Breaking Hauser's Law

Writing in the Wall Street Journal, chairman emeritus of the Hoover Institution, Kurt Hauser, strongly disagreed with the Obama administration's claim that by raising taxes on just the top two percent of all taxpayers there would be a significant increase in tax revenues to the government. He claimed that Hauser's Law would limit any anticipated increase in revenues, and it might even reduce them.

He published a study in 1993, which was confirmed by David Ranson, that concluded that "no matter what the tax rates have been, in postwar America tax revenues remained at about 19.5% of GDP." Because of that law, Hauser said that over the past 60 years, regardless of the top marginal tax rate, which has ranged from as high as 92 percent all the way down to 28 percent, tax revenues as a percent of GDP remained essentially unchanged.

> Over this period there have been more than 30 major changes in the tax code including personal income tax rates, corporate tax rates, capital gains taxes, dividend taxes, investment tax credits, depreciation schedules, Social Security taxes, and the number of tax brackets among others. Yet during this period, federal government tax collections as a share of GDP have moved within a narrow band of just under 19% of GDP.

His explanation echoes not only the classical (Austrian) economic tradition but common sense as well. The higher the tax bracket, the lower the incentive to work hard, take risks, invest capital and, in general, do the things that entrepreneurs do to improve their customers' lives. Instead, their capital is directed into safe, often low tax, havens, thus removing that capital from the economy. On the other hand, reducing tax rates increases their incentive to work, to take risks, and invest capital in new ideas. They have less incentive to shelter their income from taxation and more incentive to strive to increase it by serving their customers.

Hauser points out the "class warfare" aspect of the Obama proposals: The top two percent of taxpayers cannot be neatly separated out from the other 98 percent. He explains, "Our economy and society are interwoven. Employees and employers, providers and users, consumers and savers and investors are all interdependent." But he also makes clear that the Obama tax hike, although "targeted at the wealthy," will result in higher taxes for everyone. Hauser accurately points out that the attacks aren't so much on the wealthy but on the capitalist system itself. Calling it a three-pronged attack, Hauser says "they are attacking the income group that is the most responsible for capital formation and jobs in the private sector, and then attacking investment returns on [that] capital … in the form of [taxes on] dividends and capital gains [taxes].

In physics, laws are always operative, with no exceptions. In economics, however, laws such as Hauser's Law cannot be depended upon as a roadblock for politicians hungry for additional revenues. Daniel Mitchell wrote recently in *Forbes* that although he would like to think that Hauser's Law cannot be broken and consequently politicians will just have to live within the constraints of the law by reducing government spending to avoid bankruptcy,

> I'm not nearly so optimistic that 19 percent of GDP represents some sort of limit on the federal government's taxing power. There are many nations in Europe with tax burdens closer to 50 percent, for instance, so governments obviously have figured out how to extract much higher shares of national output….

One reason is that European countries have value-added taxes, which are a disturbingly efficient way of generating more revenue.

In addition, Mitchell points out, those countries have reduced the tax brackets substantially so that the maximum tax rate clicks in at a much lower level of income. Denmark, for example, is successfully "extracting" taxes equal to nearly a third of their GDP. And he also confirms Hauser's point that a class warfare tax as proposed by the Obama administration cannot be neatly imposed on the top two percent with no impact on the other 98 percent.

> Class warfare tax rates on the rich … serve a very important political goal. Politicians understand that ordinary people will be less likely to resist oppressive tax rates if they think that those with larger incomes are being treated even worse. Simply stated, higher tax rates on the rich are a *necessary precondition* for higher tax rates on average taxpayers. [Emphasis added.]

Hauser's Law is a good reminder that attacks on the capitalist system will continue until citizens impose their own law, available in the Constitution, on those hungry politicians sufficiently strongly to force them to restrain Leviathan before it consumes them.