The Washington Times
www.washingtontimes.com

Nobody Likes Paying Too Much

By Richard W. Rahn
Published May 13, 2009

Tax crackdown could deepen our economic woes

Other things being equal, would you start a new business in a higher- or lower-tax jurisdiction, and would you prefer to live and invest in a higher- or lower-tax locale? This is not a tough question for most people, but the powers in Washington (the administration and the congressional Democratic leaders) are incensed that the American people are answering the question in a most politically incorrect way by opting out of high-tax places.

Last week, the Treasury announced a whole series of proposed new laws and very complex regulations to prevent both American businesses and individual citizens from investing where they wish. (So much for the promise to simplify the tax code.)

These proposed measures are supposed to make it more difficult and expensive for American businesses to operate in foreign countries and for American citizens to move their financial assets to lower-tax jurisdictions (all in the name of getting more tax revenue). Oh yes, who is in charge of this crackdown on you evil tax avoiders? Why none other than Treasury Secretary Timothy F. Geithner and House Ways and Means (tax-writing) Committee Chairman Charles B. Rangel - both of whom have received some fame for their own tax problems.

If a U.S. business operating globally has to pay a 35 percent (U.S.) corporate tax rate (the second-highest in the world) plus state corporate taxes while its international competitors pay much lower rates, the U.S. company will be at a competitive disadvantage. Rather than provide necessary tax relief, the new Treasury proposals, if enacted, will give American multinational companies two basic choices for the long run - move the company outside the United States to a more tax-friendly jurisdiction, or go out of business and fire the workers.

It will come as no surprise that many of the officials and members of Congress who are behind this piece of economic foolishness come from high-tax states such as New York, Illinois, Michigan and California and seem to be oblivious to the fact that many of their most productive and highly paid residents are in flight to states with no personal income tax, such as Texas, Florida, Tennessee and Nevada.

You may not be aware that foreign citizens who invest in stocks and bonds in the United States do not have to pay U.S. income tax on the interest, dividends and capital gains from those investments. This is good economic policy for the United States because it attracts necessary foreign investment. Without foreign investment, the United States would have far less capital to invest in research and development, new plants and equipment, and job creation; also, the government would have a much more difficult time financing the federal deficit.

Some U.S. citizens have been trying to get in on the good deal the United States offers foreigners by investing in the U.S. through foreign institutions. In order to close this loophole, the Treasury and Congress are proposing regulations of mind-boggling complexity that are likely to drive many foreign investors out of the U.S. market, thus causing Treasury to lose, rather than gain, revenue.

Perhaps if we treated U.S. citizens as well as we treat foreign investors by removing the double tax from interest, dividends and capital gains, the markets would boom, businesses would expand, millions of new jobs would be created and, consequently, more taxable income likely would be created, rather than less.

Those in Washington who think that all of those Americans who evade or avoid taxes are suddenly going to comply just because the rules are made more complex have lost touch with reality (and are in denial about their own behavior). If the rules on investment become too costly and onerous, an investor can simply ignore the U.S. altogether or just spend the money.

Despite the administration's assertion that its proposed new tax increases will create some unspecified number of new jobs, the large body of empirical evidence shows tax increases decrease gross domestic product. Reputable economic studies demonstrate there is a cost to the economy from approximately $1.60 to $4.50 for each dollar of income tax collected and spent by government. This is because the income tax system is very costly to administer for both the Treasury and the taxpayer.

Also, the taxes collected suck away needed capital investment and discourage productive work and economic activity. The current size of the government is well above the optimal level. President Obama's chairman of the President's Council of Economic Advisers, Christina Romer, and her husband, University of California at Berkeley professor David H. Romer, stated in a paper published in November that "a tax increase of 1 percent of GDP lowers real GDP by almost 3 percent."

ESTIMATES OF GDP AND JOB REDUCTION RESULTING FROM THE ADMINISTRATION'S MAY 4 TAX INCREASE PROPOSALS (10 Years)

	GDP (billions of $)	Millions of New Jobs
Minimum	**-336**	**-1.7**
Most Likely	**-570**	**-2.8**
Maximum	**-855**	**-4.3**

Contrary to Treasury's assertions, the new tax proposals will result in less tax revenue, not more; a reduction in U.S. international competitiveness; higher interest rates; more unemployment; and less economic liberty. All suffer when those in charge do not (or wish to not) understand the real-world consequences of their actions.

Richard W. Rahn is a senior fellow at the Cato Institute and chairman of the Institute for Global Economic Growth.

http://www.washingtontimes.com/news/2009/may/13/nobody-likes-paying-too-much/

Copyright © 2009 News World Communications, Inc. All rights reserved.