Why Warren Buffett is wrong

Cambridge, Massachusetts (CNN) -- In a recent New York Times op-ed article, Warren Buffett asserts that the super-rich do not pay enough taxes. He suggests that any new budget deal should raise rates on the super-rich, especially on their "unearned" income from interest, dividends and capital gains.

Buffett is wrong. Bad government policies play a major role in generating inappropriately high incomes, but singling out the super-rich is misguided. And the policy Buffett criticizes most -- low tax rates on capital income -- should be expanded, not eliminated.

The first problem with Buffett's view is that the number of super-rich is too small for higher rates to make much difference to our budget problems.

In 2009, the income earned by the 236,833 taxpayers with more than $1 million in adjusted gross income was about $727 billion. Imposing a 10% surcharge on this income would generate at most $73 billion in new revenue -- only about 2% of federal spending. And $73 billion is optimistic; the super-rich will avoid or evade much of the surcharge, significantly lowering its yield.

Another view: Why Buffett is right

Focusing on the super-rich also fosters a counterproductive attitude toward material success. The way to promote a hard-working, entrepreneurial and innovative society is to celebrate great wealth so long as it has been earned by legitimate means. When this is not the case, policy should target the wrongdoing directly, not demonize everyone who hits it big.

Most importantly, singling out the super-rich distracts from the real problem: the myriad policies that make no sense in the first place because they inhibit economic growth and that simultaneously redistribute from low-income households to the middle and upper classes.

The deductibility of home mortgage interest encourages excess investment in housing. High-income taxpayers get the benefits, since low-income taxpayers own little or no housing and do not itemize deductions in any case.

The favorable tax treatment of employer-paid health insurance generates overconsumption of health care and contributes to rising health care costs. The benefits go mainly to middle- and upper-income households, since those without jobs get no employer-provided benefits.

Numerous loopholes for favored industries in the corporate tax code distort the market's investment decisions and reward the well-funded and politically connected.

And it is not just the tax code that harms the economy while favoring the better off.

Excessive licensing requirements, permitting fees, restrictive examinations and other barriers to entry into medicine, law, plumbing, hair styling and many other professions are bad for economic productivity because they artificially restrict the supply of these services. And these barriers redistribute income perversely by raising incomes for those protected and raising prices for everyone.

Crony capitalism -- the special treatment of favored industries like autos -- runs counter to economic efficiency because it protects businesses that would otherwise fail, and it maintains high incomes for executives and shareholders.

The too-big-to-fail doctrine, exhibited most recently in the TARP bailout of Wall Street banks, distorts efficiency by encouraging excess risk-taking. Meanwhile, bailouts generate huge incomes for the lucky few who keep gains in good times and pass losses to taxpayers in bad times.

In contrast to these and other policies, the one Buffett criticizes -- low tax rates on capital income -- is beneficial for the economy, including lower-income households.

Economists agree broadly that an efficient tax system should avoid taxing income, dividends and capital gains to promote savings, investment and growth. Tax rates on capital income should therefore be low or even zero. The U.S. is far from this ideal, especially given the high tax rate on corporate income and the additional taxation at the personal level.

Buffet asserts that taxing capital income has never deterred anyone from investing. Well, then he has never discussed the issue with me or many of my friends.

More importantly, taxing investment returns plays a huge role in what kinds of investments occur, and where, even if it has minor effects on the amounts. These tax-induced distortions in investment choices then reduce economic growth. High U.S. taxation on capital income drives investment overseas.

So raising capital tax rates will not make the super-rich pay their "fair" share; it will encourage capital flight, driving factories and innovation abroad. The rich will still get their high returns, but U.S. workers will have fewer jobs and lower wages.

Buffett errs, most fundamentally, by focusing on outcomes rather than policies. The right question is which policies promote differences in incomes that reflect hard work, energy, innovation and creativity, rather than reward the unethical, the politically connected and the tax-savvy.

In economics, as in sports, we should adopt good rules and insist that everyone play by them. Then we should stand back and applaud the winners.

The opinions expressed in this commentary are solely those of Jeffrey Miron.