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Taxing questions

By Richard W. Rahn
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Do you think your taxes are too high or too low? Though I expect that well over 90 percent of you are thinking "too high," many in the media and political class keep telling us taxes are too low.

The left-leaning intelligentsia, in their arrogant smugness, claim we just don't know what is good for us. Yet, they are the ones who ignore the empirical evidence and are unable to distinguish between variables and constants. As a prime example, a May 7 editorial in The Washington Post, advocating higher tax rates on the rich, states: "Economics cannot predict how high taxes can be raised before they reach counterproductive levels."

The editorial then says an increase of "taxes on the top 1 percent by 5 percentage points would raise $85 billion annually or perhaps a bit less if it spurred some extra tax evasion." The fact The Post's editorial writers did not seem to realize the contradiction in these two statements in the same paragraph is disturbing for several obvious reasons.

First, there is a great deal of empirical evidence about the effect of tax rates on tax revenues over various periods, so we know the editorial writers at The Post are unfamiliar with or choose to ignore a substantial body of economic literature. They also seem unaware that the amount of income earned and reported by the top 1 percent of the taxpayers is a variable and not a constant and is very much a function of tax rates.

The leftist media and political class have often demonstrated their impaired reasoning abilities and gaps in knowledge. They believe tax rates should be higher because the government needs more revenue. However, the evidence shows that in most nations the government is larger than it should be to maximize long-run economic growth and welfare -- which means most people would be both richer and freer if government were smaller.

Those on the left also think corporate tax rates are too low while most of them would not be able to name the actual rate (which is 39.3 percent in the U.S.? federal plus average state tax rate -- in 2006 according to the Tax Foundation). Further, none of the leftist media and political class note that a corporation is merely a legal form of business; and the corporate tax is paid by workers through lower wages and benefits, customers in terms of higher prices and by the investors (often pension and retirement funds) in terms of lower returns.

Among the developed economies, Japan and the U.S. have the highest corporate tax rates, while Ireland has the lowest at 12½ percent. Clearly, given a choice with everything being equal except the corporate tax rate, a stockholder or a worker in a company with markets and production facilities in many countries would prefer Ireland as the company's corporate home rather than the U.S.

The left has a notable ability to ignore the fact that low-tax-rate states tend to create more jobs and grow more rapidly than high-tax-rate states. We see this throughout the world, but one of the greatest laboratories of the benefits of tax competition is that between the 50 U.S. states.

More than a half-century ago, when New York was relatively much richer than most of the other states, it adopted the high-tax, big government model. Florida adopted a lower tax, limited government model. The result, Florida went from having about one-fifth the population of New York in 1950 to having a population that will exceed New York's in the next couple of years -- people voting with their feet. Florida has steadily increased its relative per capita income, while improving government services at a fraction of the per capita cost in New York.(By 2004, New Yorkers had incurred a per capita state debt of $4,964 versus $1,334 for the Floridians.)

Why is it that states without a personal income tax, like Florida, Texas and New Hampshire, can fund government services perfectly well and gain ground against their high tax competitors? The answer seems to be too taxing for the left.

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