobody announces them, they just sort of ooze.

CP: *I have a hard time imagining local newspapers hiring tax beat reporters such as yourself.*

Johnston: One of the reasons newspaper readership is declining is that newspapers are full of a lot of fluff, and one of the first things I say in lectures to journalists when we talk about taxes is look, if you cover a local government or school board or whatever, homeowners want to know first and foremost are my property taxes going up or down? And the government's probably going to give you a thing saying, "The average value of a home in our district is \$127,500 and that homeowner's bill will go up or down by so much." Which is meaningless to me if my home is 130 percent of that amount. So you turn it into what it is for \$100,000, or for \$10,000 or per \$1,000 or in percentages, so you can grasp what should be happening to your tax bill.

Journalism needs a real back to basics movement, and a lot less of this cheap, canned material from Hollywood—which movie star is sleeping with which movie star.

CP: *One of the most astounding chapters of your book described how middle-class taxpayers are making up the cost of Bush's tax cuts via a little-known mechanism called the Alternative Minimum tax. Can you briefly explain this sleight-of-hand?*

Johnston: President Bush wanted a \$1.8 trillion tax cut. Congress would only give him \$1.3. How do you fit \$1.8 trillion into a \$1.3 trillion bag? You do it by a stealth tax increase on the middle class and the upper middle class. By integrating into the regular income tax a parallel universe of taxes called the Alternative Minimum tax. Which appears as only a single line on your tax return. You'd have to look on your tax form to see whether it's line 42 or 43, but if a figure appears in that line, it means that part of your Bush tax cuts is being taken away so that the richest people in America can get 100 percent of their Bush tax cuts. If you are married, have two or more children and make \$75,000-\$100,000 you are almost certainly losing part of your Bush tax cuts. Overall that group will lose 42 percent of their tax cuts to the stealth tax.

But worse, under the Alternative Minimum tax if you, your spouse or your child gets a serious illness like cancer and you have medical bills that are more than 7.5 percent of your income, Congress raises your taxes, through this stealth tax, and explicitly uses that money to finance the tax cuts for the super rich. So it is the tax policy of the United States to tax sick middle class people so that rich people can pay less.

More than 100 members of Congress since I exposed this have denounced it, but nobody's fixed it, and President Bush's spokesman has said that that is what he was elected to do.

CP: *Given some of the fixes cited in your book that actually made things worse, perhaps we should be scared to allow them to fix it for fear it will open another tributary that will trickle up.*

Johnston: Well, keeping the bad out of fear of the worse is, I think, not good policy. If the news media would return to its roots of skeptical questioning, we wouldn't have things like this in the law. But you know there is a whole movement in this country to attack honest journalists who point out what's simply on the record if it disagrees with the line of the party currently in power. There's a whole industry now to formulate these dishonest attacks, and even when subsequent news events come along to show that the attacks were baseless there's no withdrawals or apologies by the people who make these attacks.

I've been the subject of some of these, where people have fabricated quotes and attributed them to me, they have misquoted what I said, and they have denied in writing what they themselves have written to denounce me in national publications. So I've had some personal experience with this. And the utter lack of integrity of these people is just mind-boggling.

But we will not get better tax policy until people have a better understanding of it. Despite all of the rhetoric by both political parties about family friendly tax policy, the fact is that you are 30 times more likely to lose part of your Bush tax cut if you are married and have children than if you are single. Now, I am not arguing here that single people should pay more in taxes or that married people with children should pay less. What I'm arguing is that the rhetoric of

the politicians and the reality of the tax code bear no resemblance to one another.

CP: *So how is it that you are able to do the investigative reporting you do?*

Johnston: I became a journalist when I was 17 years old because it was a way up out of poverty. My dad was a 100 percent disabled veteran of WWII, so you can imagine the circumstances I grew up under. One of the very first stories I wrote was an investigative piece and I've been doing investigative work my entire life. I try to look at big issues that I don't think are being well covered and then cover them. So years ago I did utility regulation and health care economics and the Los Angeles Police Department and charities as hard news.

Taxes was just one of the big issues I looked at and said, boy this is just not well covered at all. At the beginning, except for the managing editor of the *New York Times* at the time, the guy who brought me in, nobody thought this was an idea worthy of attention. And he had doubts as to whether I could do what I said I was going to do. But you know, a good journalist, all you have to do is take a subject and learn the principles of it, and the mechanics of it pretty much follow through.

CP: *Another complex topic you render understandable in your book is how Social Security has been used to underwrite cuts for the wealthiest taxpayers. Given how hard Bush leaned on Social Security to finance those tax cuts during his first term, is his plan to privatize it going to come back to haunt him?*

Johnston: None of the news coverage of social security is addressing how it is a subsidy program for the super rich, none of it is addressing that President Bush is not being internally consistent when he says I want you to have more of your own money. Why isn't he simply proposing that we reduce social security taxes by the amount of money he thinks younger workers shouldn't pay, and then they can choose whether they want to spend it, which would stimulate the economy, or save it, which would stimulate long-term investment? Instead, why is he proposing to create a massive, new government program that will funnel fees to Wall Street? None of the news coverage is stepping back and asking that. It's all reactive to what the president is saying. I think that's in good part because the Democrats don't have a clue. The Republicans have an agenda and the Democrats don't have a clue.

Now, the reason the president would not propose letting younger workers pay a reduced social security tax in return for smaller benefits is that it would immediately expose that the financing of his tax cuts depends in good part on middle class workers paying excess social security taxes so that rich people can have lower income taxes. It would bring it right to the front of the budget debate. So they would never propose that.

CP: *Besides which, privatizing Social Security will have huge benefits to the financial services industry-- the same donor class that's benefiting from the shift.*

Johnston: One of the salient features of Mr. Bush's social security proposals is that the big brokerage houses and mutual fund companies, who have been major sources of campaign contributions, would earn huge fees as a result of the president's proposal. And this is a perfect example of how the political donor class shapes government to benefit itself rather than the general welfare.

CP: *And this political donor class continues to push this upward bubble with every tax reform.*

Johnston: Yes. The steady trend of tax changes in the United States-- I argue starting in 1983, that's the year I picked, although you can make some arguments for 1981--has been to shift the burden of taxes off those who are the greatest recipients of the benefits of society and onto the middle class and the upper middle class. And we've seen during this era this explosion of income at the very top that is not taking place in any other advanced economy. Now, taxes are not the only reason for this, but they are clearly a very important factor.

CP: *You point out in "Perfectly Legal" that many of the tax mechanisms used to effect this shift are not available to you and me.*

Johnston: Many of the devices that very wealthy people use to defer or avoid taxes are not available to middle and upper middle class people either as a matter of law--only the rich are allowed to use them--or the transaction costs

are such that unless you've got millions of dollars, you can't do it. Very wealthy people are allowed to have what amounts to unlimited 401k plans. Middle class people can only save \$14,000, or if they are over 50 years old, \$18,000. I show in the book that while these unlimited plans are theoretically riskier—if the company goes broke you lose your money—the reality is that in 10 companies that went bankrupt that I studied the bankruptcy records of, the executives all got 100 percent of their money. It was the works whose 401k plans were all wiped out.

I went to the University of Chicago Graduate School of Economics. I am not an economist, but that's where I studied. And one of the very first things they pound into your head there is that there is no such thing as a free lunch. And so if you are a corporate executive, flying in a corporate jet virtually for free, somebody's really paying for that jet. And that somebody is the shareholders of the company and the taxpayers.

CP: *Given that we're virtually all shareholders now, and we seem to understand that equation better than we understand the tax equation, so you think this is where the revolt might start?*

Johnston: Maybe. I think one of the biggest problems America faces is the broad level of prosperity. There is literally a survey that shows more people can name Jennifer Lopez's lover than their congressman. And so long as large numbers of people feel that they're doing just fine economically, even if they have enormous risks that could wipe that all away tomorrow, they don't look at the risks, they look at their status right now, I don't think there's going to be a lot of political support to examine the tax system's socialist redistribution effect of taking money from the middle class and funneling it to the super rich. It's not intuitive and while it's unquestioned that the system is doing that, I have both right and left-wing economists who have sat on panels with me and don't dispute my data, because it's the government's official reports, it's not intuitive and I'm pretty much a lone voice out there pointing this out. I mean, there are some other people but there's no big mass movement for it.

We live in a society in which we have prospered so much and changed so much over the last half century that it's had a fundamental effect on democracy. Neil Postman, who died recently, wrote a really terrific book called "Amusing Ourselves to Death: Public Discourse in the Age of Show Business," in which he argued that without even realizing it we are giving up democracy because we are so busy with all of the entertainment possibilities in front of us. You know, television, sports, etc. In his really important book "Bowling Alone: The Collapse and Revival of American Community," the Harvard professor Robert Putnam argues that we are no longer engaged in the same kind of social interaction we used to be. Instead of bowling in leagues, people go bowling alone is his model example.

Back when one third of workers belonged to unions, 80 percent of workers benefited from that. Because there were many employers who paid union or even above-union wages to keep the union out. And if you were a manager at General Motors or some big company like that, even though you are not in the union your pay was set by the union. And now the union is back to maybe one in eight private sector jobs—some small number like that, you can look up the statistics. What's happened? Well, wages have been falling. America is the only country in the world that is pursuing a low-wage strategy.

CP: *Another favor to the donor class.*

Johnston: That's exactly right. We've lowered taxes on the rich, and to the extent that the rich own businesses we've lowered labor costs. In 1970 the bottom third of Americans [as a group] had 10 times as much income as the super rich, that's the top one one-hundredth of one percent. By the year 2000, they were equal. The super rich's income had exploded, and the bottom third's income had fallen. So literally, the rich are getting richer and the poor are getting poorer.

Now, if a rising tide were lifting all boats, this wouldn't be a concern. That is if everyone was getting better. But they're not better off. We're spending more and more money dealing with social pathologies, with people who don't have a sense that they have any future through education and hard work. We are seeing the super rich separate themselves from the rest of us. They fly in private jets, they live in gated communities, they have police departments that stop people that don't have new cars driving down the street.

I can remember literally being stopped by the cops when I was a reporter for the *LA Times* driving in Beverly Hills because of my car. Little Richard tells the story of running out of his house to his mailbox. In Beverly Hills that

mailboxes are all on one side of the street so the mail man just goes down one side of the street; they don't go to the door and put the mail in. so he ran to the mailbox in his flamboyant pajamas one morning he was literally arrested by the police who wouldn't believe that he lived there, on that street. He's told this story on national television.

Combine that with the tax cuts, which have come at a time when we are awash in capital and no demand. For 25 years we have toyed with this idea of supply side economics? Well we now have an enormous supply of capital and a shortage of demand. And a lot of the money that's been freed up by the government's tax cuts is being invested offshore. Now, if you look at the data right now, about how many jobs are going offshore, you can reasonably say it's not so many jobs. It's not that big a deal. If you look at how much money was being taken to offshore tax havens in 1990, that's 15 years ago, you'd say, "Ah, it's one percent, who cares?" Today it's 17 percent at least. When we get the data for this year it may in fact be over 20. You have to look at the trend line, and the trend line is that investment capital is moving out of the country.

There are major U.S. corporations that have a negative net worth in the United States, but that have a substantial net worth. These are U.S. companies. They have all of their net worth offshore. Jobs go where the investment goes. And at the same time, because we've narrowed the tax base, you know the amount of money and the kinds of money we're taxing has been cut back since 1986 and the tax rates have been lowered, we have less money for all sorts of things.

I don't know if you are aware of this but there is a growing argument being made among the radical right to end public education because, like social security and like Medicare, that's socialism. If you want your child to be educated you should pay for it directly out of your own pocket, goes the argument. On the one hand you can say, "Oh this is a fringe movement and there's no broad political support." Well, nobody would have thought you could have the kind of tax cut or social security changes Bush is proposing 15 years ago. I find it frustrating going to buy items at a store where the clerks can't even operate a cash register with numbers on it, so they have to put picture symbols on them. Imagine a world that's that illiterate.

CP: *This gets at an interesting point: Tax cuts are a terrific excuse for starving social services and other so-called bureaucracies out of existence.*

Johnston: There's a theory called starve the beast, that the only way to change the government is to cut off the revenue for it. Edmund Burke, in his 1793 letter, which is the founding document of the modern conservative movement, famously said the revenue of the state is the state. If you want to get rid of programs that you regard as inappropriate—social security, Medicaid, Medicare, public education, public health, arts, humanities, and probably for that group corporate welfare and agricultural subsidies—then one way to do that is to strip the government of revenues.

You're not going to outright kill the fundamental law enforcement agencies of the federal government; the FBI, the Securities and Exchange Commission, who are the Wall Street cops, the IRS, who are the tax cops, etc. etc., but you can hollow them out until they are insignificant and they have almost no ability to police the political donor class. And lo and behold, as the SEC has become smaller and smaller relative to the size of publicly traded companies, what have you seen but an explosion of corporate corruption?

There have been some famous big trials, but you think that they are catching and arresting every one of these guys? No, they're catching a handful of examples. There's a theory to this. It's called general deterrence. You arrest a handful of people and make a big show of it and it's supposed to deter everyone else's behavior. Well, that might be a perfectly rational policy as it applies to things like the middle-class taxpayer; if you're a middle-class taxpayer and you think there's a good chance the government might prosecute you, you're more likely to file an honest tax return. But if you're a financial sociopath who's worked his way up to being CEO of a major company it's not going to deter you.

I heard President Clinton at the Democratic National Convention saying, If you agree with these people you ought to vote for them. If you don't agree with them, you've got to recognize they really believe this stuff. A really fundamental important point to understand is that these people are not intellectually corrupt. I think that's a major mistake people make in looking at this. And it plays into this division that we have going on about whether you're red or blue or liberal or conservative. I mean, I can show you reviews of my book that say that I am a populist, that I am a

classic conservative, that I am a progressive, that I am a liberal Democrat. I'm glad to see that, that's good. I'm not an ideologue. If anything I am a professional skeptic.

CP: *I've spent a lot of time recently contemplating how cleverly Bush was to frame his agenda as the creation of an "Ownership Society." Our popular culture is so steeped in this nomenclature: I constantly hear people say everyone should take ownership of their own problems.*

Johnston: The fact is, there is not enough wealth in America for everyone to live off of owning assets, most of us have to work. One of the things I hope you make clear is that I want to see an America in which more people are wealthy, in which there are more millionaires, there are more billionaires, and there are more thousandaires. I think that we can be a wealthier society. But the rules that we have created are funneling all of the gains to a very narrow group of people. It is not just through their hard work. A lot of them got there by luck, by corruption, or by simply writing the government's rules.

According to the latest version of "The State of Working America," 2004-2005, which you can get from the Economic Policy Institute in Washington, D.C., average hourly wages in 1973 for men with less than a high school education, have fallen from \$13.83 in 1973, this is adjusted for inflation, to \$11.04 in 2004. Now, that's a decline of \$2.79, which is about 20 percent. You can do it with a calculator and figure it out. If you have a high school education, \$16.39 fell to \$15.07. That's about 9.5 percent. Some college \$16.76 to \$17.03—so they've gone up about .40, or 3 percent. College degree: \$22.62 to \$26.63. That's about a 20 percent increase. Advanced degrees: \$25.12 an hour to \$33.13 an hour. So people with advanced degrees after 30 years are only making one third more.

All of those numbers scream: where is all the increase going? It's going to capital and to the very top. And there are now some analyses of the official Chinese government statistics which, I know you'll be shocked to hear are biased to make things look better than they are, and what they show is that when you add up the net gains after all of the foreign investment in China—you know by American companies and Germans and everybody else, the Japanese—and you deduct the losses, because for instance when you open a Wal-Mart in China and 400 little two-bit family businesses go out of business, that were neighborhood merchants selling you things, there's a gain and there's a loss, right? When you add up the net gains and losses as listed in the official Chinese statistics, more than 100 percent of the benefits are going to the managerial and ownership classes. It has not raised the overall standard of living in China. Isn't that astonishing?

CP: *It kind of puts the lie to the idea that India and China are going to step forward and buy all these goods that, because of this massive shift in wealth, Americans can't afford any more.*

Johnston: As Warren Buffett has pointed out, we're basically selling 2 percent of America's assets each year to foreigners to prop up our consumption. We want a consumer society, but we don't want people to make enough money to be able to afford to consume. So that's why we have all this static. The number is in my book somewhere about the percentage of family who've gone bankrupt in the last 10 years—it's one in eight or one in ten or something like that?

IRS data show that from 2000 to 2002, incomes fell in real terms, inflation adjusted terms, across the board. The biggest declines were at the very top; the number of people making \$10 million or more fell by about half. But in the middle class income groups, from \$25,000 to \$100,000, incomes over the two-year period fell by at least 4.5 percent on average. This is the first time this has ever happened for two years in a row. There are two other one-year periods when it happened. All of the statisticians agree that one of them is because of a change in the way they gather data. The other one is from 1953 to 1954, there was a very slight decline overall in incomes. It's never happened two years in a row.

We don't have the data yet for 2003, we'll get it later on this year in May or June, but when it comes out I expect it will likely show that we certainly have not recovered to 2000 and we may still be down. Mr. Bush is going to end his first term with America having about 100,000 fewer jobs than it had when he took office. Because the population has grown we should have added about 7.2 million jobs. So we're down more than 7 million jobs from where we should be for population growth.

Cover Story · · Vol 26 · [Issue 1260](#) · PUBLISHED 1/26/2005

URL: www.citypages.com/databank/26/1260/article12879.asp

HOME: www.citypages.com

City Pages is the Online News and Arts Weekly of the Twin Cities