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Fraudulent Tax Revenue Forecasts

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Failure to admit that raising taxes reduces tax receipts is irresponsible

If New York City decided to increase its cigarette tax by another $5 per pack, would it gain more or less revenue from the extra tax?

Before you answer the question, you should know that New York City already has the highest combined state-local tax rate of $4.25 per pack while the national average state tax is $1.34 per pack, and South Carolina has the lowest tax in the nation of only 7 cents per pack. The bet is that New York would receive less rather than more tax revenue, because some smokers would decide to quit and many others would acquire their cigarettes legally or illegally from low-tax states (New York already has an enormous cigarette smuggling problem). The citizens, and even most of the politicians in New York City, understand that their cigarette tax is already too high to maximize tax revenue, but they argue the high tax discourages smoking and thus is justified on that basis.

The point is, you don't have to be an economist to understand that if you tax something, you tend to get less of it. Thus it makes good fiscal sense to tax products perceived as harmful, such as tobacco and alcohol, up to the point where the tax becomes so high that people engage in large-scale smuggling or produce the product themselves - moonshine stills, etc. Responsible government officials understand the behavioral response to tax rates and thus adjust their tax revenue forecasts to consider the economic disincentive effects as well as the tax avoidance and/or evasion effects.

However, many government officials like to pretend that the effects of tax rates on the willingness of people to purchase goods or services, or work, save and invest are far less than the empirical and historical evidence shows. The Obama administration is now engaging in this type of misrepresentation and forecast fraud, which will result in much higher deficits and lower levels of economic growth and job creation than it claims.

To understand how serious this type of fraud is, think about how government officials would react if a company forecast a huge increase in revenues - and sent press releases of the forecast to the investment community, but failed to reveal that this forecast was based on the intention to double the prices for the company's products while assuming it will not reduce demand. Such actions by company officials would be considered irresponsible misrepresentation, for which they could be held legally liable.

Economists engage in endless debate about the long-run revenue-maximizing rates for any tax, whether it is a cigarette, gasoline, general sales, property or income tax. All of these taxes have been raised and lowered many times at the federal, state and local levels, so there is a good deal of empirical evidence about what the effects are likely to be. For instance, economists do know that taxes on capital (interest, dividends, capital gains) tend to be the most destructive because capital is the "seed corn" necessary for economic growth and job creation, while low-rate taxes on consumption do scant economic harm.

There is little dispute among economists that an increase in the tax on labor from 10 percent to 15 percent would bring in almost 50 percent more revenue (there would only be a small behavioral effect). There is also little dispute, at least among knowledgeable tax economists, that increasing the income tax rate on upper income people from 50 percent to 70 percent will, over the long run, bring in no additional tax revenue and eventually will lead to a loss in revenue.

Despite this knowledge, the Obama administration and the congressional Democrats are proposing a series of tax surcharges and deduction phase-outs in the health care bill on people making more than $200,000 per year. These surcharges, along with the proposed elimination of the "Bush" tax cuts at the end of this year, as well as state and local income taxes, will cause many Americans to face tax rates well over 50 percent and some in the 60 percent range or even higher. Punishing productive work and investment by imposing such high tax rates has been shown time and time again to result in less investment, economic growth, job creation and ultimately, lower tax revenues.

In addition, the Senate just passed a "jobs bill" that is now being considered by the House, which would make it much more expensive to do business in the United States by imposing either a 30 percent withholding tax or very costly and intrusive regulatory requirements on foreign financial institutions. This will divert global capital elsewhere, thus reducing job creation in the U.S. rather than increasing it. The failure to recognize and admit to the fact that productive capital can move around the globe almost at the speed of light and will not stay where it is punished by either excessive taxation or regulation is as criminal as business executives providing false information.

Reasonable people can disagree about the negative effects of tax rates up to a point - but neglect and/or denial of evidence is misrepresentation. The sum of the tax rate increases on productive labor and capital now before Congress may not kill the U.S. economy but will leave it very sick - and ultimately, with less tax revenue. If corporate executives can be sued for misrepresentation, should the people not have the right to sue government officials for providing phony tax revenue and spending numbers?

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