Anatomy of a Tax Cut

Taxation is theft, I know, but the repeal of taxation, which would mean the repeal of the state, is not on the menu today. Sorry about that. So for now we must talk about the best *available* option. That's life. You must begin any journey exactly where you are.

I've watched the debate over the vanilla Republican tax bill closely during these many months. It's been fascinating at many levels, not least sociologically. People reveal much about themselves — and their views of personal autonomy — in how they discuss taxes. And many times did I see Murray Rothbard's insight affirmed:

> *It is no crime to be ignorant of economics, which is, after all, a specialized discipline and one that most people consider to be a "dismal science." But it is totally irresponsible to have a loud and vociferous opinion on economic subjects while remaining in this state of ignorance.*

Needless to say, ignorance of economics kept few cable-news "reporters" and political analysts from confidently offering opinions about the economics of taxation. Their views were filtered through their political, moral, and cultural "priors," among which was the view that no tax bill originating with Donald Trump and Republicans could have anything to recommend it. (They had a hard time assimilating the fact that Barack Obama also wanted to cut the corporate tax.)

Even when the media staged a debate between actual economists, rather than between political handicappers, those "priors" were on blinding display. CNN hosted Stephen Moore, a former Trump adviser who favored most of what's in the tax bill, and Austin Goolsbee, a former economic adviser to Obama, who opposed the bill. Goolsbee asserted — without evidence — that it would *immediately* raise taxes on the middle class. Moore asked how it would do so? Goolsbee did not — or could not — answer but instead shifted ground to the expiration of the individual tax cuts in 2025, an entirely different point. If there are no immediate middle-class tax cuts, what will expire in 2025? (This reminds me of the joke about the person who complains that the food is at a restaurant is terrible *and* that the portions are small.)

Moore might have pressed Goolsbee on his claim that the middle class would face higher taxes next year, but he didn't get a chance because host Poppy Harlow, rather than pressing Goolsbee herself, asked Moore another question. Didn't she think viewers might want to know who was right on this point?

Regarding the sunsetting of the individual rate cuts: this feature, or bug, was not a Republican desideratum; rather, it was a necessity under the Senate’s budget and filibuster rules. Republicans promise not to let the cuts expire. Much of George W. Bush’s “temporary” tax reduction was made permanent under Barack Obama. (Of course, that has implications for the deficit; more on that later.)

The putative reporters and pundits never tired of claiming the tax bill is not a middle-class tax cut because it is a tax cut for the wealthy and corporations. But why couldn’t it be both? Trump’s bloviating bears some blame for this, but his administration hardly made a secret of the corporate-tax and upper-end cuts. Trump’s opening position was to cut the tax from high 35 to 15 percent. He settled for a more competitive 21 percent. (Obama wanted 28. The European average is 18.8.) Also, the corporate tax will become, as it is in other industrial nations, territorial, meaning the U.S. government will not tax companies on foreign-derived profits on which they have already paid taxes. (Why are the tax-everything politicians never called greedy?)

Trump also made no secret of his wish to have only three tax brackets with three lower rates, which would have meant tax reductions for almost all taxpayers, depending on what happened with tax deductions. The bill retained seven brackets, with slightly lower rates, ranging from 10 to 37 percent. So much for simplification and a flattening of the rate structure. And with the tax deductions made even more complicated, we can say with certainty that the death of the era of system-gaming has been greatly exaggerated.

Of course, Trump and the Republicans were not always forthcoming about their plan either. They touted the doubling of the standard deduction to $12,000 for single filers and $24,000 for joint filers — a good thing — but less far less emphasized was the elimination of the $4,050 personal exemption for every member of a household. Thus for a married couple without children, that’s 12 steps forward, eight steps back; for a single person, that’s six steps forward, four back. Not as good as advertised.

The commentators repeatedly said the wealthy would get “most of the benefits.” That phrase, of course, logically implies that the middle class would get *some* benefits. But is their claim even true? I never saw CNN bring on a knowledgeable person to rebut this. It could have invited Chris Edwards of the Cato Institute, who used Joint Committee on Taxation data to show that the largest percentage drop in tax dollars paid would be for middle-income earners. “I recalculated the JCT results, and found that middle-income groups would get by far the largest cuts as a percentage of current income taxes. For example, households earning between $50,000 and $75,000 would get a 24 percent cut in 2019, while those over $1 million would get just a 6 percent cut,” Edward wrote. He also pointed out that since more people will be dropped off the income-tax rolls, the rate structure in fact will be even more graduated than it is today. (The top 1 percent pays 39 percent of the income-tax take. The top 10 percent pays 79 percent. The top half pays 90 percent.)

The media tout the fact that according to polling, a majority of people doesn't like the tax bill — no surprise considering the overwhelmingly negative coverage. Would the polling results have been different if CNN and MSNBC had hosted Edwards or someone else with that perspective? Most people will be able to keep more of their own money, at least for a while.

About that tax cut for corporations, I never heard anyone — including defenders of the bill(s) — point out that corporations don't pay taxes, but only collect them. Most economists know there can be a vast difference between who is explicitly targeted by a tax and who actually pays it. The corporate tax is a notorious example of this. For some libertarians, corporations may have a dubious legal status, but contrary to the progressives, they are associations of people, including stockholders (among whom are middle-class workers with 401(k)s and retirees living off them), employees (whose wages depend on productivity-enhancing investment), and consumers (who prefer lower to higher prices). Economists have long debated exactly how the tax burden is distributed among these stakeholders, but they have no doubt that together these stakeholders — not "the corporations" — pay the tax. Recent studies indicate that workers pay most of the tax. Economist N. Gregory Mankiw writes:

> *In a 2006 study, the economist William C. Randolph of the Congressional Budget Office estimated who wins and who loses from this [corporate] tax. He concluded that "domestic labor bears slightly more than 70 percent of the burden….*

A similar result was found in a recent Oxford University study by Wiji Arulampalam, Michael P. Devereux and Giorgia Maffini. After examining data on more than 50,000 companies in nine European countries, they concluded that "a substantial part of the corporation income tax is passed on to the labor force in the form of lower wages," adding that "in the long-run a $1 increase in the tax bill tends to reduce real wages at the median by 92 cents."

So why do the self-proclaimed champions of workers favor a higher corporate tax? One can be suspicious of the corporate form *and* enthusiastically support a corporate-tax cut — better yet, repeal. Business taxes impede economic activity, raise prices, impede productivity advances, and suppress wage increases. As Mankiw writes, "Populist critics deride this train of logic as 'trickle-down economics.' But it is more accurate to call it textbook economics."

Another count against the corporate tax is that any taxation of investment income is double and even triple taxation. So even if you love the individual income tax (I don't), you should oppose the corporate tax on grounds of fairness. (In 2008 Obama famously supported raising the capital-gains tax *even if it would reduce revenue*.)

The media sages also liked pointing out how the Republicans have abandoned their deficit hawkishness for this bill, which could increase the deficit by $1 trillion or more over 10 years even with some economic growth. It's true that deficit hawks have become an endangered species, and the new deficit doves have resorted to assorted shams to hide this fact. It's shameful that almost no one wants to talk about cutting spending, although it, not explicit taxation, is the real fiscal burden of government, which will get the money one way or another.

But the same sages did not also point out that Democrats have suddenly adopted the feathers of deficit hawks. Sincere conversion or talking point? I saw no discussion of that question on cable news.

As long as we're speaking of deficits, let the record reflect that they indicate a *spending* problem, not a *taxation* problem. Raising taxes in an attempt to balance the budget would be a disaster. Thus the tax bill need not be the last word. Theoretically, spending could be cut. Let the newly converted deficit hawks go at it. Pundits always wonder how tax cuts are to be paid for. When will they learn that tax cuts don't have to be paid for because they are not government outlays? What must be paid for — or, preferably, repealed — are government programs.

All this is not to say the tax bill is all good — not by a long shot. (On the positive side, the Obamacare insurance mandate is gone, in the name of exaggerated deficit reduction.) As I said, no spending cuts accompany it. In fact, it will increase spending in the form of cash subsidies called "refundable tax credits" to the tune of almost $100 billion. The resulting higher debt will fall on my generation's children and grandchildren. But there is still hope: perhaps spending will be cut (I'm not holding my breath), and our descendants could always repudiate the debt.

Finally, after the bill passed the House and Senate, the question arose in the media and among Republicans whether the victors could sell the tax package to the public. That's strange, considering the bill already passed. Isn't the package supposed to sell itself through lower taxes and higher economic growth? Trump promises dramatic growth, but that's not guaranteed because economic outcomes are determined by a complex combination of many factors. For example, if Trump follows through on his pledge to wage trade wars, we won't see the growth he predicts and his tax reform will most likely take the blame.

Quick, someone tell him the tale of Smoot and Hawley.