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Opinion

Let champagne socialists pay more tax voluntarily

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"SOAK the rich." Is this the new way for the uber-rich to clear their consciences?

Having reached the summit of their careers, using the free market to build businesses and earn mountains of money, employing top-end tax lawyers to ensure they pay not a cent more in tax than required, a form of rich businessman's guilt complex seems to set in with some of them.

Some end up denouncing the free market as evil, only after it has delivered them great wealth. And for some, the tax system is now too generous, only after they have been on the receiving end of this apparent generosity for most of their careers.

The call from Sydney businessman Mark Carnegie for the top 15 per cent of taxpayers to pay 15 per cent more in tax echoed the suggestion from Warren Buffett in the US that he and his "mega-rich friends" should pay more tax.

It's nice of them to offer up themselves and their friends to pay more into federal coffers, but as far as economics go, their kindness is misplaced. Higher taxes tend to lead to lower levels of tax revenue because higher taxes tend to lead to people changing their behaviour so they pay less tax.

It's no coincidence that recent calls to tax the rich more come from the very rich who never have to work another day. The very rich, who employ clever tax lawyers and accountants, won't notice the tax hike as much as those on a taxable income of $90,000 or more, which is all it takes to get to the top 15 per cent of taxpayers.

And there are plenty of other Australians further down the tax scales who may never enjoy Carnegie or Buffett levels of riches but aspire to make it into the top 15 per cent of taxpayers. If Australians were crying out for a higher tax rate for the rich, Treasurer Wayne Swan would be trying it on. And not even he is taking up Carnegie's offer on behalf of his mega-rich friends to pay more tax.

In the US, by contrast, Barack Obama is trying it on. With 45 million Americans making use of food stamps, unemployment above 9 per cent, a $US4 trillion federal budget and a $US1.65 trillion deficit, you can see why it's politically appealing for Obama to float the idea of fixing the country's economic woes by slugging the rich. And the feckless Occupy Wall Street protests will only fuel Obama's emotional demand that rich Americans "pay a little more" in taxes to close the deficit and fund his spending promises.

There's only one problem. It won't work.

As The Wall Street Journal calculated after Obama's budget speech in April, even if the Internal Revenue Service collected 100 per cent of the taxable income of the top 1 per cent of taxpayers (those whose income from salaries, capital gains and dividends exceeds $US380,000) on the last available figures from 2008, it would yield only $US938 billion. That's not nearly enough to fund Obama's ambitious $US4 trillion budget. Even taking tax collection figures from the boom year of 2005 doesn't help Obama in the long run.

"The rich, in short, aren't nearly rich enough to finance Mr Obama's entitlement state ambitions," concluded the WSJ editorial.

Actually there are more important problems with soaking the rich. As Brad Williams, a former economic forecaster for California, told the WSJ, taxing the rich too much leads to an unhealthy reliance on a volatile source of revenue.

Before the recession, California relied on the top 1 per cent of taxpayers (those earning more than $US490,000 a year) for almost half its income taxes. In good times, taxing the rich delivered handsome rewards, but when the economy turned, the earnings of the rich fell by more than twice as much as the rest of California's taxpayers. As Robert Frank at the WSJ wrote: "when they crashed, they took California's finances down with them". And, Frank says, it's no coincidence that those states most dependent on raking in tax revenues from the rich are "now among those with the biggest budget holes".

In California, Williams discovered the state's economic prosperity depended on a "small group of ultra-earners" and forecasting the state's revenues depended on predicting the fortunes of the rich, which meant trying to forecast the performance of shares. And that's a mug's game.

The biggest problem when you hit the rich with higher taxes is behavioural. Here, the please-tax-me-more brigade might wish to take a look at the work of Arthur Laffer, a prominent economist during the Reagan administration. He and Ronald Reagan understood that lowering tax rates, rather than hiking them, led to increases in taxable income revenues. As Laffer has written, the Reagan tax cuts meant "the highest 1 per cent of income earners paid more in taxes as a share of GDP in 1988 at lower tax rates than they had in 1980 at higher tax rates". When you tax people more, their incentive to work more and earn more income drops off. It's "pure commonsense", Laffer says.

The same applies to increasing capital gains tax on the rich. In response to Buffett's call for higher taxes on the mega-rich, Alan Reynolds from the Cato Institute points out that when, in 1977, capital gains tax was 39.9 per cent, realised gains amounted to less than 1.57 per cent of GDP. When the same tax dropped to 28 per cent between 1987 and 1996, revenues from the tax increased to 2.3 per cent. When the capital gains tax dropped further to 15 per cent from 2004-07, revenues rose to 5.2 per cent of GDP. In other words, the lower tax rates raised more tax revenue because the rich, who can afford to choose when to sell assets, will choose not to realise gains until it works in their favour. That's commonsense, too.

None of this commonsense should stop rich businessmen who want to pay more tax from doing so. Let them make a voluntary contribution to soothe their guilt. We could even work out a retrospective tax liability for them on the basis of their preferred higher rate of tax. That's a better solution than shutting down the gates to Everest for everyone else after they have climbed it themselves.

Most people, no doubt, will remember with a nodding smile what Kerry Packer told a Senate Committee in Canberra in 1991:

"I pay what I'm required to pay, not a penny more, not a penny less. I can tell you, you're not spending it that well that we should be donating extra."

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