"Taxes are what we pay for civilized society," observed Oliver Wendell Holmes in an era of very low taxation. But more taxes do not necessarily produce more civility. Nor do higher tax *rates* necessarily provide more government *revenue.*

For higher taxes are like higher prices: they affect the way people behave. Take the rental car industry . Hertz and other companies had announced the biggest rate increases in years. But consumers rented too few cars at the higher prices. When companies realized they were making less money at the new rates, prices tumbled back toward their original levels.

Similarly, government can receive fewer tax revenues by charging higher income tax rates for its services. Economist David R. Henderson reviews the growing body of evidence that higher tax rates can reduce total tax collections by affecting incentives to work and to avoid taxes. He reports that tax changes have the most impact on individuals paying the top rate.

That impact is not surprising, for a proportionate change in all tax rates *disproportionately* affects incentives of higher-income taxpayers. A 10 percent rate increase allows someone initially in a 50 percent bracket to keep 45, instead of 50 cents, of an additional dollar earned. The loss of 5 cents—which is 10 percent of the original 50 cents kept by the taxpayer—appreciably increases incentives for tax avoidance and leisure. For someone in the 20 percent bracket, however, the same 10 percent rate hike reduces the after-tax earnings of a dollar from 80 to 78 cents, a reduction of only 2.5 percent. In this later case, the incentive to avoid taxes or earn fewer dollars rises much less than for the taxpayer in the higher tax bracket.

If the top rate rises sufficiently, it can so magnify incentives for tax avoidance and leisure that tax revenues actually fall. Various studies confirm this result. In the United States, a top rate of about 35 percent appears to come close to maximizing government revenues.

Other countries might have different rates which maximize their tax collections. Still, many government leaders seem to be learning that the road to greater revenues can be paved with lower, not higher, tax rates. *The Wall Street Journal* reports that 55 of 86 nations with income taxes cut their top tax rates from an average of neatly 56 percent in 1985 to 47 percent in 1989. And here at home, government officials sooner or later will have to admit that higher income tax rates for *wealthy* individuals are unable to provide the additional funds they seek for more government spending or for a balanced federal budget.

So beware, middle-income taxpayers! If the expansion of government spending is not constrained, and if there is great pressure to balance the budget, then taxes on your *moderate* incomes are likely to rise.