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Foundation Explores Effect Of Obama's Tax Plans, by Mike Godfrey, Tax-News.com, Washington

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The Center for Freedom and Prosperity Foundation (CF&P) has released a new paper analyzing how movements in tax rates lead to behavioral changes that cause significant shifts in the amount of income reported to tax authorities.

The new paper, entitled "The Laffer Curve: Understanding the Relationship Between Tax Rates, Taxable Income, and Tax Revenue," reviews the theory and evidence for "Laffer Curve" effects and discusses how the Joint Committee on Taxation's revenue-estimating process is based on the “absurd” theory that changes in tax do not affect economic growth.

Because of congressional budget rules, this leads to a bias for tax increases and against tax cuts, the CF&P argues.

"When you tax something, you get less of it, and that applies to income. When taxable income goes down, this at least somewhat offsets the impact of higher tax rates," explained CF&P President Andrew Quinlan. "As politicians in Washington seek to expand the burden of government, they need to understand that higher tax rates ultimately becomes a self-defeating policy.”

Named after Art Laffer, an economist who served as an advisor to Ronald Reagan, the Laffer Curve attempts to demonstrate that, at a certain point, higher tax rates fail to produce more revenue.

The paper cites the example of Russia in support of the argument that lower taxes encourage economic growth and produce higher revenues for governments. The Russian government introduced a flat income tax of 13% in 2001, which replaced a graduated system in which tax rose from a basic rate of 12% to a top marginal rate of 30%. According to the study, receipts from personal income tax shot up from RUB174.5bn in 2001 to RUB930.4bn in 2006 (USD5.5bn to USD29.1bn at current exchange rates) – representing annual inflation-adjusted growth of 19%.

"With Obama planning a number of anti-growth tax measures, it is especially important to educate both the general public and policy makers that the Laffer Curve is very real,” noted Cato Institute Senior Fellow Dan Mitchell. “Higher tax rates will cause taxable income to fall. Revenues may increase, but the cost to the economy will be far higher than any gain for politicians.”

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