Abolishing income tax is crazy talk

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The recent announcement by Antigua and Barbuda Prime Minister Gaston Browne that he will be abolishing income tax has spurred another income tax debate. Browne's policy is bad and will fail. It will lead to income inequity and economic stagnation. But that is not stopping the uninformed from embracing the folly with glee.

It was one of the better economists of our time, John Kenneth Galbraith, who said: "In economics, the majority is always wrong." The majority is always wrong because they allow gut instincts to guide them. And empirical evidence shows that people tend to be more successful when they go contrary to their gut instincts.

Do we remember the glee with which we welcomed high interest rates in the 90s? How we thought it was wonderful to put money in the bank and get 20 per cent interest on it? How well did that work out? The bitter medicine of Finsac still lingers. And that was the consequence of a regime of high interest rates.

We are approaching the debate about the removal of income taxes with the same excited anticipation, and I can say without any equivocation that if we were to go down that road it would not end well. I speak with the certainty of a man who has taken the time to study the most successful economy the world has known, and have been able to analyse and understood the methods that were employed that led to success and the ones which led to failure.

I have studied the American system and reviewed its performance from 1790 to the present. I have seen how America performed when there was no income tax and how it performed when there was massive income tax revenues. I will let the reader judge which system is best.

The following was excerpted from the manuscript of my soon-to-be-published book, T*he Economic And Financial Crisis of 2007:*

According to *Wikipedia*, the first personal income taxes in America were imposed by the Congress in 1861 in order to raise funds to pay for the American Civil War effort. A three per cent tax rate was imposed on income over US$800 per annum. America became a sovereign nation on July 4, 1776.

The Internet site *Measuring Worth* [*http://www.measuringworth.com/datasets/usgdp/result.php*] covers economic statistics from 1790 to the present. It is therefore possible to compare GDP growth of America before personal income taxes were imposed and after taxes were imposed.

Let us briefly examine the period from 1790 through to 1861, as well as other periods between 1861 and the present... If paying little or no taxes is a good thing, then this should be reflected in those years when no taxes were payable. And those years should have a clear and significant advantage when compared with years when income taxes were imposed. Since the presumed prosperity of individuals must naturally be reflected in the prosperity of the country, the best measure to use to determine the growth and prosperity of a country is the speed at which it doubles its national income.

In the base year of 1790 the GDP of the US was US$1,024.87 in constant 2005 dollars. In 1846 the GDP was then US$2,083.89. It took America 56 years before it doubled its income. (Starting from a small amount, this was growth at a snail's pace. It is easier to double a small sum than when the amount gets larger. Also countries grow both vertically — doing more of what the country already does — and horizontally — doing new things. As countries mature, the opportunities to do new things get less.)

The next income doubling occurred in 35 years. In 1881 the GDP was US$4,166. By this time, the nation was collecting personal income taxes. This shorter period for income doubling was undoubtedly a result of expanded government activities made possible by the increased revenue. Indeed, subsequent developments support this thinking.

The shortest period for income doubling was nine years, from 1933 to 1942. The US per capita GDP moved from US$5,699.74 in constant 2005 dollars in 1933 to US$11,999.11 by 1942. This period saw some of the most aggressive tax increases in the history of the USA.

According to Veronique de Rugy, a fiscal policy analyst with the Cato Institute, President Herbert Hoover signed the Revenue Act into law in 1932. This was a radical departure from his predecessor's misguided policy of insane tax cuts. "The law sharply increased individual tax rates at all income levels with the top rate rising from 25 per cent to 63 per cent." When Franklin Delano Roosevelt assumed office in 1933, another round of tax increases was imposed.

De Rugy states further: "President Roosevelt signed into law a series of large tax increases for taxpayers at all income levels. At the bottom end, personal exemptions were reduced, and an earned income credit was eliminated. At the top end, the highest marginal rate was increased to 79 per cent in 1936."

In addition to the sharp increase in personal income taxes, there was a sharp increase in corporate taxes. Between 1930 and 1940, the corporate tax rates moved from 12 per cent to 24 per cent (an excess profit tax, an excise tax on dividends, a capital stock tax, and liquor taxes were imposed, and estate taxes were increased). And a two per cent social security tax was imposed in 1937. As de Rugy commented, "The scale and scope of the 1930s tax increases were extraordinary."

It is significant to note that as a result of extraordinary tax increases, the nation's income doubled at an extraordinary speed. Nine years! There should be no doubt that the fiscal measures

implemented during this period laid the foundation for the solid, safe, and secure expansion of the American middle class. This is what tax increase does.

In the next chapter you will see what tax cut caused. It is also instructive to note that in countries where governments impose substantial and steady personal income taxes, their national income doubles at more frequent intervals.

The mistake the anti-taxes forces in the US keep making is in equating the "tax and spend" by Uncle Sam practised by Democrats, to the "tax and take" that was imposed by Britain as the colonial master. Or the oppressive taxes that were imposed by the Romans on the Jews of Palestine during the time of Christ. It was those taxing practices which made the tax collector a hated profession during those days.

Tax and take is equivalent to extortion, and resistance to such practices are justified. There should be no taxation without representation! Any extraction of capital out of a country will tend to lead to a decline in economic and job growth. It does not matter if the extraction of capital is as a result of a colonial power taxing and taking, or of free men shipping tax cut monies to presumed greener or safer pastures.

In Part Two I will show why no or low taxation leads to stagnation and why progressive taxation causes growth. I will also show why relying on sales taxes to fill the breach left by the abolishing of income taxes is fundamentally flawed.