that value by $10. Every dollar of income released by tax reduction increases the value by $10. Thus accountants know that an increase in the tax assessment of a property has an automatic 10-1 negative impact on value.

Think of the economy as a single business with both fixed and working capital on which an income stream is earned. To the degree that taxes on that business rise and fall, the income stream is lowered or raised. Thus the capital value of that business falls or rises at the nation's effective price earnings ratio, which on corporate bonds is about 10 to 1.

New Taxes Kill Prosperity

A $30 billion tax increase on the economy may not seem like much in a $5.5 trillion GNP–but its real impact is a $300 billion "tax capitalization" of the asset base of the nation. Since the nation adds less than $300 billion a year in net new investment, such a tax increase effectively destroys an entire year's capital growth.

That is why President Bush and Congressional leaders are now playing with economic dynamite. Not only will a $30 billion tax increase generate a likely $40 billion rise in spending, it will kill ALL capital expansion for at least a year and send the stock market down by at least 300-500 points.

This is why Bush was so right when he told a Republican audience in Boston in 1987, "There's no quicker way to kill prosperity than to raise taxes." In Chicago on September 13, 1988, he told a national audience of business leaders and economists, "The surest way to kill the recovery is to raise taxes. That will stifle everything from investment and personal savings to consumer spending. It will clamp down on growth. It will invite a recession."

But now Bush is equivocating. The spring 1990 budget summit was clearly intended to explore all options, including raising taxes.

Warren Brookes is an award-winning syndicated columnist for the *Detroit News* whose articles appear regularly in the *Wall Street Journal, Reader's Digest, Policy Review* and approximately 50 daily newspapers nationwide. The author of *The Economy in Mind,* published in 1982, he specializes in looking at the economic side of political and social issues. The well known annual *Media Guide* has given him four stars every year, making him the only journalist to earn that distinction.

A Tale of Two Massachusetts

No wonder Massachusetts Governor Michael Dukakis, wallowing in the slough of his own 83 percent negative performance despond, with a $2.3 billion 18-month deficit yawning before him, suddenly cheered up and flew to Washington to gloat that Bush's "no-tax" pledge had been "a fraud."

The governor is unusually well-equipped to identify such duplicity. In 1974, he ran on a similar promise that it was "a lead pipe cinch" that he would NOT have to raise taxes in 1975. But of course he did, passing the largest tax increase in state history, some $500 million. That broken pledge cost him dearly in the 1978 Democratic primary, when a political neophyte conservative businessman named Ed King threw him out in a shocking landslide upset–running on the explicit promise to roll back the state's highest-in-the-nation property taxes, à la Proposition 13 in California of which Dukakis had said, "the people of Massachusetts are too smart to fall for a dumb idea like that!"

It seems no accident that in the middle-and-working-class communities where property taxes were two and three times the national average, King won pluralities of 15-20 points. In the affluent communities where taxes were at or below the nation, Dukakis scored his only majorities.

Before President Bush makes any deals with the Democrats for higher taxes in return for modest budget reforms or alleged spending cuts, he would do well to study and learn from the Dukakis/Massachusetts experience. It demonstrates the direct connection between taxation and economic growth–between political capital and economic capital. Taxes, he will discover, have not merely a direct but a powerful multiplier effect on both.

During the 1970s when the Massachusetts tax burden as a percent of personal income suddenly soared by 25 percent from about the national average to fifth highest in the nation, its average real personal income growth suddenly plummeted from 91 percent of the U.S. level to 57 percent.

By contrast, during the 1980s when the Massachusetts tax burden fell over 17 percent, to five percent *below* the nation, its real personal income grew nearly 45 percent *faster* than the nation's.

To put it in another way, from 1970 to 1978, when it became "Taxachusetts," the Bay State fell from 33rd in growth rate among states to 47th, and its per capita personal income fell from 10 percent above the nation to less than two percent above–while its tax burden jumped almost 25 percent.

By contrast from 1978 to 1983, while its tax burden fell 17 percent, it rose from third slowest growing in the nation to third fastest, and its per capita income rose from three percent above the nation to 14 percent above it–the largest and fastest turnaround in U.S. history, from the Taxachusetts Swamp to the Massachusetts Miracle in only five years.

From Fiscal Restraint to Spending Boom . . .

Sadly, it is now all too clear that Mike Dukakis had no idea what caused this turnaround or he would not have fought it at every step and then so willingly risked squandering it the way he did.

In June 1984, a booming and fiscally flourishing Massachusetts had its bond rating raised to AA. The same month, the state manufacturing base rose to 684,000 jobs, the highest level since the late 1960s in a state whose economy was literally exploding, after surviving the worst U.S. recession in postwar history with surprising ease. State revenues were growing at a 12-14 percent annual rate, 30 percent faster than its spending level, and unemployment was dropping by the month.

Unfortunately, that huge revenue surge merely encouraged a newly re-elected and rejuvenated Dukakis to go on a spending spree, partly to pay off the special interests that had brought him back to office, and partly to build a powerful new campaign army for the 1987-88 national run.

State payrolls which had fallen by 6,000 under King re-exploded by 23,000 under Dukakis. State borrowing for housing development doubled in four years. State executive department spending, which had been going down in real terms under King, took off and rose to triple-inflation rate levels, 30-40 percent faster than the nation's.

The results were neither pretty nor hard to predict. A state that had been running four percent annual surpluses through FY1986 suddenly started running annual deficits of six percent. An FY1986 state surplus of more than $600 million suddenly turned into a $1 billion deficit by FY1989. A state that had been trying to fund its huge pension liability was secretly borrowing from it by the end of 1988, and running $300 million overdrafts at major Boston banks. Revenues that had been rising nearly 13 percent a year from FY1984 through FY1987 fell to a two percent annual rise FY1988 through FY1990, and are down this year one percent from 1989.

. . . to Total Fiscal Disaster

Above all, an economy that had been booming at one of the fastest rates in the nation began to fall apart under the pressure of that government explosion. As we speak, the once proud manufacturing job level is below 560,000 jobs, a 124,000 job plunge in a 4-year period when the nation's manufacturing jobs have actually risen by nearly 100,000. The state's total employment in March was 70,000 *lower* than in March of 1989, and its unemployment was 61,000 *higher*, rising from 3.3 percent to 5.4 percent. In spite of more than $400 million in special employment and training programs for welfare mothers, the welfare case load is almost 2,000 higher than it was when that program started in 1984.

In March, the state's bond rating was lowered for the third straight time, this time to BBB by Standard and Poors and Baa by Moody's. Not only is that the *lowest* bond rating of the 50 states, it is only one very small step above junk bonds.

Last December, just to meet its current obligations to distribute local aid to the cities and towns, Massachusetts had to obtain a $1.2 billion line of credit from Japanese banks–a line that comes due this September. In fact, the state warned cities and towns it could not make all its June local aid distributions, even though the state Supreme Court has ordered it to reinstate some $200 million it cut last fall.

> "Last December, just to meet its current obligations to distribute local aid to the cities and towns, Massachusetts had to obtain a $1.2 billion line of credit from Japanese banks–a line that came due this May."

Despite significant $300 million plus tax increases in 1988 and 1989, the state is now staring at a total fiscal disaster. State spending that was supposed to have been cut in FY1989, instead rose by 11.5 percent. Through April, the current FY1990 budget was in the red by a little under $800 million, headed for a fiscal year gap of over $1 billion. The state legislature is now trying to resolve the differences between a $1.3 billion tax increase passed by the House and $1.6 billion passed by the Senate. Both were rushed through as the Japanese creditors were calling in their notes. The day that latter increase was passed two of the state's oldest institutions checked out. Boston Gear decided to move to North Carolina taking all of its manufacturing jobs with it and the FDIC took over the venerable Merchant's Bank as insolvent.

Those were merely the latest evidences of the fallout from what one of the bond rating vice presidents called "the worst case of fiscal mismanagement I have ever seen. . . ."

The Destruction of Political Capital

At the heart of that bond-rating problem was not so much an impoverished economy as the disastrous slide in political capital which made either serious budget-cutting or significant tax increases virtually impossible until immediate bankruptcy was threatened. Over 70 percent of Massachusetts voters now have "no confidence" in state government. The mobs outside the State House recently have had a curiously familiar East European flavor.

This destruction in political capital is now directly causing an equally severe destruction in economic capital. Over the past six months, regulators have forced the four major Boston banks to set aside over $2.2 billion in additional reserves against losses on real estate loans. Those losses, in turn, are the direct result of a sudden collapse of the real estate market.

That market's unprecedented boom in values had been built almost entirely on the capitalization of the major property tax-cut and cap called Proposition 2-1/2 passed by the state in 1980, which stimulated a 22 percent annual rise in property values from 1981 to 1988.

But that growth rate collapsed in 1989, when it became clear that there was no way the state could continue to fund the Proposition 1-1/2 property tax cap with large local aid distributions.

That signaled the likelihood that the cap would not only begin to be over-ridden by fiscally starved communities (nearly 30 have already done so), but might eventually be amended by a desperate legislature. That in turn meant that taxes on property could once again soar and values could once again have to decline.

The results of anxiety about tax levels were almost immediately devastating to the state's real estate market which went from boom to bust within less than 12 months, forcing scores of Bay State banks onto the FDIC credit watch list because of large real estate loans gone sour.

That precipitate reversal in the state economy's fortunes is as clear proof of the direct role of taxation in economic growth and capital formation as the unexpected and rapid rise in those fortunes had been nearly a decade before.