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RAHN: Buffett rule's deceitful consequences

The rich have the means to decide how much tax is 'fair'

By Richard Rahn
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Do you think it is more important to have a tax policy that raises the most revenue at the least cost in order to maximize job growth and economic opportunity or to have a tax policy like the Buffett rule, which falsely claims it would make all millionaires pay a higher tax rate than their secretaries?

President Obama released his tax return last week, showing he had an effective rate of a little more than 20 percent of his income, even though he is rich by his own definition. One of major ways the Obamas were able to reduce their tax rate was by giving away 22 percent of their income to charity, which I applaud. But their actions raise several interesting points. The president's actions illustrate how people have the ability largely to determine their own tax rate both by the amount of money they choose to give away and the types of investments they choose to make.

When we donate money to a charity, church or some other worthy cause, we are allowed a tax deduction, which means the government gets less of our money. The president and many in his party keep telling us that the government needs more money, but if they believe this, why are they taking charitable deductions? I expect the reason is that most of us implicitly believe (for good empirical reasons) that private charities and other tax-exempt groups spend our money more wisely and carefully than the government.

Do a thought experiment. Assume rather than just being able to take a tax deduction for your contributions to qualified nonprofit organizations, you could take a tax credit. That is, you would get a dollar deduction in your income tax liability for each dollar you chose to give away. Assume you make $50,000 a year and after you calculate your tax liability you find you owe $10,000, or 20 percent. But then you have the choice of paying some or all of it to the government or some or all of it to nonprofit organizations. How much would you send to the government and how much to nongovernmental organizations? How much do you think your friends and family would send to organizations other than the government?

The federal government is spending about 24 percent of gross domestic product (GDP). Most of it goes for Social Security, Medicare, Medicaid and other entitlement programs. The “discretionary” portion of the budget equals about 9 percent of GDP, with about half going for defense. Until 1930, the federal government normally spent less than 4 percent of GDP, except for the periods during World War I and the Civil War. The Constitution gives the federal government very few tasks for which it is required to spend money - the big item being the “common defense.” Again, up until 1930, the courts forced the federal governmentto live largely within the confines of the Constitution. Deducting defense spending from the federal budgets before 1930 shows that the federal government lived perfectly well on 2 percent to 3 percent of GDP for the first 140 years of the republic.

What all of this means is that approximately three-quarters of all federal government spending is not required by - and often is contrary to - the Constitution. So we should be asking ourselves: Are there any better and less damaging ways to accomplish what government is claiming to do for us? The answer, of course, is yes. Think tanks and others have produced many serious documents and books about how the private sector can do almost everything better than the public sector.

All of which gets us back to the Buffett millionaires’ surtax. Even the official government scorekeeper, the Congressional Budget Office, says the tax would only bring in a minuscule amount of revenue. Also, private tax economists, using dynamic models rather than government models that fail to account for all the changes in behavior, find the tax would be a big revenue loser. So the president and his allies have largely switched their argument to one of “fairness” and reducing the disparity in income distribution. They are never willing to define why 30 percent or any other number is “fair,” nor are they able to explain why people who work harder and contribute more should be taxed at a higher rate.

Even if the Buffett tax ever passes, it was crafted by members of Congress to hit few of their own. Very rich members of Congress, such as Sens. John F. Kerry and John D. Rockefeller IV, receive much of their income from tax-exempt state and local bonds and from trust funds, which largely avoid the tax. Members of Congress generally are restricted from entrepreneurial activities. So, of course, they have decided to increase the tax on entrepreneurs - the capital gains tax - which is a tax on becoming rich, not a tax on being rich.

Most people, such as students, are relatively poor by government methodology when they are young but rise through the income ranks as they become more productive and experienced and then fall in relative income as they near and enter retirement, even though they may have considerable net wealth. By increasing the tax on capital gains and marginal rates, the government makes it more difficult to move into higher income brackets, thus actually reducing income-class mobility.

Those who support the Buffett millionaires' surtax as written reveal themselves either to be economically ignorant or to believe the voters are fools who will not see through their destructive games.

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