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RAHN: Thoughtless taxation

We're past the point of diminishing returns

By Richard W. Rahn

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Treating variables as constants is a sign of a damaged brain. In the real world, almost any action taken by government is going to cause a behavioral response - and often one that is not intended. Wise people think through what is likely to happen with any given action. Unfortunately, the ongoing lame-duck Congress(/topics/congress/) and the administration are again demonstrating the shortage of wise people.

Many Democrats, including many lame ducks, are still demanding that tax rates for entrepreneurs be increased under the absurd claim that not to do so will "cost" the government "almost $2 trillion over the 2011-20 period" in lost tax revenues. To believe these bogus numbers that the Joint Tax Committee(/topics/joint-tax-committee/) staff and the administration put out about the revenue loss, one needs to believe that upper-income people will not alter their behavior when faced with higher tax rates, that high marginal tax rates on capital (the seed corn of the economy) and double taxation of it do not damage economic growth and job creation, and that the government is smaller than its optimum size to maximize the general welfare. The empirical evidence as well as good economic theory demonstrate that none of the above is true - but to those politicians, mainstream media sorts and left-wing economists who cannot understand the difference between variables and constants, facts don't matter.

The Wall Street Journal(/topics/the-wall-street-journal/) reported this past week, "Some of the nation's largest banks are exiting or scaling back their dealings with foreign embassies and missions because of the burden of complying with money-laundering regulations." The head of the Angolan mission(/topics/angolan-mission/) to the United States(/topics/united-states-of-america/) said, "Bank account closures strain relations with the U.S.(/topics/united-states-of-america/) ... Without bank accounts, we find it very difficult to function." Surprise, surprise. Most people (other than members of Congress(/topics/congress/) and government bureaucrats) can figure out not to take an action if the costs outweigh the benefits. U.S. government(/topics/us-government/) financial regulations on banks have reached the point where it is no longer profitable for banks to engage in many normal and necessary banking operations, particularly with foreigners. Not a good way to make friends.

In March, Congress(/topics/congress/) passed the "HIRE Act" which has had the unintended - but not unforeseen by many of us - consequence of causing foreign banks to withdraw from investing in the United States(/topics/united-states-of-america/) because of the costs and uncertain liabilities of dealing with U.S. government(/topics/us-government/) regulations. Thus, the United States(/topics/united-states-of-america/) may lose a trillion or more dollars in foreign investment under the guise of picking up a few billion dollars in tax-avoidance revenue. The members of Congress(/topics/congress/) who voted for this foolishness, along with the Treasury bureaucrats who have yet to come up with sensible and workable regulations, do not seem to understand that foreign investment is a variable, not a constant.

There are many members of Congress(/topics/congress/) (virtually all of them Democrats) who are still resisting repeal of the truly boneheaded regulation they passed earlier this year to require all businesses to file a 1099 form with the Internal Revenue Service (IRS) for any purchase of $600 - yes, just $600 - or more. How tough is it to figure out that such a regulation not only does not meet any reasonable measure of cost-benefit, but in a practical sense, there is no way that the IRS could properly process all the paper (even electronically)?

Finally, last week, the co-chairmen of President Obama's deficit-reduction commission, former Sen. Alan Simpson and Erskine Bowles, released the outline of their plan, and a private group co-chaired by former Senate Budget Committee Chairman Pete V. Domenici and former Clinton Office of Management and Budget Director Alice M. Rivlin released their deficit-reduction plan. Both plans recognize that the budget deficit could only be reduced if entitlement spending was reduced, particularly the medical entitlements. Both plans recognize that tax increases have adverse economic consequences and are far more damaging than spending cuts, but both plans endorse major tax increases. Neither plan seems to have asked the fundamental question, which is: Why do we need to have a government bigger than the revenue the tax code now produces? The simple answer is that we don't.

Government is growing faster than the private sector, and thus it is an arithmetic fact that no amount of tax increases can solve this spending problem. When a politician promises a spending "entitlement" to one person, that politician is also making the normally unstated promise to make someone else a tax slave to pay for the entitlement. Tax revenue is a variable, not a constant. At some point, the slaves revolt and the game is over. We are now in the endgame.

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