Florida's Tax Structure Fails Tests for Fairness, Efficiency and Simplicity

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Economists, public administration professionals, and governmental experts agree on several requirements for a sound tax system at any level of government. These requirements include adequacy, fairness, efficiency, and simplicity. The National Conference on State Legislatures includes the last three of these in their publication entitled "Principles of a High-Quality State Revenue System." They did not include the issue of adequacy. That is a subjective determination and is best left to the political side of governance.

The first three major requirements are more objective and can be analyzed from an apolitical standpoint. When such an analysis is conducted on Florida's system, it fails in all three areas.

The single most significant failure is in the area of fairness. Florida has a very regressive tax structure. That means the lower a person is on the economic ladder, the greater the relative burden of taxation. The richest residents of the state pay a substantially smaller percentage of their income in taxes than do the poorest. In a 2009 study, the Institute on Taxation and Economic Policy (ITEP) found that, after federal tax deductions and credits, the poorest 20 percent in Florida paid 13.5 percent of their income in state and local taxes. The top 1 percent paid 4.2 percent, or less than one-third the rate for the poorest people.

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In an interstate comparison, ITEP found that Florida has one of the most regressive tax systems in America. The poorest 20 percent of Floridians pay at the third-highest rate in the U.S., while the top 1 percent pay at the third-lowest rate.

The causes of this inequity and possible solutions will be the subject of future analyses. First, it is necessary to challenge assertions issued by proponents of the current system and the built-in travesties that are inherent in it.

One of the greatest misconceptions in current tax policy is that reducing tax rates can increase revenues. This misconception is based on a theory called the Laffer Curve. This is a hypothetical concept that says tax rates can become so high that revenues will actually begin to fall and that once this level is reached all future tax increases will further reduce revenues. This is a purely hypothetical concept and no one knows what level of taxation would have to be reached before it would be realized. But it is clear that no government in America, including the federal government, has reached such a level. Even European countries that tax at a much higher level have not experienced any semblance of this hypothetical phenomenon.

Some erroneously claim that the Reagan tax cuts in 1981 prove that cutting taxes can increase governmental revenue. Some people claim that federal revenues actually increased in the early 1980s after the massive Kemp-Roth tax cuts of 1981. The data refute that claim.

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During the eight years of the Reagan Administration revenues did increase. They went up 152 percent. However, during the previous eight years, federal revenues went up 224 percent, or almost half again as much as during the Reagan years. The revenue picture in the early 1980s had such a dramatic effect on the budget and the deficit that Reagan actually approved tax increases in 1982, 1983, 1984, and 1986.

More importantly, two of the chief architects of Reaganomics refute the claim that tax cuts can increase revenues.

On August 1, 2010, Alan Greenspan was a guest on NBC's "Meet the Press." He was asked a simple question about whether or not tax cuts pay for themselves. He gave a concise and unequivocal response: "They do not." Such a strong and absolute statement is truly rare from an economist.

In his book, *The Triumph of Politics,* David Stockman said the 1981 tax cuts were not designed to increase revenues, but to reduce them. By reducing revenues, it was thought that government could be forced to reduce spending on domestic programs. Two of the programs identified for cuts are of importance to Floridians: Social Security and veterans benefits. Stockman said such cuts would be necessary to pay for the Kemp-Roth tax cuts of 1981.

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– David Stockman.

Another reason offered for providing tax breaks for the wealthy concerns the assertions that economic activity is stimulated by these choices in taxation. That is the old trickle-down economic theory. It is false.

The assertion is that by allowing the producer class to accrue wealth and income, they will be motivated to create jobs and income for the consuming class. The way it is supposed to work is that wealth in the hands of investors and producers will motivate them to increase production of goods and services. That will necessitate the creation of jobs. It is also supposed to benefit consumers by reducing prices. It is based on the assumption that supply-side manipulations will benefit all elements of the economic system.

One of the clichés used to support this proposal is: A rising tide lifts all boats. But Warren Buffet, a recognized expert on markets and finances, refutes this cliché, and responds with a cliché of his own: Reaganomics lifted all the yachts and left the rowboats to founder.

The reason this theory is wrong is easy to understand. First, ours is a demand economy. Every economist and student of economic activity in America realizes that almost 70 percent of all economic activity is consumer demand. When consumer demand is reduced, the economy retracts. When consumer demand increases, the economy expands. These are irrefutable facts. It should not be difficult to understand, then, that increasing the ability of the consumer to engage in economic activity is good for the overall economy. Indeed, few dispute that truism. The only good reason to cut taxes is to put more money in the hand of the consumer so economic activity will increase. The current debate about renewing the tax cuts for the wealthy is because the proponents argue that the beneficiaries would continue to spend the income that is not taxed, and those expenditures will help the economy.

The statements about the role of consumption are not denied by economists. The only question is whether guiding money into the hands of the consumers is equal to, less than, or greater than, guiding it into the hands of the producers and investors.

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A simple mental exercise should answer that question. All we have to do is consider what a producer would do with extra cash during times of economic difficulties and the concomitant reduction in demand.

Would a car company increase production of their cars if there are unsold cars on all the dealer's lots? They would not!

Would any investor use his/her funds to increase the production of any good or service that would not be consumed because of lack of demand or the inability to demand? They would not!

In his book *The Politics of Rich and Poor*, Kevin Philips investigates what the economic elite did with the enormous transfer of wealth they received during the early 1980s. He found they did not invest in increased production and new jobs. Nor should we ever expect them to.

If they do not invest in increasing positive economic activity, what do they invest in? History shows they invest in new activities. They invest in speculative ventures. Remember the tech bubble? How about the housing bubble? These were created largely by people with money to spend who did not want to waste their money on goods and services that could not be consumed. And these adventures created wealth – for a short time. And when they burst, it was the middle class that suffered the most. And the overall economy was the second victim.

We also should ask what investors would do if demand exceeded supply of any good or service. They would surely increase production of that item. New jobs would be created. Those new jobs would increase overall demand for goods and services, and growth would continue. The economy would expand.

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The only conclusion that can be reached is that tax fairness is not only a moral imperative, it is a sound economic principle.

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