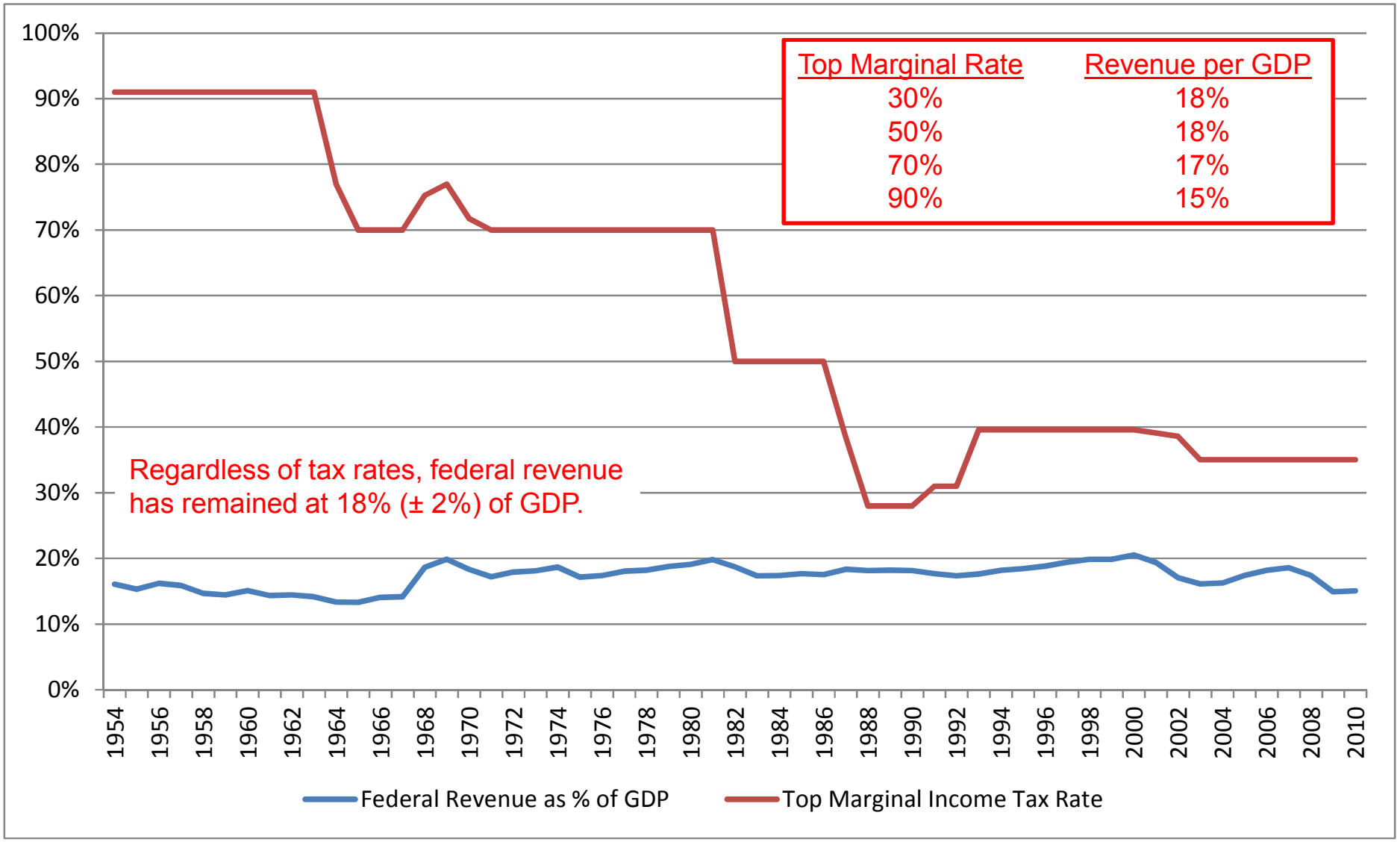
Historically, altering the top income tax rate has had no effect on tax revenue as a fraction of GDP.

The same is true for the average marginal tax rate, Social Security and Medicare tax rates, the effective corporate tax rate, and the capital gains tax rate.

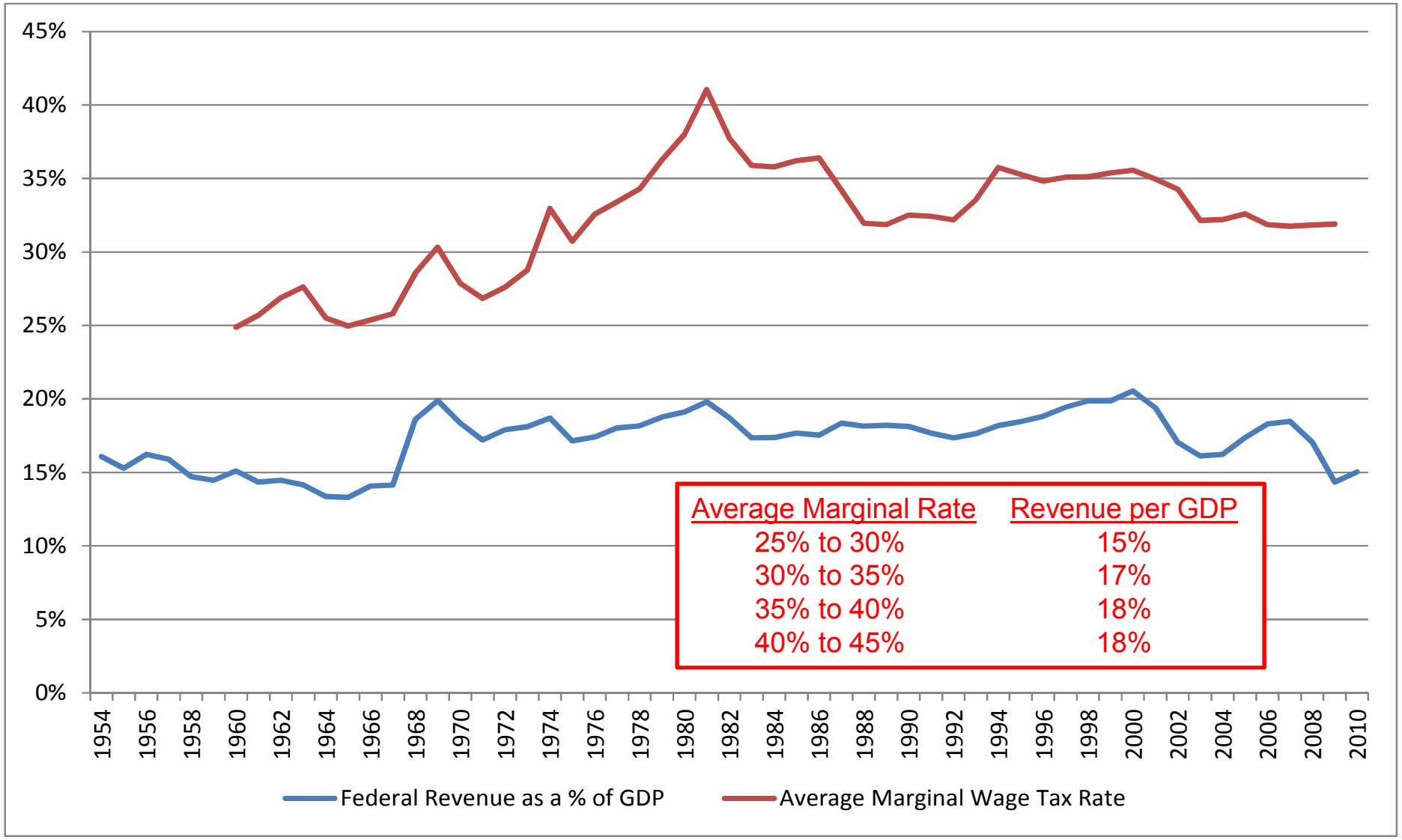
There are a variety of reasons that may explain this. It could be the Laffer Curve, maybe people are good at shifting the sources of their income in response to tax rate changes, maybe people expend more effort looking for loopholes as tax rates rise, or maybe Congress plays a shell game – raising tax rates while exempting more income from taxes.

Whatever the reason, the evidence remains – the government can only set tax rates, it has little control over tax revenue.

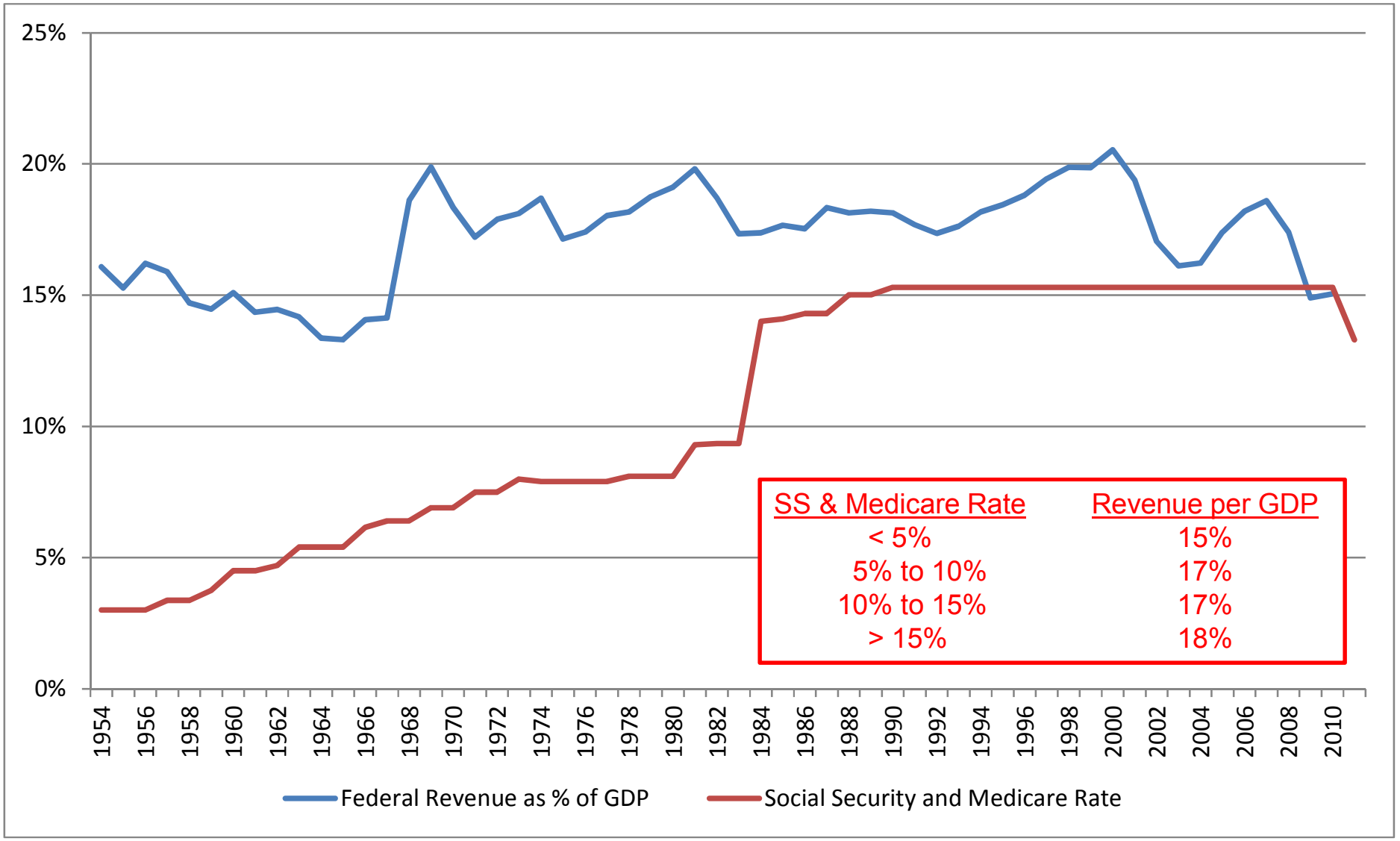
Since, regardless of tax rates, tax revenue is a relatively constant 18 percent of GDP, this suggests that the solution for raising tax revenue is to adopt a tax policy that causes GDP to grow more quickly.



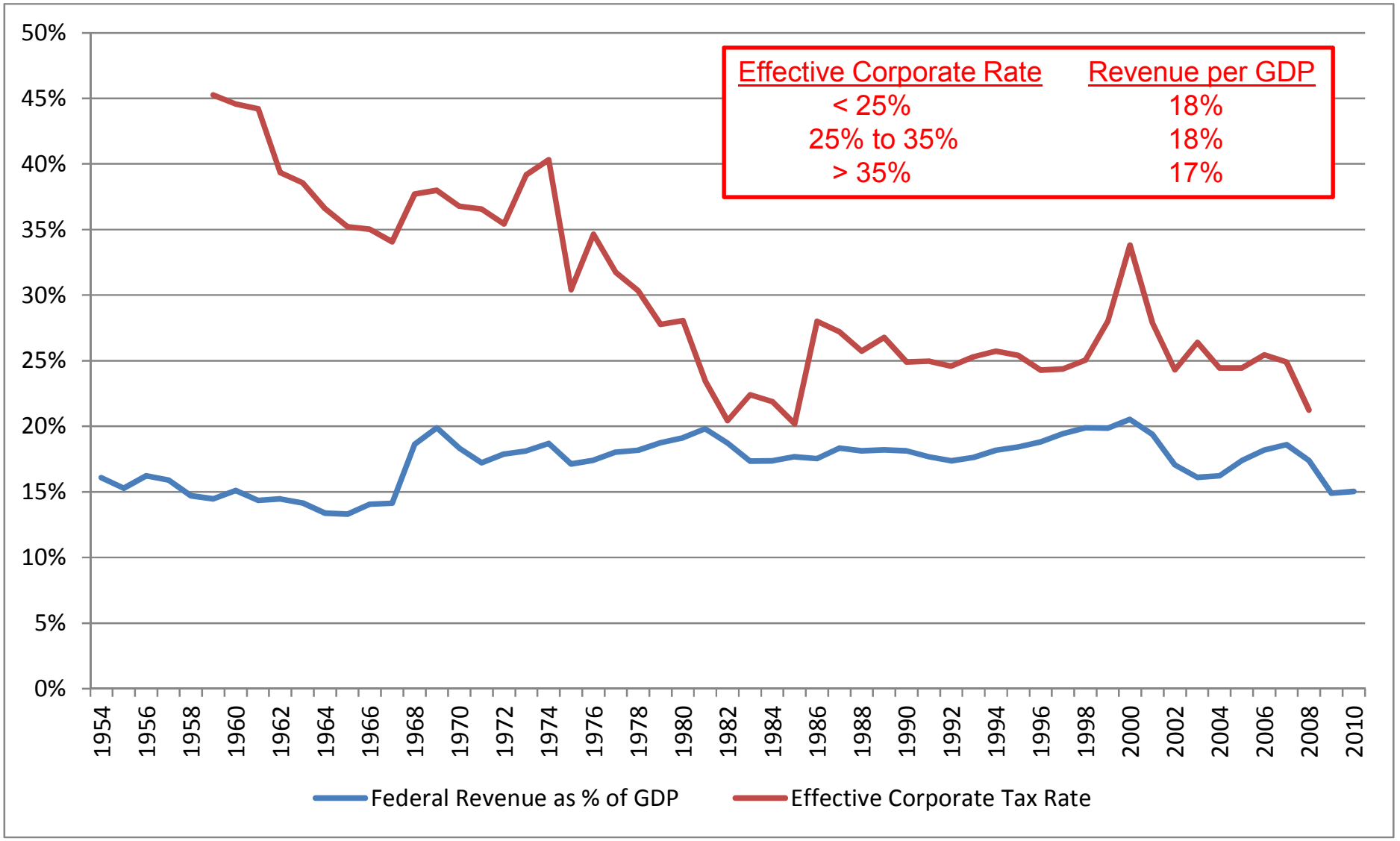
Data sources: Internal Revenue Service, Bureau of the Census



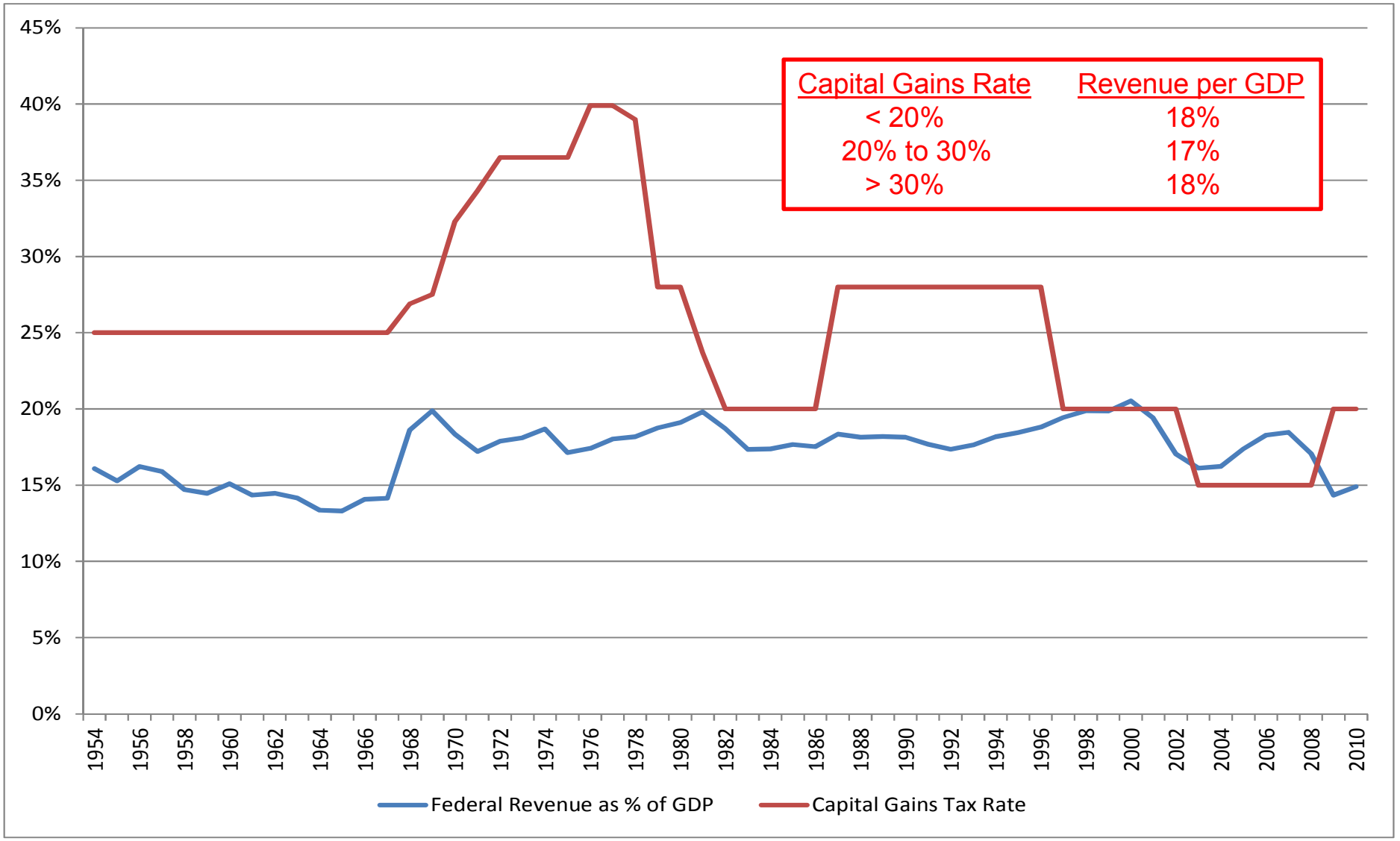
Data sources: Internal Revenue Service, Bureau of the Census, Barro and Redlick (2011)



Data sources: Internal Revenue Service, Bureau of the Census



Data sources: Internal Revenue Service, Bureau of the Census, Tax Foundation



Data sources: Internal Revenue Service, Bureau of the Census

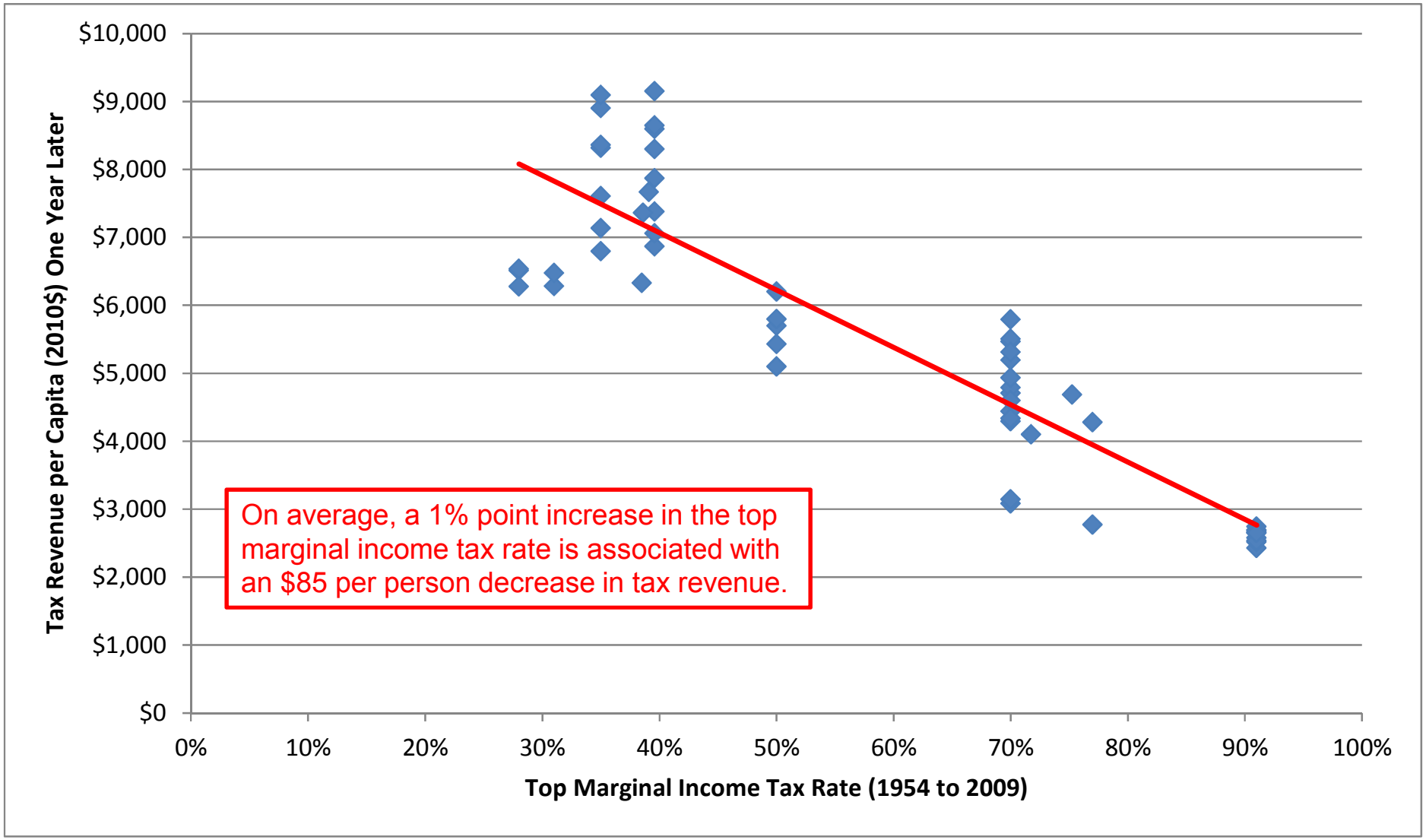
The previous data shows the relationship between tax rates and tax revenue as a fraction of GDP.

Maybe it doesn't matter that tax revenue as a fraction of GDP remains constant. What is the relationship between tax rates and tax revenue?

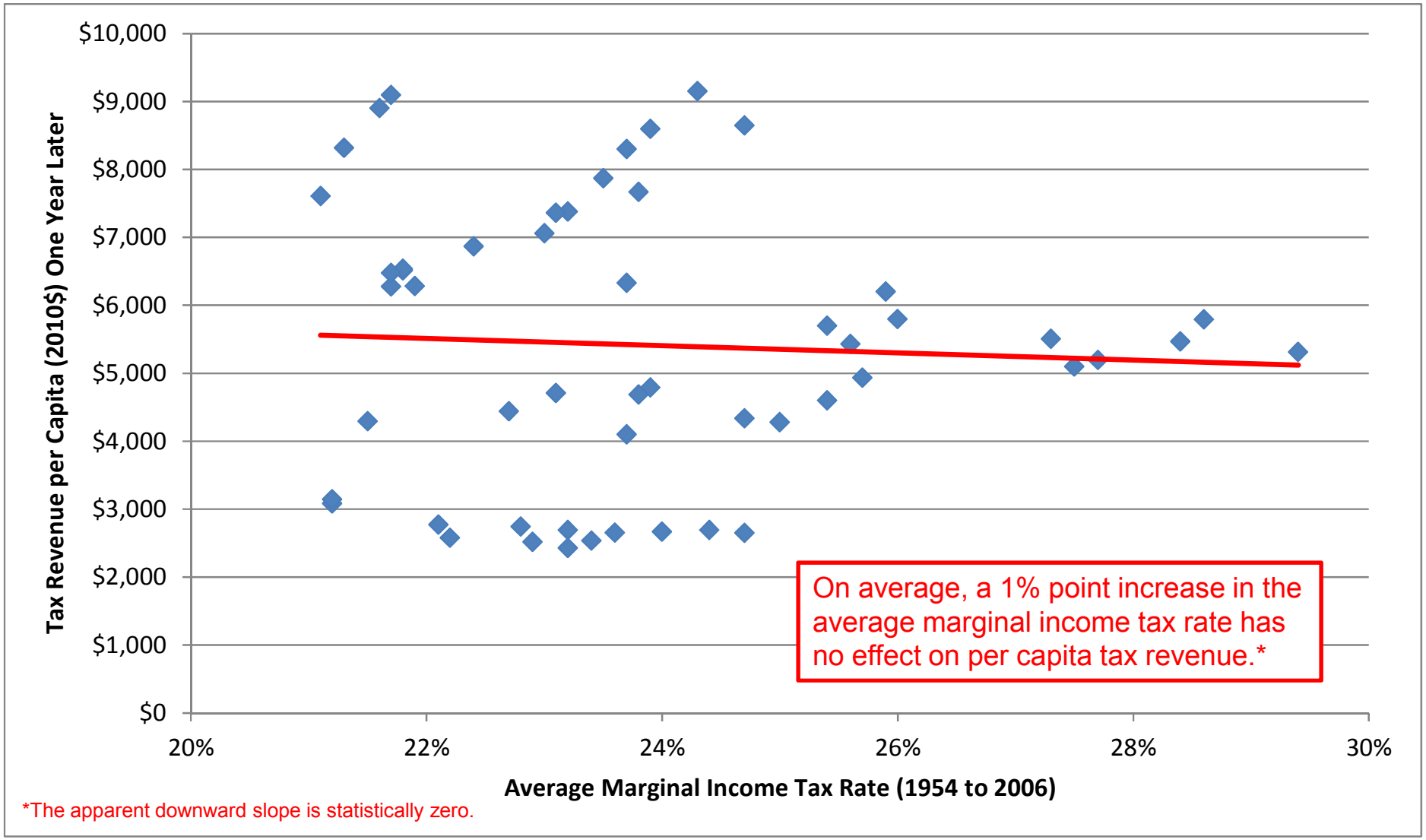
To answer this, we need to hold prices constant because inflation makes it look like tax revenues are rising when, in fact, the purchasing power of the tax revenues are not. We also need to hold the population constant because tax revenues will naturally rise as the number of people taxed rises.

Also, to be fair to the pro-tax argument, let's allow one year for the new tax rates to take effect.

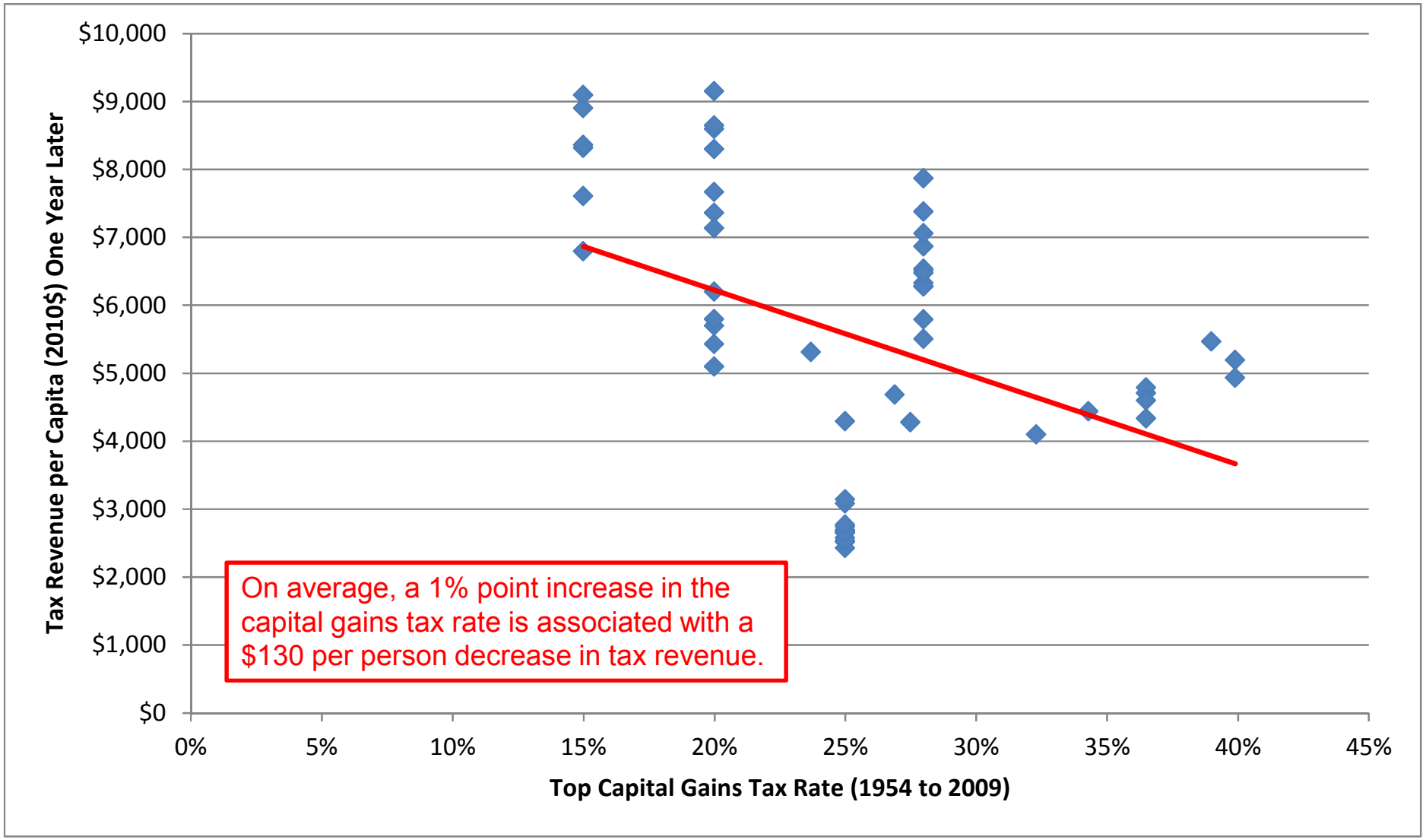
So, let's compare tax rates in each year to tax revenue per capita and adjusted for inflation in the following year.



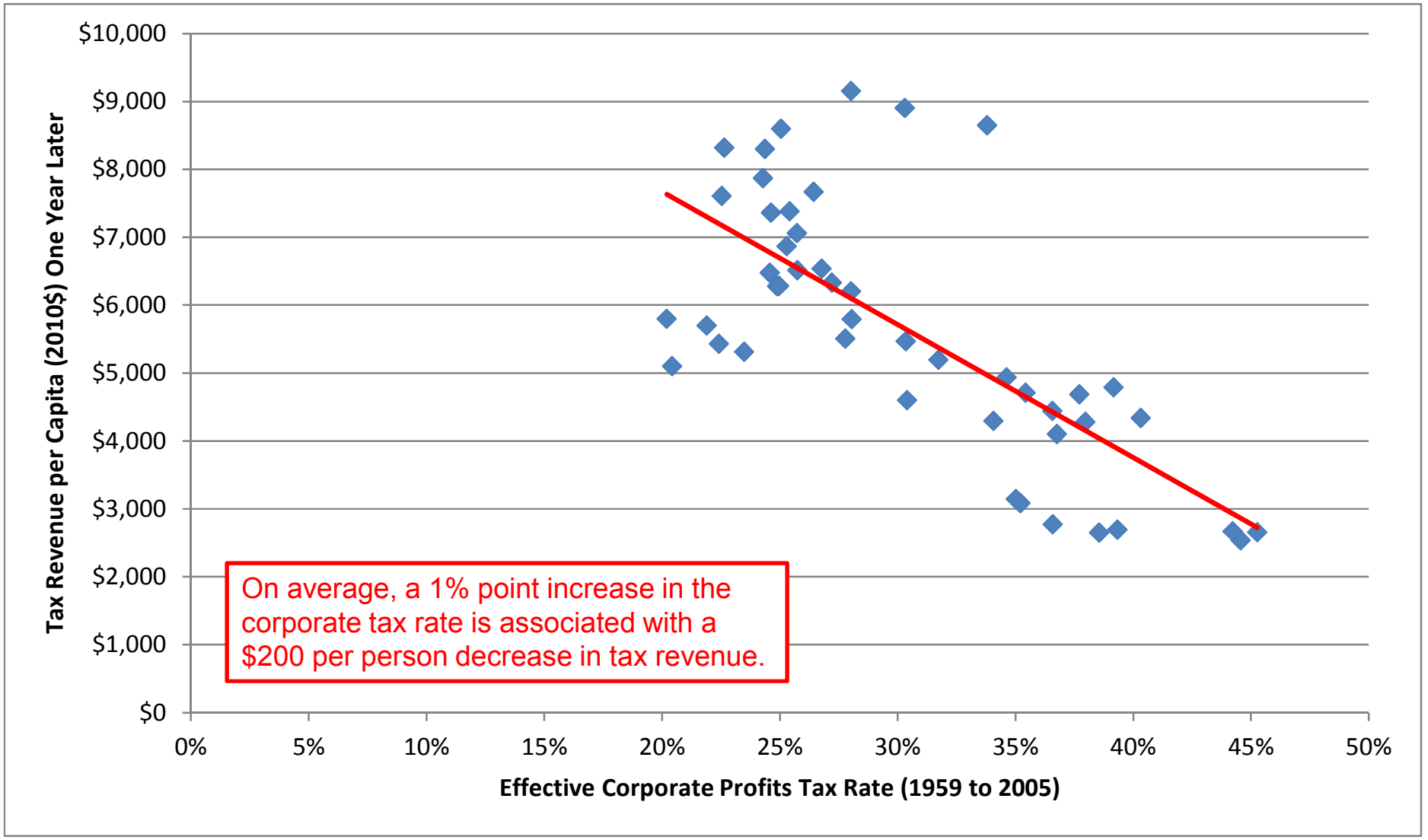
Data sources: Internal Revenue Service, Bureau of Economic Analysis



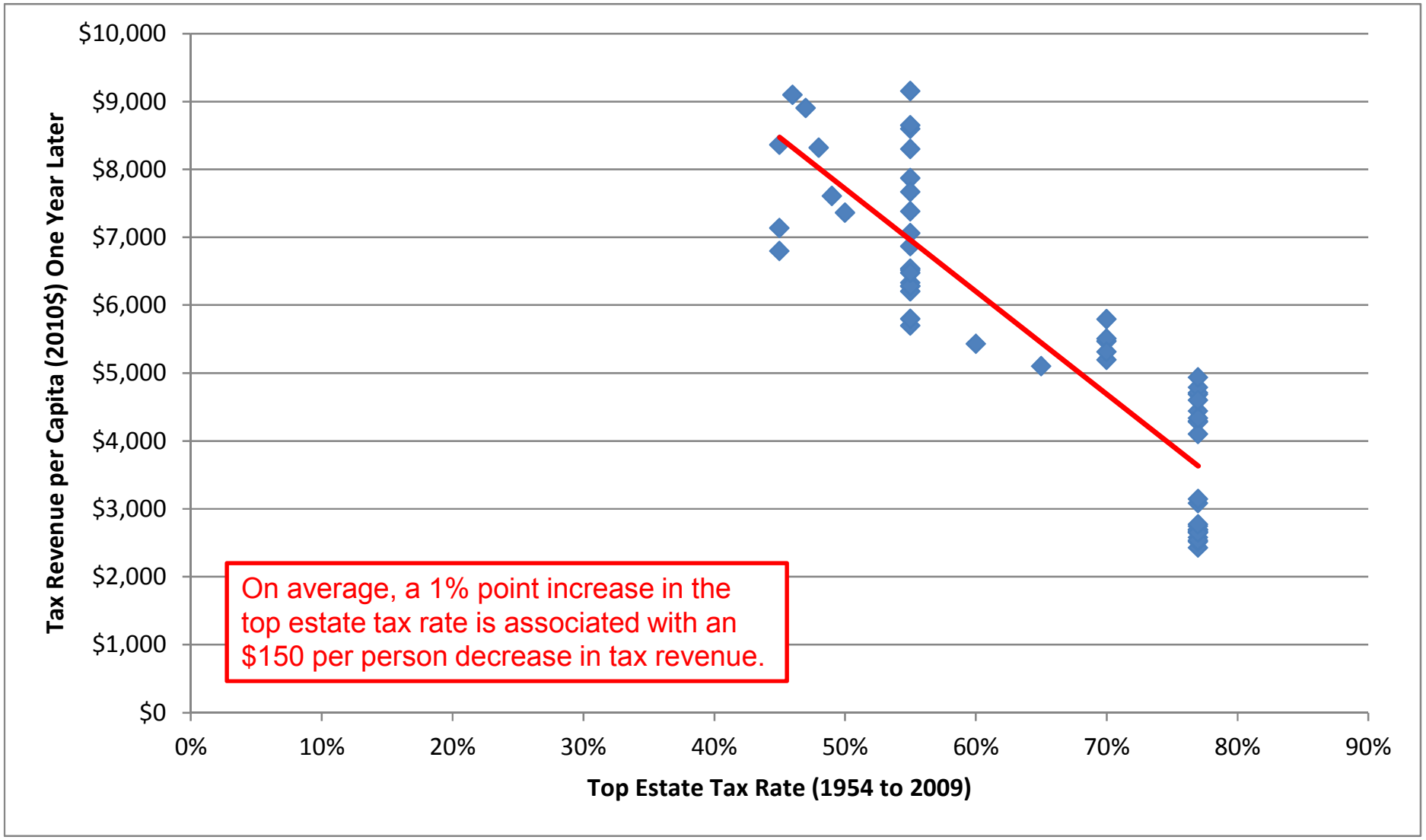
Data sources: Internal Revenue Service, Bureau of Economic Analysis, Barro and Redlick (2009)



Data sources: Internal Revenue Service, Bureau of Economic Analysis



Data sources: Internal Revenue Service, Bureau of Economic Analysis



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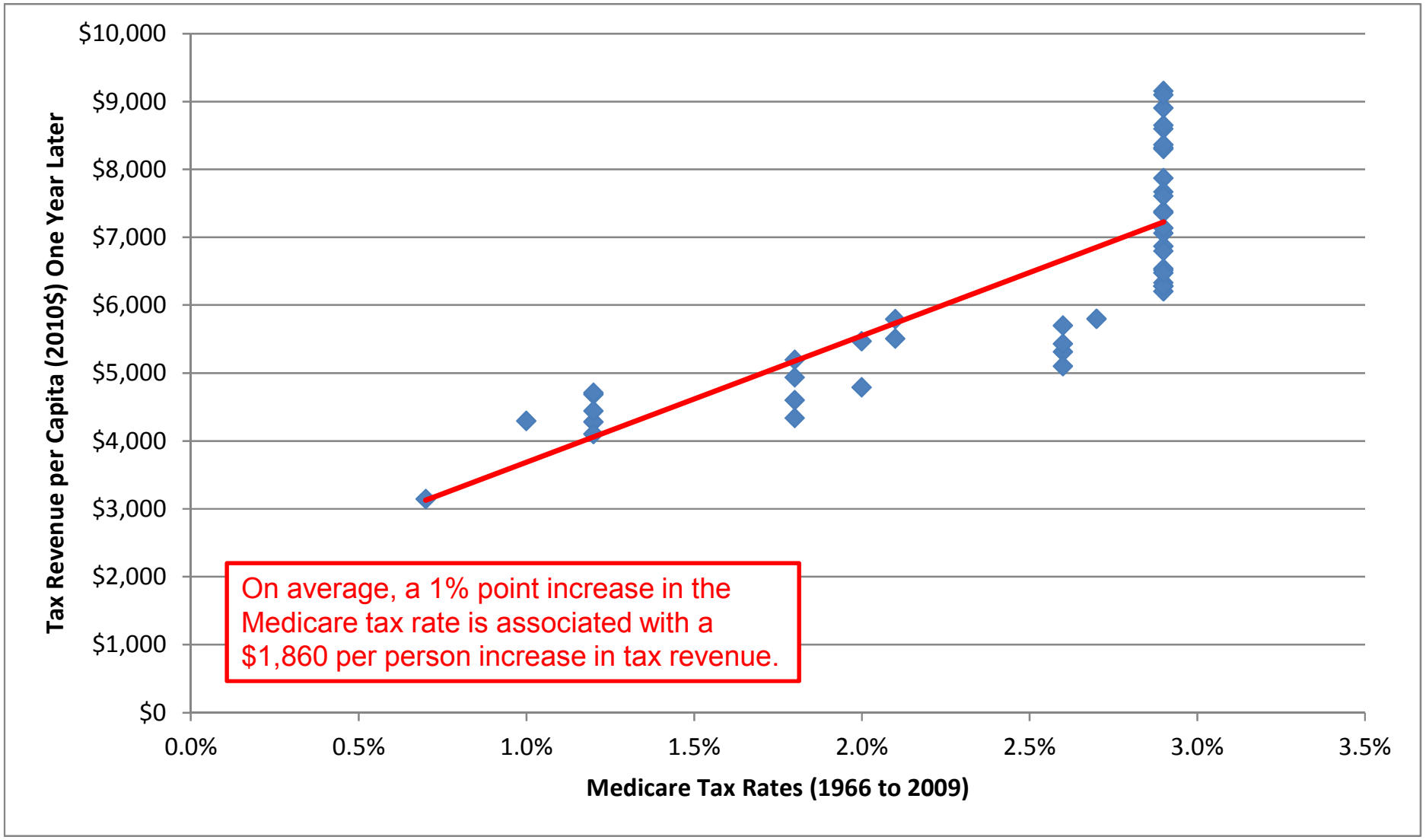
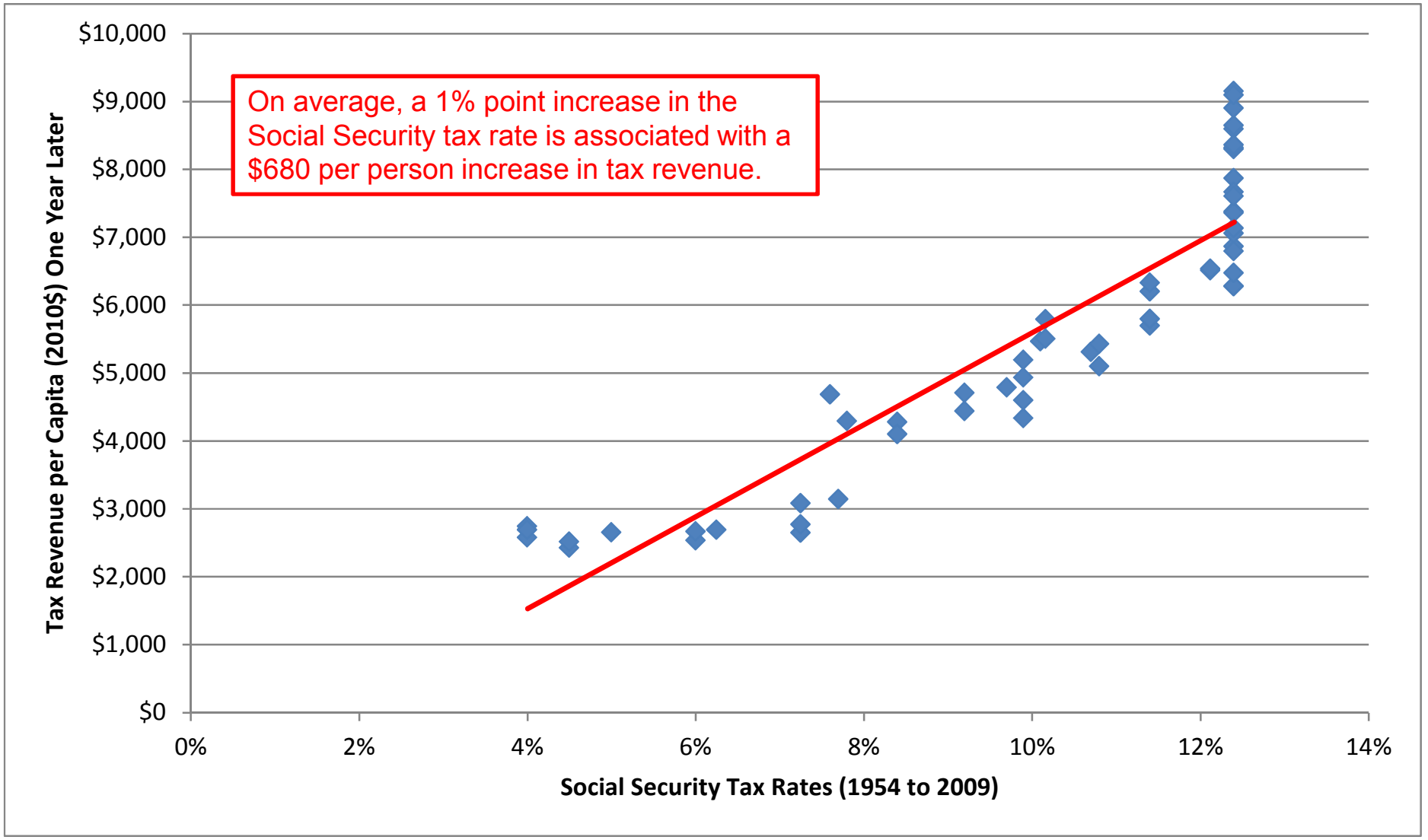


Data sources: Internal Revenue Service, Bureau of Economic Analysis



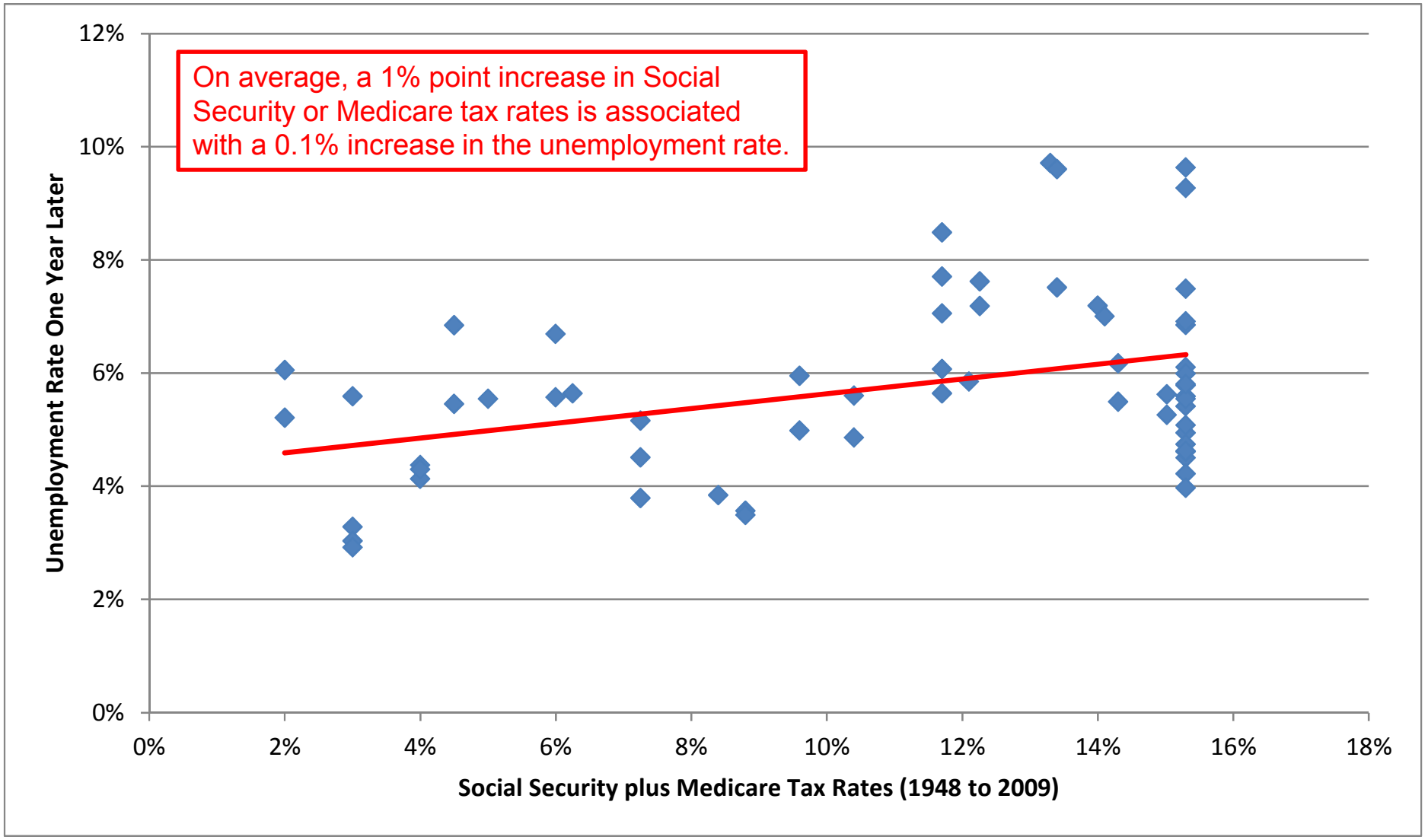
Data sources: Internal Revenue Service, Bureau of Economic Analysis

What is interesting about this data is that there are only two tax rates that, when raised, increase tax revenue: Social Security and Medicare tax rates.

One possible reason for this is that, because more than 50% of Americans pay no income tax, the only taxes that hit all working Americans are the Social Security and Medicare taxes.

Alas, there is no such thing as a free lunch. In the following slide, we see that increases in Social Security and Medicare tax rates are associated with increases in unemployment rates.

Thus, increasing Social Security and Medicare tax rates increases tax revenue, but does so at the cost of increased unemployment.

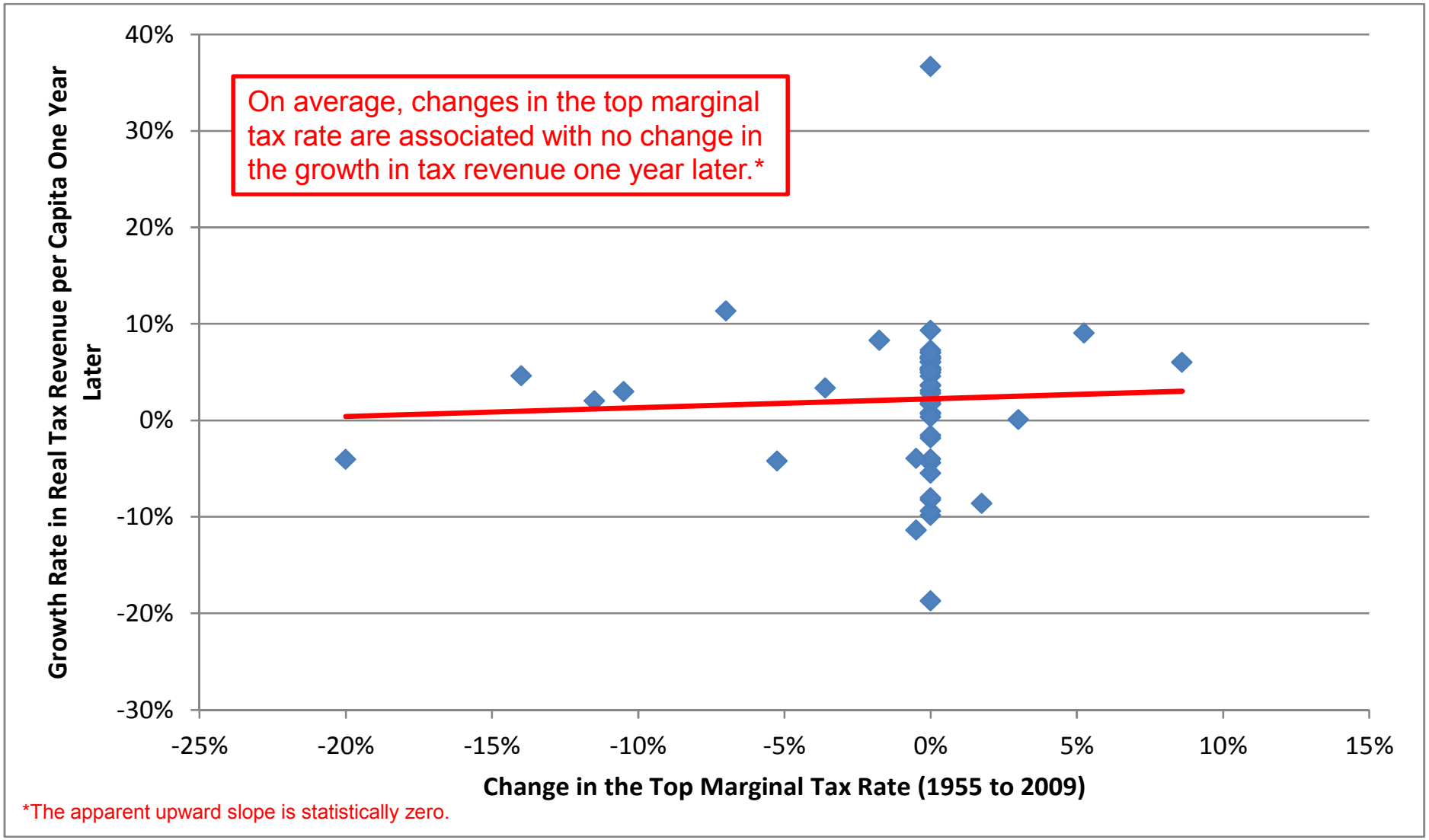


Data sources: Internal Revenue Service, Bureau of Economic Analysis

A reasonable criticism of some of these results is that tax revenue per capita has naturally been rising over time because the economy has been growing. Similarly, some tax rates have (for whatever reason) been falling over time.

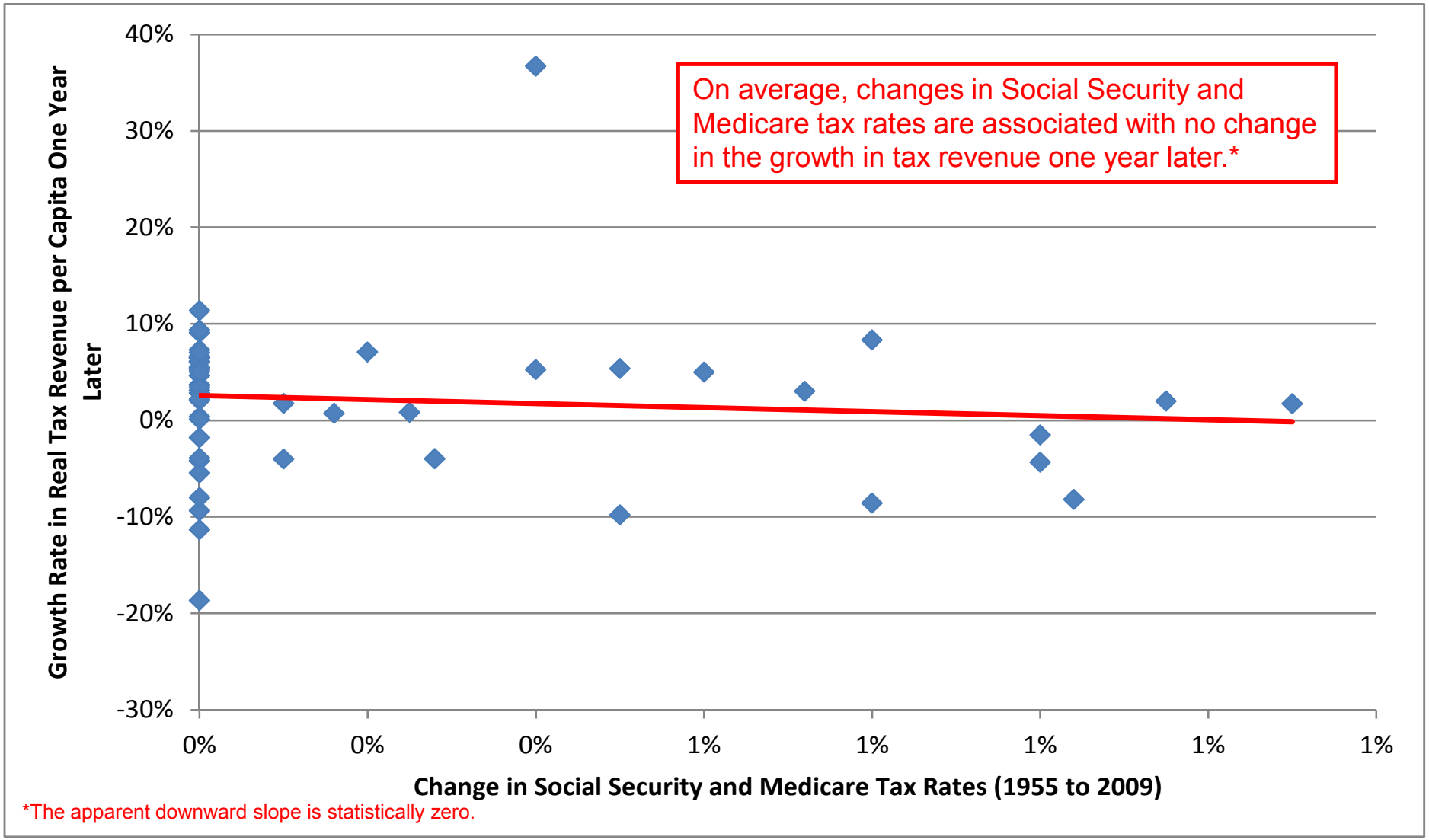
Consequently, it may simply be a matter of coincidence that we see lower tax rates accompanying higher tax revenue per capita.

One way to attempt to address this criticism is to compare changes in the tax rate to changes in per-capita tax revenue. This approach eliminates any coincidence of trends in tax rates with trends in tax revenue.



*The apparent upward slope is statistically zero.

Data sources: Internal Revenue Service, Bureau of Economic Analysis



*The apparent downward slope is statistically zero.

Data sources: Internal Revenue Service, Bureau of Economic Analysis