THE TEN

GOLDEN RULES

OF TAXATION

– Stephen L. Bakke – April 26, 2012

> ***Would it not be better to simplify the system of taxation rather than to spread it over such a variety of subjects and pass through so many new hands.*** – Thomas Jefferson, letter to James Madison, 1784

I Wonder as I Wander (my apologies to the religious hymn)

I wander all over the place - books, newsletters, and the internet – trying to learn something or pick up pieces of wisdom. As I wander, I wonder about ways to use the information. I was reviewing a recent report on economic policy, and a part of it caught my eye. This was in the preface to the large report, "Rich States, Poor States," which deals with the impact on states of their respective economic policies. This is an annual project of the American Legislative Exchange Council.

This study presents key variables that allow states to thrive, or cause them to struggle. It deals with, among other things, empirically evaluating the impact of tax policy on each state's social and economic vibrancy. The authors are Dr. Arthur B. Laffer (Laffer Associates – economic research and consulting), Stephen Moore (The Wall Street Journal), and Jonathan Williams (director of the Center for State Fiscal Reform). If you check the bios for these gents, they have done so much more than I listed!

The "wisdom" that I chose to borrow from the aforementioned report, is a great introduction to the massive subject of federal tax reform which I plan to deal with more in the future. Since one of my goals in all my reading and research is to learn, and another is to share the things I learn, I present here "The Ten Golden Rules of Taxation."

The Ten Golden Rules of Taxation

I think these Golden Rules are not only clever, they form a very practical, common sense way of evaluating motives, incentives, and results related to tax policies. Here are these Golden Rules:

1. ***When you tax something more you get less of it, and when you tax something less you get more of it.*** Tax policy is all about reward and punishment. It is wise to keep taxes on work, savings, and investment as low as possible in order not to deter people from participating in these activities.

2. ***Individuals work and produce goods and services to earn money for present or future consumption.*** Workers save for the purpose of conserving resources so they or their children can consume in the future.
3. ***Taxes create a wedge between the cost of working and the rewards from working.*** All taxes ultimately affect people's incentive to work and invest, though some taxes clearly have a more detrimental effect than others.
4. ***An increase in tax rates will not lead to a dollar-for-dollar increase in tax revenues, and a reduction in tax rates that encourages production will lead to less than a dollar-for-dollar reduction in tax revenues.*** Tax rate changes affect the amount of tax avoidance.
5. ***If tax rates become too high, they may lead to a reduction in tax receipts. The relationship between tax rates and tax receipts has been described by the Laffer Curve.*** Within what is referred to as the "normal range," an increase in tax rates will lead to an increase in tax revenues. At some point, however, higher tax rates become counterproductive, and an increase in tax rates leads to a reduction in tax revenues, and vice versa.
6. ***The more mobile the factors being taxed, the larger the response to a change in tax rates. The less mobile the factor, the smaller the change in the tax base for a given change in tax rates.*** As an example, taxes on capital are almost impossible to enforce in the 21st century because capital is instantly transportable.
7. ***Raising tax rates on one source of revenue may reduce the tax revenue from other sources, while reducing the tax rate on one activity may raise the taxes raised from other activities.*** For example, an increase in the tax rate on corporate profits would be expected to lead to a diminution in the amount of corporate activity, and hence profits. Conversely, a reduction in corporate tax rates may lead to a less than expected loss in revenues and an increase in tax receipts from other sources.
8. ***An economically efficient tax system has a sensible broad base and a low rate.*** Ideally, the tax system of a taxing jurisdiction will distort economic activity only minimally. High taxes alter economic behavior. If the tax base is broad, tax rates can be kept as low and non-confiscatory as possible.
9. ***Income transfer (welfare) payments also create a de facto tax on work and, thus, have a high impact on the vitality of a taxing jurisdiction's economy.*** High welfare benefits magnify the tax wedge between effort and reward. As such, output is expected to fall as a consequence of making benefits from not working more generous. Thus, an increase in unemployment benefits is expected to lead to a rise in unemployment.
10. ***If A and B are two locations and if taxes are raised in B and lowered in A, producers and manufacturers will have a greater incentive to move from B to A.*** This "Golden Rule" applies to cities, states, or the entire country.

There is much discussion provided for each of these Golden Rules and I encourage any interested individual to find it and read it. You will find a "boatload" of good common sense, which is so lacking in our government and its current policies. Maybe some of this wisdom will "stick" if we convey it enough times. I'm going to try!

In closing let me present what a very bright and clear thinking 20th century Nobel Prize winning economist said on this topic. This is from Friedrich A. Hayek's classic, "The Constitution of Liberty."

> ***The illusion that by some means of progressive taxation the burden can be shifted substantially onto the shoulders of the wealthy has been the chief reason why taxation has increased as fast as it has done and that, under the influence of this illusion, the masses have come to accept a much heavier load than they would have done otherwise. The only major result of the policy has been the severe limitation of the incomes that could be earned by the most successful and thereby gratification of the envy of the less well off.***