



Analytics

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RE: Higher taxes? No way baby!

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Research by economist W. Kurt Hauser demonstrates that since World War II U.S. government tax revenues have averaged just under 19% of GDP. This proportion has held steady despite 30 major changes in the tax code across all sources of revenue (e.g., personal income, corporate, investment tax credits, depreciation schedules, Social Security).

Why? Apparently higher tax rates encourage taxpayers “to shift, hide and underreport income...and to divert their effort from pro-growth productive investments to seeking tax shelters, tax havens and tax exempt investments.” Lower tax rates encourage increased productivity and economic growth, and thus increased tax revenue.

Using GDP and tax revenue data over the past two decades for Delaware (1989-09), CRI has found the same taxpayer behavior occurs in the First State. The application of Hauser’s Law in Delaware shows that over the past 20 years, despite the ups and downs of the business cycle and multiple changes in the tax code, state tax revenues have averaged about 5.5% of Delaware GDP.

Mathematically over this time period, Delaware tax revenue is perfectly correlated to Delaware GDP, and GDP estimates Delaware tax revenue at the highest level of statistical significance.

What does this mean for the Governor and the legislature? No matter how many combinations and variations are used to squeeze out revenue, Delaware taxpayers will always find a way to

keep the total tax burden unchanged relative to economic output. It may be through estate taxes causing wealthier households to change their place of residence or higher gross receipts tax dampening the investment and growth rate of Delaware business. Raise the state tax rate on cigarettes by 39% and cigarette tax revenue is down 9% so far in FY-2011.

Changes in individual incentives through taxes do cause offsetting changes in behavior. This should be recognized and anticipated every time a tax change or new tax is under consideration in Delaware.

If the State wants more tax revenue, the only way to get it is to grow Delaware’s economy.

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