Growth and Taxes

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Over the past thirty-five years, there has been a great deal of debate as to the effectiveness of tax cuts as a policy to promote and support growth. While this discussion is most often focused on national tax policy, it has also been directed towards the state and regional level as well. Do reductions in taxes spur growth? Can we pay for large tax cuts by growth? Are high taxes and tax rates driving firms and individuals to move out of the country, the state, or off of Long Island?

Tax rates can certainly be high, whether we are talking about income taxes, corporate tax rates, sales taxes, and even various excise taxes. But that still does not mean that they are too high. Every student that has ever taken a macroeconomics course (or a microeconomics course for that matter) knows that taxes, regardless of how they are applied will cause some redistribution (of income) from one group of taxpayers to another. Smokers buying cigarettes in New York City pay a combined state and city tax of $5.85 for a pack of 20 cigarettes. Cigarettes are one of the few items that most people appear to have had little concern over raising taxes. As tobacco products are generally considered to be a public health hazard, higher prices are intended to reduce or inhibit the growth of cigarette market, and the revenues raised from the taxes can be used for a wide range of public health initiatives.

Outside of tobacco and possibly alcoholic beverages, the perception that tax rates across the board are too high resonates with a significant portion of the population. Policymaker’s responses to tax concerns vary. New York State’s STAR (School Tax Relief) program is one response to concerns over high property taxes and provides homeowners (falling below established income caps) along with other restrictions, some reductions in school property taxes.

Over the past decade, other states have followed a number of different paths in pursuit of reducing taxes with varying results. Louisiana and Kansas are perhaps the best known cases where elected state representatives to both legislative and executive branches of government have pursued low tax strategies. These policies essentially have had serious negative impacts on public education and the provision of various public services (road and infrastructure maintenance, state higher education systems, etc.). Most recently, legislators in Kansas approved rollbacks of many of the tax cuts to business that had been enacted over the past five years and overrode Governor Brownback’s veto of the tax bill. This action has restored close to $900 million in tax revenues over the next two years.

At the federal level, there is now a great deal of discussion over income tax rates, both individual and corporate rates. Underlying some of this discussion is the ongoing debate of the effectiveness of supply-side policies. Will businesses and entrepreneurs invest more as a result of lower tax rates? That is really one of the pillars of supply side theory – create incentives for individuals to work by allowing them to keep more of their income thus expanding the supply of labor, and to allow more household and business income to be funneled towards production enhancing investment. In practice though, it is hard to say that tax cuts necessarily lead to increases in productive capacity. For most households, even high income households, tax cuts very often lead to increased consumption spending.

That brings us back to the initial question, are taxes to high? The answer really depends primarily upon the types of government goods and services that need to be provided across a wide range of activities including defense (military services), education, emergency management (emergency response and management from natural and manmade disasters), infrastructure (bridges, highways, roads, etc.), judicial, legal and regulatory activities, and environmental protection. These are of course just a short list of the many services provided by federal, state and local governments.

If taxes are too high, the answer is not simply for legislators to reduce taxes but to review the broad range program and spending initiatives and adjust budgets accordingly. Legislators will equally have to grapple with other issues such as actual and perceived equity and fairness in the tax system, especially in relation to marginal tax rates, exemptions, and the treatment of capital gains and carried interest. This fall promises to be an interesting time to observe where political leaders take this discussion.