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Let's talk about tax, baby

POSTED AT: MONDAY, MAY 23, 2011 06:17:22 PM
AUTHOR: KEVIN CLARKE

Much talk these days swirls around the impending crisis over the national debt ceiling. That's certainly true within the friendly (mostly) confines of **America**'s Web site. It's too bad there's no painless way around the debt crisis. It looks like the U.S. middle and upper class will have to pay more in taxes, and social, defense and all other fed spending must endure some cuts if we want to get serious about closing the deficit and preventing our great grandchildren from a hat-in-hand relationship with China.

But wouldn't it be great if we could cut taxes and raise as much money, no wait, even more money, as we raised before?

It's the self-financing tax cut, the golden chalice (fleece?) of American tax policy, and it's the oft-repeated contention of some Conservatarian politicians. My father always told me if it seems to be good to be true, it probably is (it's amazing how much smarter he gets as I get older) and sad to say I suspect that's the case when it comes to launching an offensive on annual deficits by outflanking them with tax cuts.

The tax cuts=more federal revenue formula has evolved from a notion scribbled on a napkin to something close to an unshakable article of faith among a certain breed of American fiscal conservative. But it's far from an easily demonstrable historical reality, though I doubt even a thorough debunking will do much to dissuade its enthusiastic repetition (probably the opposite will ensue). But as several posters at our venerable site have repeatedly thrown down this assertion as if it were an uncontested historical fact, I feel obliged to at least attempt to set the fiscal record straight on behalf of site visitors who have not whiled away their weekends poring over O.M.B. revenue records.

Famous one-time believers have turned harsh critics of the idea, most famously Reagan budget director David Stockman who still finds time to try to tear down the rhetorical battlement he helped construct. And here's former domestic policy adviser to President Reagan Bruce Bartlett, one of the original supply-siders, writing in the New York Times in 2007: "[S]upply-side economics has become associated with an obsession for cutting taxes under any and all circumstances ... The original supply-siders suggested that some tax cuts, under very special circumstances, might actually raise federal revenues. For example, cutting the capital gains tax rate might induce an unlocking effect that would cause more gains to be realized, thus causing more taxes to be paid on such gains even at a lower rate.

"But today it is common to hear tax cutters claim, implausibly, that all tax cuts raise revenue. ... This is a simplification of what supply-side economics was all about, and it threatens to undermine the enormous gains that have been made in economic theory and policy over the last 30 years."

Supporters of the less tax, more revenue thesis typically elevate the Kennedy, Reagan and Bush tax cuts as exemplars of the phenomenon. Trouble is, despite what the Heritage Foundation or Cato Institute might say, the numbers don't hold up under scrutiny. In fact, many economists point out the tax cuts/revenue outcomes can only look remotely favorable if you ignore inflation, population growth, economic growth owing to other factors, the normal vicissitudes of the business cycle, etc. For instance, in inflation-adjusted dollars, Reagan's 1981 tax cuts reduced federal revenue until late in his second term. Does that mean that the tax cuts finally did the trick or did something else that happen in those ensuing years to make the difference? A couple of variables that have to be considered is the nation's population expansion over his two terms and the inescapable fact that in responding to dramatic revenue shortfall's, Reagan's administration raised taxes 11 times after his famous tax cuts started off his presidential watch. An increase in Social Security taxes also made a significant contribution to the improved revenue profile by the end of Reagan's second term, hardly the unqualified outcome a supply-sider might hope for; finally in fiscal carousel fashion, Reagan's (un)healthy appetite for deficit spending supercharged the economy and in a painfully roundabout manner delivered more revenue (and long-term debt). That Reagan debt-spending precedent also gets at one of the major flaws in the behavior of the supply-siders. Whether or not the theory of revenue-generation they espoused was completely bunk was pretty much beside the point as the vastness of their increased spending and other loosey-goosey fiscal habits, say, funding a war with off-budget supplemental spending requests, tended to overwhelm whatever good—or not—their tax philosophy was up to.

The Tax Policy Center had this unflattering assessment of the Bush tax cuts:

"The Bush tax cuts contributed, along with underlying economic conditions, to a historic decline in federal tax revenue. In 2000 total federal tax revenue was as high in proportion to the U.S. economy as it had ever been. By 2004 federal tax revenue in proportion to the economy had fallen to its lowest level in almost fifty years." (http://www.taxpolicycenter.org/briefing-book/background/bush-tax-cuts/revenue.cfm). And more bad news on the effect of the Bush tax cuts is courtesy of the nonpartisan Congressional Budget Office, which in 2001 projected a $5.6 trillion surplus for the 2002-2011 time frame, but the U.S. ended up instead with a $6.2 trillion additional debt—a swing of $11.8 trillion from the January 2001 projections with substantial annual revenue shortfalls.

So two rounds of Bush tax cuts = less revenue = bigger deficit/debt, a clear-cut answer? Well, yes and no. Obviously those Bush years include the 9/11 terrorist attacks and the beginning of the war on terror, which naturally had an impact on the performance of the economy and tax revenue. But that's part of the general problem with the tax cuts = more revenue formula. There are a lot of variables affecting revenue besides tax rates. Bill Clinton raised taxes in 1993, the economy boomed and federal revenue went up because of the higher rates and personal income. So does that mean that raising taxes helped the economy? (Some say yes.)

Have cuts in capital gains increased tax revenues? Yes, they have. But capital gains cuts often provoke a rush of tax settling stock sales as investors reckon the break may only be short-term. That leads to a revenue spike that does not last. Would a combination of lower taxes and closed loopholes produce more revenue? Now we're getting to the interesting challenge for the years ahead. Advanced studies in human nature, like Arthur Laffer's best conduced over drinks, suggest raising taxes encourages dodging and deters consumption. The trick is finding the taxable sweet spot, the point of optimal taxation, that will get the government the most before discouraging income growth and encouraging scamming. No one today is seriously arguing for a top rate like 90 percent (under Eisenhower) or 70 percent (under Kennedy-Carter); the current discussion centers around moving the top rate back to a Clintonian 39 percent.

And no one who has ever wrestled through tax season, even girded with Turbo Tax and an array of Internet resources, can argue that our excruciating tax code couldn't use with a thorough house cleaning that, if done fairly and well, could—perhaps—mean lower tax rates and more revenue. But blanket cuts do not appear to automatically mean more dough. That's just the way the federal pie chart crumbles.

Here's more on this subject for those suffering from insomnia:

Believers:
http://www.cato.org/pub_display.php?pub_id=1120
http://www.heritage.org/research/reports/2003/08/the-historical-lessons-of-lower-tax-rates

Skeptics:
http://www.time.com/time/magazine/article/0,9171,1692027,00.html
http://www.cbpp.org/cms/index.cfm?fa=view&id=692
http://www.brookings.edu/articles/2004/0919useconomics_gale.aspx
http://curiouscapitalist.blogs.time.com/2006/10/29/tax_cuts_and_their_consequence/
http://krugman.blogs.nytimes.com/2010/07/15/carter-reagan-revenue/

COMMENTS (14)

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Comments

1. A huge minority wanted to believe Obama was not a native. And the idea that tax cuts increase revenue has been absorbed into the ideology of the same bunch. Imagine only paying 15% capital gains while the wage workers pay 35% and having the nerve to ask for lower capital gains. I had it affirmed by an un-employed middle aged college economic graduate friend whose only job in the the last two years was the census. Yep, he didn't like the Government either. I hear that people in Joplin MO have started to appreciate the Government responders.

   Report comment

Posted By ed gleason | Monday, May 23, 2011 06:33:52 PM

2. At 0% tax rates you collect no taxes. At 100% tax rates you collect no taxes. The maximum is somewhere in between. Also the tax rates on different types of individuals returns different behavior patterns and tax revenues are affected. It is possible that 40% tax rate on the middle class and a 15% tax rate on millionaires will generate more revenue than if you reversed the two.

   No knows the tax rate that will create the maximum tax revenue. Many just wants to raise them because they think it will generate more tax revenue and when it was pointed out to Obama that reductions of capital gains taxes under Clinton increased dramatically the tax revenues he said he was more interested in fairness. He has a strange sense of fairness, screwing the poor so that he can also punish the rich. Maybe that is what he meant by fairness. Here is the link

   http://www.youtube.com/watch?v=WpSDBu35K-8

   Mr. Clarke also made a false comparison above and he probably knows it. There was a very deep recession during the first two years of the Reagan administration as he had to reduce the high inflation of the Carter years. Despite that recession and the tax cuts, tax revenues rose dramatically under Reagan. Here is the results of the Carter and Reagan years.

   Starting in 1977 under Carter, growth in GDP after inflation 3.5% (total for 4 years so less than 1% with a stimulus package and low Fed rates implemented by the Democrats under Carter. The growth in government revenues after inflation was 9.3%. As Carter's policies pushed people into higher tax brackets, they paid a greater percentage of their wages in taxes. We had a new term in US economic performance called Stagflation and people paid higher taxes but the economy only grew barely. Hey maybe the higher taxes had an effect.

   Reagan first term: growth in GDP after inflation 11.1%, more than triple that of Carter.

(there was a deep recession the first two years as part of this) and growth in government revenues after inflation - 9.0%. Much higher growth in GDP than Carter and good growth in government revenues despite the tax cuts. Reagan second term: growth in GDP after inflation 13.3%; growth in government revenues after inflation - 16.8%. Again much higher growth in GDP than Carter and outstanding growth in government revenues despite the tax cuts. This puts to rest the myth that tax cuts cost the government money. it was just the opposite.

Since Ronald Reagan implemented his economic policies, total GDP had doubled (about 104% gain) and Federal revenues have doubled (105%). These include adjustments for inflation. Population growth during this time was about 32%. From 1981 to 2005, 45 million new jobs were created in the US and all this new job growth can be credited solely to small business start ups. None can be attributed to large business expansion as some obviously grew but others contracted so the net was zero. The reason for this were the financial incentives Reagan's policies provided and the removal of regulation inhibiting start ups.

All this is from official government websites on GDP, tax revenues and inflation by year.

The stock market prior to Reagan had languished for years and after Reagan came in it more than doubled during his term.

Report comment

Posted By JR Cosgrove | Monday, May 23, 2011 08:20:45 PM

And by the way, I am anti Wall Street since they seem to contribute very little to the economy except keeping New York City alive. Without them, NYC would be a ghost town or the Gotham City of Batman movies with lousy public services and few able to go to the theater or the expensive restaurants.

I would also tax the high income lawyers who contribute nothing to the economy. I am
3. much more interested in preserving the job generating centers such as those in Silicon
Valley and MIT and other centers of entrepeneurship than the high bonuses of Wall
Street and lawyers. But how can you single out these two groups. I wish there was a
way but that will not happen since these are two of the three financial rivers for
Democratic party funding. The other is the public employee unions. All three are
negatives on the economy and our lives but they are the life blood of the Democrats.

Report comment

Posted By JR Cosgrove | Monday, May 23, 2011 08:53:10 PM

" I hear that people in Joplin MO have started to appreciate the Government responders. "

4. Eighty-nine people lost their lives in Joplin, and Ed Gleason uses the tragedy to score a
(lame) partisan political point. Shame on you.

Report comment

Posted By Mark Harden | Monday, May 23, 2011 10:06:25 PM

<Mr. Clarke also made a false comparison above and he probably knows it.>

Not content with impugning people's intentions gratuitously, I see you've moved on to
5. mind reading and accusing people of dissembling, also gratuitously. Please conduct
yourself with more courtesy in the future.

Mr. Gleason, Mr. Harden has a point.

Report comment

Posted By Kevin Clarke | Monday, May 23, 2011 10:35:24 PM

6. The Government responders were and are appriecated by the people of Joplin.as they praised FEMA, National Guerd et al on TV Mr. Harden seems to believe that pointing out the work and praise of Gov workers is both partisan and lame. Shame on you.

Report comment

Posted By ed gleason | Monday, May 23, 2011 10:57:19 PM

7.

1. Reagan was a serial tax raiser. As governor of California, Reagan "signed into law the largest tax increase in the history of any state up till then." Meanwhile, state spending nearly doubled. As president, **Reagan "raised taxes in seven of his eight years in office**," including four times in just two years. Reagan raised taxes 11 times in his administration.

2. Reagan nearly tripled the federal budget deficit. During the Reagan years, the debt increased to nearly $3 trillion, "roughly three times as much as the first 80 years of the century had done altogether." Reagan enacted a major tax cut his first year in office and government revenue dropped off precipitously. Despite the conservative myth that tax cuts somehow increase revenue, the government went deeper into debt and Reagan had to raise taxes just a year after he enacted his tax cut. Despite ten more tax hikes on everything from gasoline to corporate income, Reagan was never able to get the deficit under control.

3. Unemployment soared after Reagan's 1981 tax cuts. Unemployment jumped to 10.8 percent after Reagan enacted his much-touted tax cut, and it took years for the rate to get back down to its previous level. Meanwhile, **income inequality exploded**. Despite the myth that Reagan presided over an era of unmatched economic boom for all Americans, Reagan disproportionately taxed the poor and middle class, but the economic growth of the 1980′s did little help them. Since 1980, median household income has risen only 30 percent, adjusted for inflation, while average incomes at the top have tripled or quadrupled.

4. Reagan grew the size of the federal government tremendously. Reagan promised "to move boldly, decisively, and quickly to control the runaway growth of federal spending," but federal spending "ballooned" under Reagan. He bailed out Social Security in 1983 after attempting to privatize it, and set up a progressive taxation system to keep it funded into the future. He promised to cut government agencies like the Department of Energy and Education but ended up *adding* one of the largest — the Department of Veterans' Affairs, which today has a budget of nearly $90 billion and close to 300,000 employees. He also hiked defense spending by over $100 billion a year to a level not seen since the height of the Vietnam war.

5. Reagan gave amnesty to 3 million undocumented immigrants. Reagan signed into law a bill that made any immigrant who had entered the country before 1982 eligible for amnesty. The bill was sold as a crackdown, but its tough sanctions on employers who hired undocumented immigrants were removed before final passage. The bill helped 3 million people and millions more family members gain American residency. It has since become a source of major embarrassment for conservatives.

6. Reagan illegally funneled weapons to Iran. Reagan and other senior U.S. officials secretly sold arms to officials in Iran, which was subject to a an arms embargo at the time, in exchange for American hostages. Some funds from the illegal arms sales also went to fund anti-Communist rebels in Nicaragua — something Congress had already prohibited the administration from doing. When the deals went public, the Iran-Contra Affair, as it came to be know, was an enormous political scandal that forced several senior administration officials to resign.

7. Reagan vetoed a comprehensive anti-Apartheid act which placed sanctions on South Africa and cut off all American trade with the country. Reagan's veto was overridden by the Republican-controlled Senate. Reagan responded by saying "I deeply regret that Congress has seen fit to override my veto," saying that the law "will not solve the serious problems that plague that country."

8. Reagan helped create the Taliban and Osama Bin Laden. Reagan fought a proxy war with the Soviet Union by training, arming, equipping, and funding Islamist mujahidin fighters in Afghanistan. Reagan funneled billions of dollars, along with top-secret intelligence and sophisticated weaponry to these fighters through the Pakistani intelligence service. The Taliban and Osama Bin Laden — a prominent mujahidin commander — emerged from these mujahidin groups Reagan helped create, and U.S. policy towards Pakistan remains strained because of the intelligence services' close relations to these fighters. In fact, Reagan's decision to continue the proxy war after the Soviets were willing to retreat played a direct role in Bin Laden's ascendency.

Report comment

Posted By Jimmy Winston | Monday, May 23, 2011 11:00:40 PM

8. " Mr. Harden seems to believe that pointing out the work and praise of Gov workers is both partisan and lame. "

The problem, Mr. Gleason is that everyone can page up to see the context of your original content and see that you meant nothing whatsoever about praising the workers, but only had condemnation for the presumably anti-government hicks in Joplin flyover country.

Just admit you went rhetorically overboard without charitable consideration and peace be with you.

Report comment

Posted By Mark Harden | Monday, May 23, 2011 11:10:01 PM

9. The International Monetary Fund (IMF) semi-annual report "Fiscal Monitor" of April, 2011 observerd the Unted States does not have a credible plan to reduce its national debt.

This IMF report made a seriies of recommentdations to reduce the hugh and hard-to-finance 14.3 trillion dollar national debt by spending cuts to rapidly expanding entitlement programs. The report did not make any recommendation for increadsing taxes. Instead recoommended going to a VAT Value Added Tax as is done in most European nations that raises a lot of revenue form a relatively much smaller base than the 15 trillion dollar United States Gross Domestic Product (GDP). Note the VAT tax is not to expand or even maintain entitilment programs at their current level. The VAT tax revenue would be to reduce the debt to GDP ratio over ten years to 60 percent of GDP. Our current ratio of nation debt to GDP (14.3 divided by 16 trillion) is over 90 percent of GDP. This debt ratio is projected to go to 100 percent in the next year.

The IMF identifies a debt to GDP ratio of 100% as a critical debt problem. The IMF should know. In the last year the IMF has bailed out Greece, Ireland and recently Portugal. These countries dept was above or near 100 percent of their GDP. Spain and Belguim may require IMF financial assistance in the future. These countires were either no longer able to finance their debt at any interest rate becasue no one would buy its debt securities or their debt securites could only be sold at avery high double-digit intrest rate. In return the IMF made these countires cut all government services and payments including salaries and pensions.

So it is not a happy day when the IMF starts noticing let alonge controlling the United States government's severe national debt crisis. The IMF report recommends urgent action to reduce the national debt to GDP ratio.

It os important to note the that total debt needs to be reduced while the GDP needs to be increased.

Increasing taxes foes not do the job here. Taxes would be used to finance the budget with less barrowing but the size of the debt would not be reduced without spending cuts. But tax increases would also tend to put a break on the economy which is already minimumlly growing at stagnant 2 percent rate. The GDP needs to grow to help reduce the debt to GDP ratio. The IMF reports recommends keeping the debt to GDP ratio well under 100 percent and eventually in ten years to 60 percent.

We should listen to the IMF recommendations so that the United States does not go into default for its excessive national debt the way Greece, Ireland and Portugul did.

Report comment

Posted By Tom Maher | Monday, May 23, 2011 11:35:13 PM

I find it amazing how we go around and around with "Reagan did this, Clinton did that" arguments while virtually no one mentions the role of the party that controls the House might be in the equation.

Reagan had to work with a Democrat House. The House is where all spending bills begin and it's in the House were pork and the overall size of government is largely established....so Reagan had to pass his tax cuts by winning over a large enough group of Democrats to win passage. Any one of you political junkies want to wager a guess as to the price he had to pay to get half of what he wanted? If you guessed more spending.... you'd be right.

Now if the tax rates were cut and spending held low.... it'd have been ever more successful. But by letting the Democrats spend more while rates are cut....the inevitable effect is deficits.

Clinton had to work with a Republican House after 1994. Guess when the vaunted and ballyhooed "surplus" was achieved (on paper)? Why what a coincidence! It was reached after the GOP forced welfare reform, after the GOP forced some spending cuts (which were more reductions in the rate of growth than absolute cuts).

10.

Meanwhile Reagan won the cold war and Clinton did what, exactly in his foreign policy dossier? Invade Haiti, mess up a successful mission in Somalia, sit by and watch genocide in Rwanda, dither in the Balkins, give up steath for a tactical mission over Serbia, give tech to the chi-coms to help them launch satellites (because ICBMs are sooooo different from satellite launch vehicles, right?), and let OBL get away 3 times..... yep, ol willy sure was a genius and Reagan a dunce. Meanwhile the talking heads pronounce Reagan's policies as the cause of deficits and ignore Congress....and praise Clinton's policies for the surplus and ignore Congress' role in forcing his hand.

And how many of you democratic "catholics" think big government spending is the moral equivalent to private charity? Or think me wanting to cut government to increase private charity is evil, while your desiring more government obstensibly to 'help the poor' makes you virtuous is "catholic social justice"?

We say things, we believe things. but strip away the rhetoric, get down to historical record and the players involved and a lot of what passes for common knowledge is myth.

Report comment

Posted By John Lyons | Tuesday, May 24, 2011 12:46:33 AM

11. Taxation in this country is just a cost of living, like breathing polluted air and going to work. And it's double labor - first, they take if from you at work and at the store; then, at the end of every year, they force you to tell them how much they took. In return for this pain, you get badly paved streets, dirty air, spotty police protection, and exorbitant and impossibly complex hospital bills.

But those weren't the main points of the essay, which seems to have had something to do with how stupid and deceitful conservatives are and how interesting tax policy can be if you're a speed reader and a masochist. No doubt.

Report comment

Posted By David Smith | Tuesday, May 24, 2011 01:21:13 AM

12. 'Mr. Clarke also made a false comparison'

Actually you made a false statement. Your statement was 'Reagan’s 1981 tax cuts reduced federal revenue until late in his second term' An absolutely false statement. Here are the tax revenues for 1976-1989

1976 - $506
1977 - $567
1978 - $646
1979 - $728
1980 - $798 inflation over previous 4 years 48.7% under Carter. ($536 without inflation compared to $506 for Ford's last year or it grew $30 billion in constant dollars)
1981 - $918
1982 - $939
1983 - $1000
1984 - $1113 inflation over previous 4 years 21.3% under Reagan ($917 without inflation compared to $798 for Carter's last year or it grew $119 billion in constant dollars)
1985 - $1214
1986 - $1290
1987 - $1403
1988 - $1502 inflation over previous 4 years 14.7% under Reagan ($1309 without inflation compared to $1113 for Reagan's first term or it grew $196 billion in constant dollars)

There was a severe recession with very high unemployment in 1982 as Reagan supported Volker's restriction of the money supply to kill inflation but despite this both GDP and tax revenues grew with lower tax rates. Taxes were lowered again in 1986.

Whether you knew it or not is certainly not in my mind reading capabilities and that is why I used the world probably. This was a post on taxes with some obviously false information so I assumed you did some homework but apparently not. So I apologize for saying you may have consciously distorted the information but you did distort the information presented. So I expect an apology to your readers for that.

Report comment

Posted By JR Cosgrove | Tuesday, May 24, 2011 07:30:36 AM

13. "Imagine only paying 15% while the wage worker pays 35%..."
This past year 51% of all wage earners paid no income tax. The typical wage earner Ed speaks of now pays zero income taxes. This is the understated problem with the Bush tax cuts, that as a compassionate conservative, Bush gave the largest tax cuts in rates to the lowest income earners, a full third reduction to the lowest levels. By President Obama only addressing the top earners, the supposedly lost tax revenue (discounting totally for comparison purposes supply side effects), over 80%, will remain lost. It is why he can be credibly accused of fishing for votes thru class warfare rather than sincere interest in deficit reduction.
The other understated issue is that President Bush was a big-time liberal when it came to spending. In the 8 years since the Bush cuts were introduced in 2003, actual revenues increased over 21%, despite the worst recession in 70 years. The problem is not revenue, but that spending increased 72%. In Clinton's 2 terms, non-defense discretionary spending increased 35%; in Bush's 2 terms, it increased 65%. (Granted most of Clinton's economic accomplishments occurred after Republicans gained control of the house, yet the fact remains.)
I don't mean in any way to imply that Bush's liberal outlook on spending can remotely

compare with Obama's. But Clinton, for whatever reasons, was the far more conservative president on spending.
Kevin's quote of Bartlett's comment is to me an appropriate one. Everything is a matter of degree, including supply side tax cuts. Keep cutting the temperature, and hot water becomes cold water. Cut taxes to zero, and you have no revenue. Yet we also must recognize that the competitive environment of taxation has changed, with tax cuts rather than increases becoming the norm. Canada's income tax rate, for example, has been cut to 16.5% this year, with a drop to 15% scheduled for next year. If we wish to attract top talent to the US rather than run it off, we must bear in mind remaining competitive in taxation.

Report comment

Posted By walter mattingly | Tuesday, May 24, 2011 08:47:58 AM

The only school of economic thought that espouses the view that cutting taxes always increases revenue is "my" school; that is, anyone who is actually paying taxes in this country wants to pay less, be they the struggling 9-to-5-ers or the CEO of the multi-national corporation who has to answer to the stockholders. So I think Mr. Clarke is making a straw man argument.

Conversely, many who think that taxes are not high enough are the ones who are paying no taxes.

14.

As one of the 50% of the US citizens who actually pays taxes but doesn't pay much attention to where my money goes, I was a little surprised to find that over 50% of federal revenue goes to support and provide for people who are not working. No analysis here, just an observation that something seems grossly out of whack and that it seems that changing the tax policy is not going to be the panacea that either side seems to think it is going to be.

Report comment

Posted By Michael Brooks | Tuesday, May 24, 2011 09:08:20 AM

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