NYDailyNews.com
DAILY NEWS

Opinion

Opinions – Guest Contributor

Debt commission members: Forget about tax hikes and focus on growing the economy

BY Antony Davies

Friday, August 19th 2011, 4:00 AM

Carolyn Kaster/AP

Politicians including U.S. President Barack Obama have devoted much attention to the tax issue.

With a debt deal in place, a downgrade in hand, and a further downgrade possible, the tough choices now fall to the 12 members of a Bipartisan Joint Committee of Congress to finalize $1.5 trillion in further cuts. To avoid wasting time, this committee must understand that political posturing over whether to use spending cuts versus tax increases to solve our debt problem is useless. History shows that the government has no control over tax revenues.

It can set tax rates, but a tax rate is merely a claim on a specific percentage of people's incomes, while tax revenue depends on the amount of income there is to tax.

Since 1968, federal tax revenue from all sources combined has been a relatively constant 18% of GDP - regardless of tax rates. Here is the recipe for both economic recovery and fiscal responsibility: To balance the budget, the government should have its eye on the same goal that occupies the private sector: growing the economy. To argue that the government can't afford to cut tax rates is to miss the point. No matter what it does, the government will collect 18% of the economy in taxes.

The right question is: Which tax rates will encourage economic growth? Lower tax rates encourage businesses to create jobs and to invest in the future.

Lower tax rates encourage people to work and to spend. Many of the current plans to solve our budget crisis call for increased taxes on the wealthiest Americans, but history shows that neither major cuts nor increases in the top federal income tax rate have caused any significant change in the government's slice of the economic pie. From 1968 to 1986, the top federal income tax rate was at least 50% and, typically, was above 70%. During that period, federal tax revenue averaged 18.2% of GDP. In 1986, the top income tax rate was slashed to 40% then later to 28% - the lowest level since 1931.

According to some of today's politicians, these massive cuts in tax rates should have resulted in fiscal Armageddon. However, from 1986 to 1992, federal tax revenue averaged 17.9% of GDP. Since 1993, the top income tax rate has been at least 35%, but federal tax revenues remained at 17.9% of GDP.

In the past 40 years, we have taxed the rich at astronomical rates, we have taxed the rich at today's middle-class rates, and we have taxed the rich at many levels in between. But the rate at which we tax the rich hasn't mattered - the government's tax revenue has remained 18% of GDP.

So: The argument that we need tax increases to solve a revenue problem is null and void.

A look at the lower income tax brackets and Social Security and Medicare tax rates reveals the same story. Since 1968, the average tax rate on wages has ranged between 27% and 41%. In the 10 years of the highest tax rates, the government collected 18.5% of GDP in taxes. In the 10 years of the lowest tax rates, the government collected 18.1% of GDP in taxes.

The much reviled capital gains tax rate provides no joy either. The government's tax revenue averaged the same 17.9% of GDP when the capital gains tax rate was 20% or below, as when the tax rate was 30% or above. Doubling effective corporate tax rates has virtually no effect on tax revenues either. From 1968 to 2005, the average corporate tax rate fluctuated from a low of 20% to a high of 40%. In the 10 lowest tax years, the government's tax revenue was 17.8% of GDP. In the 10 highest tax years, the government's tax revenue was 18% of GDP.

Experts can argue as to whether the reason is that people get better at avoiding taxes as tax rates rise, or that tax increases are accompanied by increases in favored tax credits, or that the Laffer curve really does exist and we're at its sweet spot. Whatever the reason, the bottom line is that for the last 40 years the government has demonstrated that it has no control over tax revenues. What drives changes in tax revenues are not changes in tax rates but changes in economic growth.

A look at the lower income tax brackets and Social Security and Medicare tax rates reveals the same story. Since 1968, the average tax rate on wages has ranged between 27% and 41%. In the 10 years of the highest tax rates, the government collected 18.5% of GDP in taxes. In the 10 years of the lowest tax rates, the government collected 18.1% of GDP in taxes.

The much reviled capital gains tax rate provides no joy either. The government's tax revenue averaged the same 17.9% of GDP when the capital gains tax rate was 20% or below, as when the tax rate was 30% or above. Doubling effective corporate tax rates has virtually no effect on tax revenues either. From 1968 to 2005, the average corporate tax rate fluctuated from a low of 20% to a high of 40%. In the 10 lowest tax years, the government's tax revenue was 17.8% of GDP. In the 10 highest tax years, the government's tax revenue was 18% of GDP.

Experts can argue as to whether the reason is that people get better at avoiding taxes as tax rates rise, or that tax increases are accompanied by increases in favored tax credits, or that the Laffer curve really does exist and we're at its sweet spot. Whatever the reason, the bottom line is that for the last 40 years the government has demonstrated that it has no control over tax revenues. What drives changes in tax revenues are not changes in tax rates but changes in economic growth.

Davies is a professor of economics at Duquesne University and a scholar at the Mercatus Center at George Mason University.