

# If elections have consequences, then so does economics [1]

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Speaking on Fox News Sunday following the U.S. presidential election, Bill Kristol, editor of *The Weekly Standard*, said that [Republicans, having lost to the Democrats, could no longer hold out free market principles with respect to taxation](#)<sup>[3]</sup>. ?I think there is a very good chance that [President Obama will] pass major consequential legislation in the second term, and people like me won?t like it that much. I think Republicans will have to give in much more than they think,? he said.

Kristol elaborated on the GOP fallout: ?The Democrats picked up seats in the House and Senate, and the President is in good shape ... the Republicans in the House will be able to get some concessions and some compromises, but I think there will be a deep budget deal next year, it will be an Obama-type budget deal, much more than a Paul Ryan budget deal, type budget deal. And elections have consequences.?

Kristol?s musings were the subject of much Democratic smugness and Republican alarm, with his singular sacrifice for the greater good [echoing Cato?s 10th Letter](#)<sup>[4]</sup>:

No man living laments the calamities brought upon his country, more than I do those brought upon mine: Yet I freely own, that I think the paying off the nation?s debts, and restoring, by that means, the kingdom to its power, its grandeur, and its security again, was an end worth all the evils which we have yet suffered; an end which ought, if possible, to have been purchased with greater than we have yet suffered, if it could not otherwise have been purchased. I think that it ought to have been done, though attended with many ill circumstances; and might have been done, even upon those hard terms, with justice to private men, and honour to the nation. We are not a people without it; nor is it worth while to dispute about the best cabin in a ship that is sinking.

But not only elections have consequences; so do economics. For those who believed that GOP intransigence on ?tax cuts for the wealth? ? or ?tax cuts for the economy?, a rhetorical ploy by one knowing Republican wit ? was motivated by selfish greed, no doubt this *volte face* must come as a welcome return to common sense. To their peril, they ignore the findings of the Laffer curve.

Named for Reagan-era economist Arthur Laffer, the curve charts government revenues against taxation rates, based on the idea that at both zero and one hundred per cent taxation the State will collect no monies, but that somewhere along this curve are rates for optimum private sector growth (nurtured by the provision of public goods by the State) and optimum government revenue. ?The uniform, constant, and uninterrupted effort of every man to better his condition?, wrote Smith, ?the principle from which publick and national, as well as private opulence is originally derived, is frequently powerful enough to maintain the

natural progress of things toward improvement, in spite both of the extravagance of government, and of the greatest errors of administration ([II.iii.31](#)<sup>[5]</sup>).?

Ultimately, the question must be focussed on what the market will bear. It is one thing if additional taxes will be no more than an irritant for entrepreneurs and corporations; quite another, though, if these additional burdens occasion distortions and disincentives to economic activities. Such conditions met one of Smith's definitions of a bad tax, for "it may obstruct the industry of the people, and discourage them from applying to certain branches of business which might give maintenance and employment to great multitudes ([V.ii.b.6](#)<sup>[6]</sup>).?"

For adherents of Laffer, studies indicate that the threshold lies at government expenditure at about 18-20 per cent of GDP; that is, up to this point most business activity will continue unabated, but once this nominal level has been crossed, then extraneous considerations enter into business calculations. (Thus, [there is a gap between growth-maximisation and revenue-maximisation on the Laffer curve](#)<sup>[7]</sup>, the difference being that greater government pressure via increasing tax rates will result in slowing private-sector profits.)

What this means is that applying additional taxes past their maximisation point will not result in higher revenues, but lower "bringing neither justice to private men nor honour to the nation. The nineteenth-century French economist Frédéric Bastiat popularised this economic phenomenon as "[That Which Is Seen, and That Which Is Not Seen](#)<sup>[8]</sup>":

Between a good and a bad economist this constitutes the whole difference—the one takes account of the *visible* effect; the other takes account both of the effects which are seen and also of those which it is necessary to *foresee*. Now this difference is enormous, for it almost always happens that when the immediate consequence is favorable, the ultimate consequences are fatal, and *the converse*. Hence it follows that the bad economist pursues a small present good, which will be followed by a great evil to come, while the true economist pursues a great good to come, at the risk of a small present evil.

A step in foresight to improve the nation's finances proves in hindsight a wounding blow to the public treasury. A century earlier, Bastiat's compatriot the Baron de Montesquieu proclaimed pithily in [The Spirit of the Laws](#)<sup>[9]</sup> that when savages "are desirous of fruit, they cut the tree to the root, and gather the fruit. This is an emblem of despotic government." Now savagery and despotism are camouflaged as enlightened policy.

Though unaware of Laffer curve economics, Cato was not unmindful of its effects. "If, in taxing labour and manufactures, we exceed a certain proportion, we discourage industry, and destroy that labour and those manufactures," he astutely noted. "The like may be said of trade and navigation; they will bear but limited burdens: And we find by experience, that when higher duties are laid, the product is not increased; but the trade is lost, or the goods are run."

Key to policy formation is whether America has reached or exceeded the optimum marginal tax rates for optimum government revenue; and whether increases in the one will lead to increases in the other. Indicators are that the threshold has been met: record amounts in bank reserves and corporation coffers suggest that current levels are curtailing business growth, as does anecdotal evidence from CEOs and small business owners who fear that further taxes and regulations will eat into viable profit margins. Yet, were the highest marginal tax rates decreased toward growth maximisation levels, innovators and entrepreneurs would doubtless invigorate the market, boosting tax revenues further "another facet of Bastiat's counterfactual analysis.

“You know what?” Kristol concluded, “It won’t kill the country if we raise taxes a little bit on millionaires. It really won’t, I don’t think.” But the financial argument is not about the supposed merits of any nominal marginal tax rate on the highest incomes (moral issues are another matter), but on its effects on the total American economy. Kristol sees only short-term political compromise and is blind to long-term revenue shortfalls; his apparent graciousness in electoral defeat is economic illiteracy in disguise.

Political equivocations cannot trump economic realities. By masquerading as a commendable compromise to save the nation’s sinking finances, will the ship of state surely be lost.

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[8] <http://mises.org/page/1434>

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