

Happy year of the Dragon!

On the Chinese calendar, 2012 is a very auspicious year. On the American calendar, 2012 is a national election year at which taxes will be the fodder for the political skirmishes, if not for the outright war, that has been conducted these last many months and will continue at least until November.

For this letter, I've struggled more than I usually do to put the events of 2011 into a framework that makes it possible to map where we are and where we are likely to go. Where we have been is fairly clear: we have been fiscally irresponsible at both the federal level and state levels. The last balanced federal budget was 12 years ago under Clinton, when tax inflows and government expenditures balanced on the positive. Since then, two unfunded wars and tax reductions proposed by President Bush and passed by the Congress have left the country trillions of dollars in debt.

In 2011, the battle lines over taxes got much more entrenched. The Tea Partyists said no not only to more taxes but also to more borrowing and held on until Wall Street made clear that defaulting on our borrowings might dramatize the direness of the budget situation but would do so at the cost of a major drop in the stock market. Not the best maneuver for the party that strongly favors wealth development. At the end of 2010, President Obama traded an extension of the Bush tax cuts for an extension of unemployment benefits and for a payroll tax cut of 2%. The 2011 payroll tax cut reduced the payroll tax on wages of \$50,000 by a \$1,000 and by up to \$2,120 on higher wages. The theory behind this trade off was that the extended unemployment and the 2% payroll tax cut would be stimulative, giving those households who spend everything a bit more money to put back into the economy. In the wrangling that led up to the passage of the payroll tax cut, it turned out that some members of congress had not only taken an oath to serve the Republic but also have made a pledge to a private individual, Grover Norquist, not to raise taxes under any circumstance, presumably even if it conflicted with their oath to uphold the Constitution and their duty to preserve the good faith and credit of the nation.

While the Tea Party members had the spotlight from early on in 2010 for, in Obama's words, the unexpected shellacking that they gave the Democrats, it was the Occupy Wall Streeters that were in the spotlight by the end of 2011. Casting the tax struggle into a 1% versus the 99% provided a rallying point for a goodly amount of pent up frustration with a tax system that is clearly riddle with special provisions that give tax breaks that don't benefit the larger taxpaying public. While there might be surface agreement that the tax system needs to be modified, there is little likelihood that there will be a revision of the tax code anytime before the November election. The willingness to make any changes

only goes as far as the changes that each of the camps want- the battle again being whether continuing the cuts for the wealthiest 1-plus percent creates more jobs or whether jobs are created by the distributed spending of those of us who are part of the greater mass of taxpayers.

We can't just tear up the national credit cards, in effect freezing our debt, without major disruption that will likely further devalue the kind of assets most of us have, namely our homes and investment or retirement savings. On the other hand, we can't go on the way we have been. Reducing the size of government seems attractive until we realize that massive layoffs of teachers, police, firemen and other governmental workers increases the level of unemployment and results in less folks being able to afford the goods and services that make the economy healthy. Most of us support limiting further unessential spending but it becomes contentious when we try to define what is unessential. Federal and state budgets would have indisputably been more in balance had there been no tax reductions at the higher income levels. So wouldn't the first step be to reverse those reductions as part of, if not the entire, solution to the fiscal imbalance? With that additional revenue, wouldn't the next step be to put in place targeted reductions or if no agreement can be reached, then across the board reductions that would bring the budget into balance, if not in one year, at least in three or four years?

That appears to be the approach Governor Brown seems to be taking in California. Major cuts will certainly have to be made if we, the electorate, do not approve an increase in state income taxes at the higher income levels as well as an increase in sales taxes that more heavily impacts lower income taxpayers. We in California will have a say in whether taxes should be increased, at least temporarily, to avoid drastically curtailing the amount of funding available for education (whether at the pre-school, childcare level or at the post secondary level) or for other social services that many fully depend on. We may not be so lucky at the federal level where the composition of the next Congress will determine what gets done first: eliminating the deficit or preserving the services of a modern democracy.

There are ideological walls that have proved nearly impossible to breach. It is unlikely that 2012 will bring final resolution to thorny questions like how much money should a 21st century country make available for Medicare or for universal health access. It is easy to forget that since late 2008, we have survived, albeit with less than we had before, a stock market devaluation of 40%, a bank liquidity crisis and the potential loss of the auto industry. So perhaps what the year of the Dragon will bring us is the good fortune to survive 11 months of campaign rhetoric and to take steps towards fiscal stabilization that does not make those who have the least alone pay for what those who had the most happily received. What politicians seem generally to forget is that incremental progress often gets you there more solidly than a rush to corrective steps that may have very unpleasant side effects for the larger populace. All the best to you in 2012.

A handwritten signature in cursive script, appearing to read "Jack".