Taxation, Individual Actions, and Economic Prosperity: A Review

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Introduction

A move toward socialist, government-centered economic systems in the United States, as proposed by the political left, would require a substantial increase in government resources, which could only be brought about through significant increases in tax revenue. According to data from Organisation for Economic Co-operation and Development (OECD) (figure 1), the US government spent 38 percent of GDP in 2019, placing it above countries such as Ireland (25 percent), Chile (26 percent), Korea (30 percent), and Switzerland (34 percent), but significantly below most OECD nations. The countries that top the list are France (56 percent), Finland (53 percent), and Belgium (52 percent).

While increases in government expenditures can temporarily be financed through public sector borrowing, eventually such borrowing must be repaid through taxation or monetarization of the debt by the central bank. In this piece, we review research on the distortionary effects of taxation to shed light on the likely consequences of attempts to move to a system in which a significantly larger share of the economy consists of government expenditures.

Most current proposals to fund large-scale expansions of government programs, such as Medicare for All or the Green New Deal, rely on progressive income taxation and wealth taxation. That is, the proposals typically involve raising the top tax rates for high-earning households, lowering the earnings thresholds at which households face those top tax rates, imposing taxes on wealth, or some combination of these measures. Analyses, including those by the Committee for a Responsible Federal Budget, have concluded that the extent of spending in these proposals could not be financed though these channels alone—in fact it would be mathematically impossible to do so—and the United States would have to resort to other forms of taxation, introducing a national consumption tax, for instance, or value-added taxes, which would be directly paid by a very large share of the population, not just the upper end of the income or wealth distribution.[1]

However, surveys by the Pew Research Center suggest that a large majority of Americans (86 percent) favor the government raising taxes on "the wealthiest Americans," while rather few (12 percent) favor raising taxes on "people like them."[2] Given these preferences, it seems most likely that the first main political movement toward the financing of a substantially expanded government sector would take place through increased income taxation and wealth taxation. In this piece, we therefore focus on income taxation and wealth taxation, the limits to their potential for raising revenue, the impact they have on taxpayer behavior, and the societal costs of such distortions.

The basic principle underlying the study of taxation is that the imposition of taxes will alter the behavior of agents in the economy. In the words of seventeenth-century French minister of finance Jean-Baptiste Colbert, "The art of taxation consists in so plucking the goose as to procure the largest quantity of feathers with the least possible amount of hissing." From the perspective of government authorities aiming to extract maximum value from the economy, the ideal tax is one that does not induce any behavioral response that would reduce the size of the government's take or the overall economic pie that represents the economy. Finding such taxes necessarily implies a starting point of ignoring the distributional features of the tax, including whether the tax at application is progressive or regressive, as the government can redistribute the proceeds of the tax to achieve any distribution it views as equitable.

For the purposes of this piece, we will focus on taxation of individuals, as corporate income taxes remain quantitatively less important for raising revenues—although they may be highly distortionary in terms of both capital allocation and employment.[3]

The simplest individual tax that cannot be avoided through individual behavioral change is a lump-sum tax that applies universally and is unaffected by the taxpayer's actions. Taxes that are levied in equal amount on all taxpayers are known as poll taxes or head taxes.[4] Of course, if individuals can change jurisdictions by moving out of the country or region that imposes such a tax, they can escape this tax as well. A tax on land value, most famously espoused in the nineteenth century by Henry George, has similar or possibly even superior efficiency properties, since if there is an efficient real estate market, there is nothing an individual can do to avoid the land tax: selling the land to leave the jurisdiction would occur at a price that reflected the land's reduced value due to the tax.[5] In the words of Milton Friedman, "The least bad tax is the property tax on the unimproved value of land, the Henry George argument of many, many years ago."[6]

Several other lines of inquiry about taxation stem from a string of early twentieth century University of Cambridge economists. One insight of the work of Arthur Pigou in 1920 was that government should tax activities that it would like to encourage less of due to their imposition of negative externalities. These ideas are today manifest in pollution taxes and carbon taxes, among others.[7] A young Cambridge mathematics lecturer, Frank Ramsey, pioneered research in 1927 on the optimal structures of sales and commodity taxes.[8] His main conclusion was that the optimal consumption tax on each good should fall with the representative consumer's demand elasticity. This minimizes the societal economic loss (or "deadweight loss") for any given amount the government must raise through commodity taxation.

Despite the theoretical advantages of lump-sum taxes, land-value taxes, Pigouvian taxes, and consumption taxes on goods with inelastic demand, 70 percent of taxes in the United States are collected in the form of income tax. The challenge of income taxation is that it may discourage productive activities that grow the economy, and it may also lead taxpayers to invest in tax avoidance or tax evasion. In the spirit of Colbert, public finance economists often view the effect that changes in tax rates have on reported taxable income as a measure of how efficient or inefficient the income tax is, an approach pioneered by Martin Feldstein in the 1990s.[9]

As we discuss later in this paper, there is increasing evidence that the responsiveness of the individual income tax base to taxation is higher than is typically assumed, particularly when one considers the high-income individuals who pay a large share of income taxes. A broader issue that we also address is that the economics profession has paid more attention to government revenue maximization than to overall economic prosperity.

As regards the approach of directly taxing wealth, history increasingly suggests that wealth taxation is an inefficient means through which to raise tax revenue. For one, any taxpayer potentially subject to the wealth tax is strongly incentivized to alter his behavior from economically productive behaviors such as capital investment to inefficient behaviors such as paying lawyers and accountants to avoid the tax altogether, thus lowering tax revenues and effectively compounding the cost of the tax. A number of European countries that once had such tax policies eventually faced this reality and abandoned the measures altogether.

Finally, the distortions and flaws of different approaches to taxation raise questions about the fundamental premise on which most recent taxation proposals rest: that government involvement in the market is more effective in remedying societal problems, such as inequitable distribution of resources, than the private market. This remains the single most problematic argument that has undergirded most socialist arguments around wealth or income confiscation throughout history.

Income taxation

In the implementation of income tax policy, a fundamental distinction that must be understood is the difference between marginal tax rates and average tax rates. Under a progressive tax regime, marginal tax rates increase with higher levels of income, which is the main reason, together with their higher incomes, that high income individuals pay a greater share of the tax burden (figure 2).

While a given taxpayer's income may place him or her in a particular tax bracket with a corresponding marginal tax rate, the *average tax rate* at which taxpayers pay the entirety of their taxes is usually much lower. This is because only the portion of a taxpayer's taxable income that falls within a given bracket is subject to that corresponding marginal tax rate. Therefore, after an individual claims deductions and pays the taxes owed at the proper rates of different brackets, the overall percentage of income that is paid will be less than the top marginal rate. As income rises, the average tax rate approaches the top-bracket marginal tax rate.

It is an underappreciated fact that the US income tax system is one of the most progressive among OECD countries (figure 3). Furthermore, this has been trending in a more pronounced direction over the last forty years. In that time frame, the share of federal taxes paid by households in the highest quintile increased from 55 percent in 1979 to 69 percent in 2017.[10] This outpaces the United Kingdom, Germany, Sweden, and even France.[11] That is in part due to the differences between the tax rates at lower income levels across these countries. For example, in France upon reaching the income level of $33,000, the marginal tax rate is 30 percent. The federal marginal rate at this same income level in the United States is a mere 12 percent. Therefore, in order to make the United States tax regime even *more progressive*, the higher rates at which high-income individuals are already taxed would need to be increased to an even more extreme degree.

Due to the lack of uniformity in states' approaches to taxation, the United States provides an interesting experiment on the effects of progressive tax systems. According to the Illinois Policy Institute, immigration trends over the past decade show that four out of the five states with the worst trends in net population growth had progressive income tax regimes.[12] Conversely, the states that experienced the greatest population growth over the same period had a flat tax or no state income taxes. A poll of individuals leaving Illinois—the state with the most negative change in population numbers in raw terms and second to worst in percentage (–1.3 percent)—showed that the top reason for leaving was in fact taxes.[13] Thus, while making taxes higher may seem to be an effective approach to raising revenues, one must consider the potential revenue loss generated as a result of a behavioral response to these measures.

The modern tradition of serious economic modeling of optimal income tax rates goes back to yet another economist from the United Kingdom, James Mirrlees, who in a noted 1971 paper introduced endogenous labor income to the classical utilitarian model and derived revenue-maximizing marginal tax rates that *decline* with income, seeming to provide theoretical evidence against progressive income taxation.[14] In this framework, individuals with an ability to earn high incomes can choose to work less and produce at lower income levels, thus paying less tax. In theory, if there is a single top earner in an economy with positive marginal tax rates at that earner's income level, the marginal tax rate on income above that earner's income should be set to zero—the government would collect no less income tax and the individual might produce more.[15] However, the public economics profession has spent the intervening decades modifying and revising this fundamental result. The "zero tax rate at the top" result is local to the top earner, and the shape of the ability distribution near the top can have large effects on the efficiency-maximizing rate of high earners.[16]

Martin Feldstein emphasized the so-called elasticity of taxable income (ETI) as a measure of the efficiency of a tax system. The ETI is an attempt to measure the impact on tax revenues of changes in tax rates and subsequent behavioral changes. For example, an ETI of 1 means roughly that if an individual's marginal tax rate rises by 1 percent, he will report 1 percent less taxable income to the government. To take the example further, imagine a taxpayer with taxable income of $250,000 facing a 50 percent marginal tax rate. If that tax rate increases to 51 percent, that is a 2 percent increase in the individual's marginal tax rate, so an ETI of 1 would imply that such an increase would lead the individual to report $5,000 less taxable income (2% x 1 x $5,000) after the tax reform.[17]

Many research papers attempt to calculate an "optimal" marginal income tax rate that would maximize government revenue, taking into consideration the fact that higher marginal tax rates will reduce taxable income. While the mainstream economics profession rarely cites the work of Art Laffer, his famous curve that peaks at a revenue-maximizing tax rate (figure 4) is certainly the clearest available exposition of this concept. The revenue-maximizing income tax rate depends on a number of assumptions about economic behavior, first and foremost among them the ETI.

The ETI might not be a perfect measure of the ability of an income tax system to collect revenue without changing economic behavior, but it is close. As pointed out by Raj Chetty, some of the costs of sheltering income are transfers from one economic agent to another, including charitable contributions, trusts for descendants, or even payments to tax attorneys. In this context, Chetty essentially provides an argument that high taxation is not as bad as the behavioral response of taxable income would make it seem, since the welfare of all of the beneficiaries of tax evasion may be undervalued by taxpayers.[18]

Of course, this also highlights the fact that tax systems that allow for these types of avoidance effectively favor one activity over another. Furthermore, the nature of this discussion makes obvious that the goal pursued by most of the public economics research profession as far as income taxation is concerned is quite narrow. If a tax can be collected without changing the activity that generates the tax base too much in a distortionary way, then it is viewed by the profession as a good tax, and as long as the government doesn't actually lose money by raising tax rates, then such tax increases are acceptable.

Perhaps the most widely known recent paper in this literature, by the Nobel Prize–winning economist Peter Diamond and his coauthor Emmanuel Saez, calculates an optimal top tax rate of 73 percent, while another, by Thomas Piketty, Saez, and Stefanie Stantcheva, calculates an optimal top tax rate of 83 percent.[19] Although they do not cite Laffer, in effect their approach is analogous to identifying the top of a Laffer Curve. If the definition of socialism is "a system in which the perceived unjust distribution of income is righted through extensive state intervention and control," these papers sound as though they are advocating a socialist approach to taxation.

These results have been criticized on many grounds. Certainly, by incorporating the possibility of disincentives to invest in human capital and innovation, the long-term revenue-maximizing top tax rate must be lower than those implied by the above papers. The work of many economists, including Joseph Stiglitz, has confirmed the general intuition of the Mirrlees results.[20] In a recent paper from the Hoover Institution, Ken Judd and three coauthors come to similar conclusions as Mirrlees, going as far as supporting negative rates on top income levels. Overall, since the publication of Mirrlees's research and related examples, OECD countries have become less progressive in their tax systems, as the United States has grown increasingly progressive.[21]

Another issue with papers that claim to justify high optimal top tax rates is their assumptions about key behavioral parameters, particularly the ETI, which is set to 0.20 or 0.25. Further, recent empirical evidence that considers effects on both extensive margin (out-migration) and intensive margin (tax avoidance by stayers) raises the possibility that the ETI for high earners might be significantly higher.

One issue is that many ETI estimates do not account for taxpayer departures. Two papers—the first by Enrico Moretti and Daniel Wilson, the second by David Agrawal and Dirk Foremny—both establish that average tax rates matter significantly as they relate to changes in out-migration trends among high earners, in both intranational and international settings.[22] Moretti and Wilson study star scientists in the United States and write: "Overall, we conclude that state taxes have a significant effect on geographical location of star scientists and possibly other highly skilled workers. While there are many other factors that drive when innovative individual and innovative companies decide to locate, there are enough firms and workers on the margin that relative taxes matter." These out-migration trends also largely depend upon how easily one is able to move between geographical locations. For example, in the United States state-to-state migration is quite easy; however, international migration, or emigration, may spur greater barriers.

Tax avoidance behavior is also important for the high earners who ultimately pay most of the income taxes. A study by Joshua Rauh and Ryan Shyu examines both extensive and intensive margin impacts on expected gains in tax revenues due to Proposition 30 in California in 2012.[23] These impacts together are shown to have eroded 45.2 percent of windfall tax revenues from the reform within the first year and 60.9 percent within two years, but the intensive margin of tax avoidance accounts for 90.5 percent of the total response. With the deductibility of state taxes removed by the 2017 Tax Cut and Jobs Act, California's income tax is likely close to the top of the Laffer Curve.

The finding that high-income taxpayers are more elastic in their behavior than had been previously modeled is a necessary correction to the research in this field. It is perhaps even more important, however, to emphasize how narrow the objective is of studies that claim to derive an optimal top income tax rate.

Their objective is simply to maximize the government's collection of economic resources. That is, the public economics profession has in large part decided to focus on what tax rate allows the government to redistribute the most economic resources from those whose earnings primarily comprise the taxable income base to those whom the government chooses. While the "hissing" metaphor of Colbert has sometimes been given the interpretation of referring to behavioral responses, it might be better applied to overall losses in total economic activity. Seen in this light, it seems that research in public economics has in fact been asking how to pluck the goose so as to procure the largest quantity of feathers, regardless of the amount of hissing. This would be the top of the Laffer Curve.

An objective grounded in prosperity would begin by asking what system and size of government would maximize the total long-term productive output of a society, subject to some constraints involving distributional outcomes, not what income tax rate maximizes government revenue. This is of course a more challenging enterprise, and preferences as to the distributional outcomes and how to specify them will naturally vary. Yet it would be better to go in this direction than to implicitly accept the notion that the optimal tax rate is at the top of the Laffer Curve—at the point where the government literally cannot squeeze another dime out of a given tax base by raising its rate.

Wealth Taxation

In January of 2019, Senator Elizabeth Warren proposed the "Ultra-Millionaire Tax," which sought to place a 2 percent annual rate upon those with a household net worth exceeding $50 million and a 3 percent rate upon those with a household net worth of $1 billion. Senator Bernie Sanders in September of that year provided his own version of the wealth tax, with a greater number of wealth brackets, ultimately culminating in an 8 percent tax rate on taxpayers with a net worth over $10 billion.

These would not be unprecedented measures when one considers tax policy from an international perspective. In 1990, twelve OECD countries had their own versions of a wealth tax; however, today this number stands at four (Spain, Switzerland, Norway, and Belgium). Why the fall in popularity? Wealth taxes have proved difficult to administer due to the avoidance measures taken by the targeted taxpayers. As a result, the taxes never yielded the anticipated revenue. [24] Worse, the impact due to the outward flow of wealth in some instances proved to compound the problem. According to French economist Eric Pichet,[25] France's wealth tax cost the government as much revenue as the total ultimately yielded by the tax.

Saez and his fellow UC Berkeley economist Gabriel Zucman—the primary advisers on the Warren wealth tax plan—aimed to address these risks by including various measures in the proposal, including a "large exit tax" of 40 percent on wealthy taxpayers attempting to evade payment by renouncing their citizenship. Additionally, they would revoke exemptions for certain asset classes that were included in the European plans. [26]

Setting aside questions regarding the precedents this would set as relates to the government's ability to confiscate a citizen's property, these types of measures, as noted by Pichet, incentivize one set of unproductive behaviors over a set of more productive ones. Even the precise value of wealth when tied up in private businesses or other illiquid assets becomes very challenging to ascertain, and despite Saez and Zucman's efforts, high net worth taxpayers will still pay a fortune to lawyers and accountants to avoid this tax. The Berkeley economists admit this reality at least in the context of estate taxes when explaining in their wealth tax proposal:

> Estate tax revenue collected in 2017 from wealthy individuals who died in 2016 was only $20 billion. This is only about 0.13% of the $15 trillion net worth that the top 0.1% wealthiest families owned in 2016. This demonstrates quantitatively that the estate fails to take much of a bite on the wealthiest (in spite of a reasonably high 40% nominal tax rate above the $5 million exemption threshold, set to increase to $10 million in 2018). The main factor driving such low tax revenue is tax avoidance.[27]

While the writers of this quote presumably would argue this is evidence of the need to implement wealth taxes that are airtight to all possible evasion or avoidance, they are up against the empirical fact that essentially all major countries that have attempted the wealth tax have failed to achieve this goal.

At the end of the day, even if the targeted taxpayers were somehow unable to shelter their accumulated wealth, such a tax disincentivizes the accumulation of wealth for part of the targeted class of taxpayers, as there is no longer a clear reason to accumulate substantial wealth. Instead, high earners are incentivized to consume as much as they have to in order fall below the threshold that initiates the tax. Again, these types of behaviors come at the cost of more productive behaviors, such as investment in productive new companies or innovations, and those compounding costs must be understood when projecting potential revenue growth as a result of the wealth tax. And under the structure of this tax plan, the imbedded incentives encourage an important class of potential investors to avoid investing altogether.[28]

One therefore understandably wonders what possible benefits there could be from a tax that has historically yielded little return in the form of tax revenues and has a costly impact on economic growth. Saez and Zucman in their public writings represent a different public policy aim than simply trying to raise tax revenues to fund government expenditures. A month prior to the release of the economics of their plan, they articulated this aim in a *New York Times* op-ed, "Alexandria Ocasio-Cortez's Tax Hike Idea Is Not About Soaking the Rich." They explain:

> Just as the point of taxing carbon is not to raise revenue but to reduce carbon emissions, high tax rates for sky-high incomes do not aim at funding Medicare for All. They aim at preventing an oligarchic drift that, if left unaddressed, will continue undermining the social compact and risk killing democracy.[29]

With this statement, the authors reinterpret the wealth tax as a Pigouvian tax against the externality of "oligarchic drift." This is a much different public policy objective than simply attempting to raise adequate tax revenues for a particular policy initiative that may or may not help poor Americans. Instead, this is a more clearly stated desire to bequeath to the state the ability to confiscate property on the pretext of maintaining democratic norms. This is a separate argument that is more a question about the importance of private property rights. However, what is clear is that this line of reasoning does not constitute a real refutation of the existing evidence that wealth taxation fails as a means in raising tax revenues and in incentivizing productive economic activities.

As a practical and political philosophical matter, private property rights are essential to the maintenance of a functioning free society. As Friederich Hayek presciently explained in *The Road to Serfdom*:

> The system of private property is the most important guarantee of freedom. It is only because the control of the means of production is divided among many people acting independently that we as individuals can decide what to do with ourselves. When all the means of production are vested in a single hand, whether it be nominally that of "society" as a whole or that of a dictator, whoever exercises this control has complete power over us. In the hands of private individuals, what is called economic power can be an instrument coercion, but it is never control over the whole life of a person.[30]

This is not merely a hypothetical consideration, as the countries that have violated the private property rights of private entities throughout history have paid a steep price. As recently as 2012, the Argentinian government decided to take an extraordinary step in nationalizing 51 percent of one foreign shareholder's stake in the country's largest oil and gas company, based on the government's claim that the gas company was not producing a sufficient amount of energy for the country. However, the shareholder pointed out that this was due to the fact that the government had instituted draconian price controls that disincentivized further production and exploration.[31]

Nevertheless, what followed was predictable: Argentina became a far riskier market for foreign investors. The World Bank ranks countries by the ease with which individuals can conduct business there, and between 2011 and 2012, in the aftermath of the nationalization efforts, Argentina fell eight spots in those rankings, from 113th to 121st.[32] In the most recent rankings, from 2019, Argentina reached its all-time low: 126th.[33]

The case of Argentina is typical of the lessons to be gained about the efficacy of central governments' ability to achieve policy goals. Government involvement begets further government involvement, and this ultimately results in economically disadvantageous results for the general population. This begins with the same false presuppositions of the proponents of the wealth tax—that centralized bodies transcend personal interest and therefore can do better than the private market in achieving fairer results. As Adam Smith famously explained regarding this idea, "By pursuing his own interest [the individual laborer or investor] frequently promotes that of the society more effectually than when he really intends to promote it. I have never known much good done by those who affected to trade for the public good."[34]

Between the evidence showing the small proportion of tax revenue captured by the tax as well as the inordinate cost imposed on local economies due to wealth and its owners flowing out to evade it, the imposition of a wealth tax seems likely to lead to reduced economic prosperity overall. Furthermore, even if the tax is intended to achieve more equitable outcomes for the broader society through wealth confiscation, the historical record suggests that these efforts only worsen the economic conditions for the wider population in the name of ameliorating them. Violations of this sort must be considered in the broader context of the historical record and what have proved to be the vital societal preconditions for economic success.

Implications for the Economic Impact of Plans for Higher-Income and Wealth Taxation

Aside from considering the general thrust of the policy prescription coming from the left, it is helpful to examine specific measures. One tax proposal in particular that has garnered significant interest is Senator Sanders's plan to establish a new top marginal rate of 52 percent on incomes above $10 million and a 4 percent income-based premium on households. These two changes would result in a federal top marginal rate of 56 percent on incomes above $10 million, which, combined with FICA taxes and state tax rates, would put top bracket marginal rates above 70 percent.[35]

The Tax Foundation estimates that the overall change in tax revenues *without considering the macroeconomic or behavioral impacts* would be an additional $3.1 trillion in tax revenue between 2020 and 2029. However, when one considers the aforementioned impacts, additional tax revenues ultimately fall to $2.1 trillion in the same time frame. Worse, the United States' gross domestic product and capital stock would fall 2 percent and 2.5 percent, respectively. Consequently, the country would lose approximately 1.5 million jobs.[36]

The pretexts for such heavy-handed measures and the subsequent pain endured as a result are the potential benefits from programs like Medicare for All. However, programs of this sort are never as straightforward as they initially seem. For example, independent analysis from policy think tanks, ranging from the Urban Institute to the Mercatus Center, have concluded that the cost of Medicare for All for just ten years would be $32 trillion to $34 trillion.[37] The annual additional federal costs that would result would therefore be approximately $10,000 per American. Thus, the taxation plan proposed by Sanders would be nowhere near adequate in paying for such a program. An analysis by the Heritage Foundation shows that if financed through payroll taxes, there would have to be "an additional 21.2 percent tax on every dollar that every American earns," even assuming that there would be no economic responses that would reduce the tax base.[38]

Further concerns surround the availability of health care under such a regime. Sanders's plan aims to reimburse health care providers at rates used by Medicare. However, this is only potentially 60 percent of what private insurers currently pay. Therefore, it is quite likely that access to care would become more strained due to severe cuts to the revenues.[39] The example of Medicare for All is instructive in understanding how large government programs funded through laborious tax regimes ultimately result in worse outcomes for the general population. This is not a new observation. In 1988, a former proponent of socialist policies, Chinese scholar Peter Nolan, described the failures of socialist policies in rural China as follows:

> Errors of all kinds have been made in the socialist countries' rural polices, but . . . none has been so important as the misplaced belief in the virtues of large-scale (in terms of numbers of workers) units of production. Not only are there managerial diseconomies of scale, but a potentially powerful weapon in propelling forward a poor, capital-scarce economy is lost, the dynamism of myriads of "petty commodity producers" struggling to improve their families' situation.[40]

While food production and health care are obviously much different industries, the fundamental premises on which the logic of the argument rests are the same. Hence, there is reason to be skeptical of legislation that establishes centrally controlled "Rube Goldberg machines" that promise better efficiency and outcomes. Such approaches are increasingly in opposition to the historical and current data-driven analysis of such policies. Therefore, we argue that tax policy must avoid a repeat of the same mistakes of the past and reject higher top-bracket income tax rates and wealth taxes, as these will serve to reduce economic activity and overall prosperity.

Conclusion

Throughout the course of history, movements to increase redistribution have arisen alongside narratives surrounding material imbalance or unfairness. As these movements grow in intensity, it is often the case that a desire to right these perceived wrongs becomes a goal that proponents believe is worth achieving by any means necessary. In such an environment, facts are paramount, and the willingness to express realities must become stronger in order to counter extreme passion.

To any passing observer, it appears that the United States has reached an inflection point with respect to the country's prospective economic vision. While these debates rage, the mainstream economics profession has converged on certain norms of calibrating economic models in order to derive revenue-maximizing marginal tax rates. Economists can debate the level of income tax rates that maximizes government revenue, but taxing society at those rates involves forgoing massive amounts of economic output and economic prosperity, as economic activity is reduced or driven abroad and the remaining spending power becomes concentrated in the hands of government. The profession has devoted little effort to measuring that forgone prosperity.[41]

Meanwhile, while much of the economics profession highlights the flaws of capitalism, there have been growing calls for more invasive, socialist policies like greater progressivity in the United States' tax regime; wealth confiscation; and more nationalized sectors of the economy. These calls come despite a body of evidence showing that the country is already one of the more progressive tax regimes in the world, that wealth confiscation results in worse outcomes for the broader economy, and that nationalizing areas of the economy creates worse outcomes for American. However, these policies do provide certain narrow benefits: greater power and control to a select group of insiders at the expense of freedom.

Almost any human being is susceptible to such passion, especially in times of great uncertainty. James Madison and Alexander Hamilton understood this back in 1788. Discussing the best way by which to organize Congress, they wrote in Federalist No. 55, "In all very numerous assemblies, of whatever characters composed, passion never fails to wrest the sceptre from reason. Had every Athenian citizen been a Socrates; every Athenian assembly would still have been a mob."[42] This struggle with human nature remains relevant today.

Therefore, before abandoning the economic vision that made the United States a beacon of freedom and opportunity for generations of people from all around the world for a vision misguidedly put forth through weaponizing the envies and passions of a reasonably concerned public, we hope that people heed the words of Edmund Burke when he reflected upon the French Revolution,

> I should . . . suspend my congratulations on the new liberty of France, until I was informed how it had been combined with government; with public force; with the discipline and obedience of armies; with the collection of an effective and well-distributed revenue; with morality and religion; with the solidity of property; with peace and order; with civil and social manners.[43]

It is with that same spirit that one must ponder the potential outcome of proposed changes in our tax system, our broader economic system, and most importantly the way in which our government treats our natural rights as Americans.

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[1] Committee for a Responsible Federal Budget, *Choices for Financing Medicare for All* (March 17, 2020), http://www.crfb.org/papers/choices-financing-medicare-all.

[2] Pew Research Center, *Most Americans Say There Is Too Much Economic Inequality in the U.S., but Fewer Than Half Call It a Top Priority* (January 9, 2020), https://www.pewsocialtrends.org/2020/01/09/most-americans-say-there-is-too-much-economic-inequality-in-the-u-s-but-fewer-than-half-call-it-a-top-priority/.

[3] Xavier Giroud and Joshua Rauh, "State Taxation and the Reallocation of Business Activity: Evidence from Establishment Level Data," *Journal of Political Economy* (2019): 1262–1316. As with other taxes, the burden of corporate income taxes will be carried most of all by those who cannot alter their behavior to avoid the taxes. Corporations may be particularly adept at tax avoidance, primarily by shifting the location of their capital to other jurisdictions.

[4] Oxford Reference: lump sum tax, https://www.oxfordreference.com/view/10.1093/oi/authority.20110803100118753.

[5] Henry George, *Progress and Poverty: An Inquiry into the Cause of Industrial Depressions and of Increase of Want with Increase of Wealth; the Remedy* (1879).

[6] "An Interview with Milton Friedman," *Human Events* 38, no. 46 (1978).

[7] Arthur Pigou, *The Economics of Welfare* (1920).

[8] Frank Ramsey, "A Contribution to the Theory of Taxation," *Economic Journal* 37: 47–61.

[9] Martin Feldstein, "The Effect of Marginal Tax Rates on Taxable Income: A Panel Study of the 1986 Tax Reform Act," *Journal of Political Economy* 103, no. 3 (1995): 55–72; Martin Feldstein, "Tax Avoidance and the Deadweight Loss of the Income Tax," *Review of Economics and Statistics* 81, no. 4 (1999): 674–80.

[10] Congressional Budget Office, "The Distribution of Household Income, 2017," October 2020, https://www.cbo.gov/publication/56575.

[11] Dylan Matthews, "America's Taxes Are the Most Progressive in the World. Its Government Is Among the Least," *Washington Post*, (April 5, 2013), https://www.washingtonpost.com/news/wonk/wp/2013/04/05/americas-taxes-are-the-most-progressive-in-the-world-its-government-is-among-the-least/.

[12] Illinois Policy Institute, "Slowest-Growing States Have Progressive Income Taxes," (2020), https://www.illinoispolicy.org/slowest-growing-states-have-progressive-income-taxes/

[13] Illinois Policy Institute, "Poll: High Taxes Are Top Reason Illinoisians Want to Leave State" (2019), https://www.illinoispolicy.org/poll-high-taxes-are-top-reason-illinoisans-want-to-leave-state/.

[14] James Mirrlees, "An Exploration of the Theory of Optimum Income Taxation," *Review of Economic Studies* 38, no. 2 (1971), 175–208.

[15] The Library of Economics and Liberty, Encyclopedia Biographies, https://www.econlib.org/library/Enc/bios/Mirrlees.html#lfHendersonCEE2BIO-057_footnote_nt443. The library's website notes that Mirrlees had been an adviser to Britain's Labour Party, which "for decades imposed marginal taxes in excess of 80 percent." Mirrlees wrote: "I must confess that I had expected the rigourous analysis of income taxation in the utilitarian manner to provide arguments for high tax rates. It has not done so."

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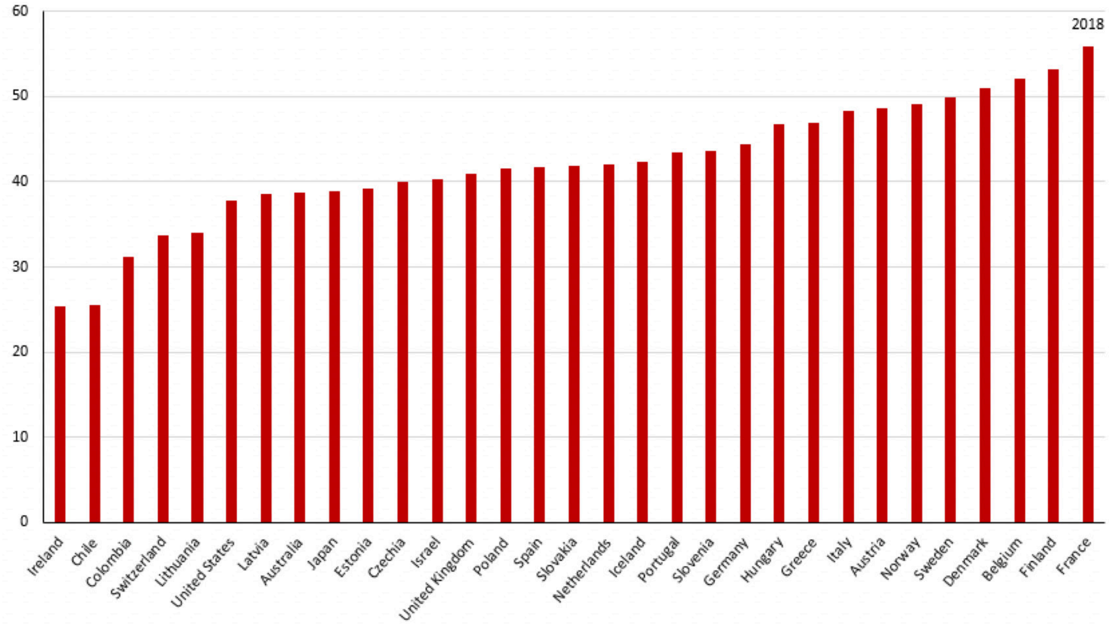
Supporting Figures

Figure 1. General Government Revenue as a Percentage of GDP, 2018

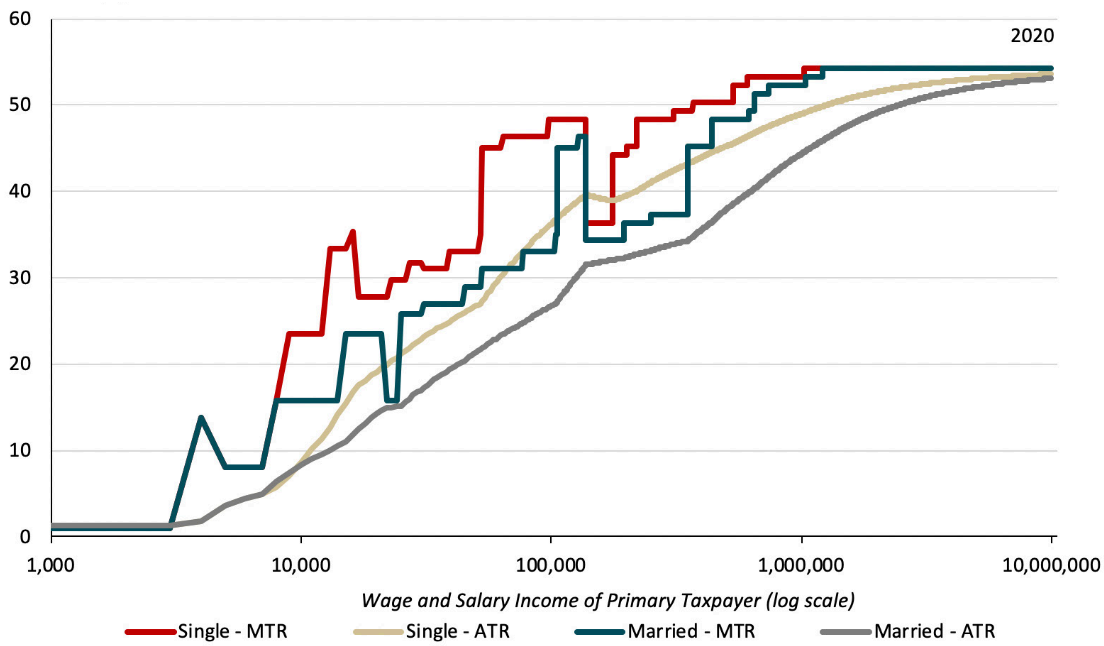
General Government Spending as a Percentage of GDP (%)



Source: Organization for Economic Co-Operation and Development.

Figure 2. Total Marginal Tax Rates and Average Tax Rates by Income Level for Married and Single Taxpayers in California, 2020

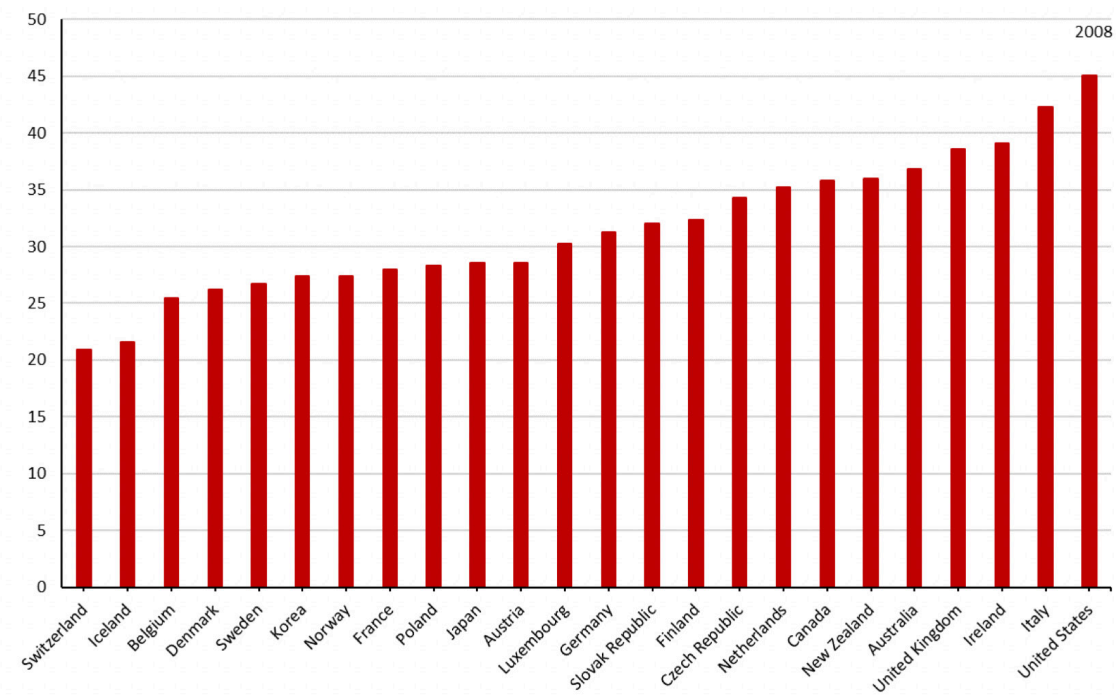
Tax Rate (%)



Note: Simulation was run using the TAXSIM tool through the National Bureau of Economic Research (NBER). Simulations assume a single taxpayer and married taxpayers with two dependents living in California.

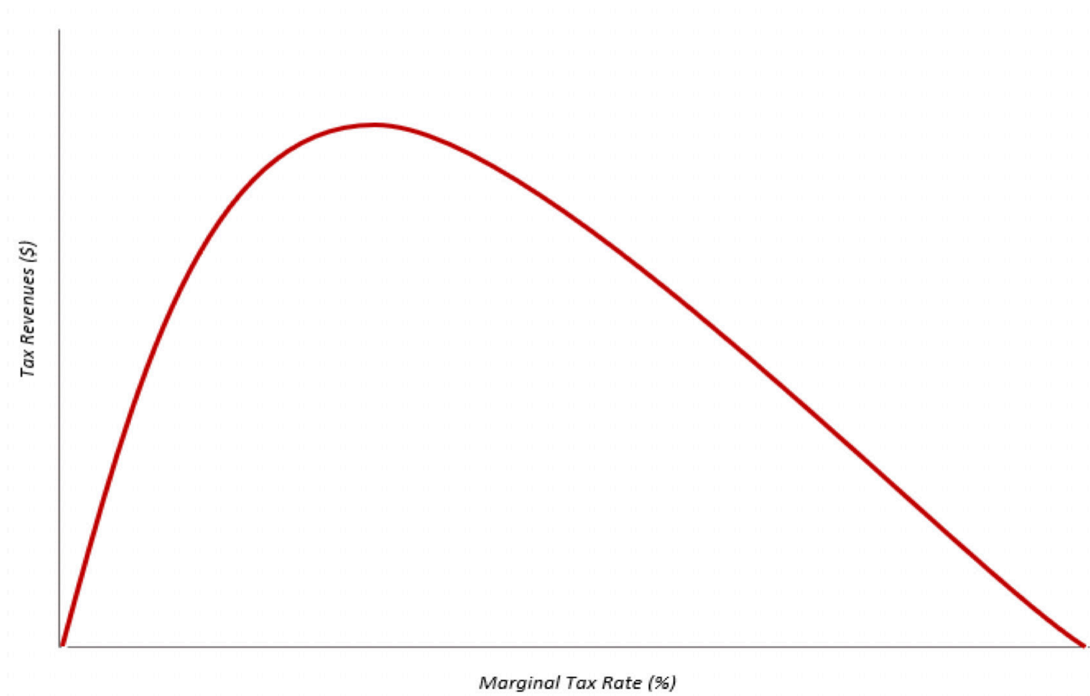
Figure 3. Share of Taxes of Richest Decile, 2008

Share of Taxes Paid by Richest Decile (%)



Source: "Growing Unequal? Income Distribution and Poverty in OECD Countries - OECD"

Figure 4. Laffer Curve Graphical Representation



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