

The Law of Unintended Consequences

No discussion would be complete without a mention of the Law of Unintended Consequences. This is a law of economics that states that any action will have unforeseen effects, and these will usually be the most consequential.

This failure of foresight mainly is based on the use of linear assumptions—the idea that whatever is happening will continue to happen in a straightforward fashion. In reality, people have this habit of adapting to circumstances.

Let us decide, for example, to raise some money for the Columbia Graduate School of Journalism. Let us decide that every person wearing sneakers during next week's class will "contribute" an extra \$10,000 in tuition. If we look around and see that there are seven people wearing sneakers, we would be using a linear assumption if we calculated that seven people would wear sneakers to class next week, bringing in \$70,000 for beer and pretzels for faculty parties.

The Law of Unintended Consequences is fairly clear in this case, though. Chances are people would show up barefoot before coughing up ten grand.

This example illustrates the greater point: One must be careful with assumptions. One reason tax policies so often go wrong is that the complexity of the economy makes it difficult to see things as clearly as in the sneakers example.

Not always, though. During the Bush administration a luxury tax was pushed through on expensive boats. Both the administration and Congress predicted the tax would bring in millions in new revenues by "soaking the rich."

The rich, being rather unreasonable, decided not to get soaked. Even worse, the Law of Unintended Consequences showed up in full regalia.

The net result of the tax hike was that the government lost money.

How? Once the tax was in place, it was cheaper to take a Caribbean vacation and bring a yacht home as a souvenir than to buy a comparable American-made yacht.

So the result of the tax hike was the collapse of the American yacht industry coupled with a corresponding boom in Caribbean yacht construction.

Not what was intended—but you can't run from The Law.

—Christopher J. Feola

their income—within 10 percentage points—that they kept in 1980.

That's 70 percent of the population, 69 percent of whites, 72 percent of blacks, more than 75 percent of indigenous people, 58 percent of Asian and 33 percent of Hispanics.

The people with incomes of \$50,000 and higher are doing the best. They keep up to 57 percent more of their income than they did in 1980.

That's 24 percent of the population, 35 percent of all Asians, 26 percent of all whites, 13 percent of all blacks, 13 percent of all indigenous people, 6 percent of all Hispanics.

Married couples filing their tax returns jointly have fared the worst of three groups: single, head of household and married filing jointly. In general, this group keeps a few percentage points less—from 1 to 5—than their income counterparts in other groups.

Social Security

The Social Security tax rate is the same for all income earners; in 1995, it was 7.65 percent, with a \$61,200 income cap. The cap limits the amount of income the tax can claim. So, for example, if you make \$10,000 a year, all of it is subject to the tax. If you make \$100,000 a year, only \$61,200 of it will be taxed. So the higher your income climbs, the lesser portion of it you pay to Social Security.

Both the tax rate and the cap rose since the 1980s. Today most people contribute between 1 percent and 5 percent more to the system.

The heaviest burden of these changes has fallen on people who make between \$35,000 and \$75,000 a year. They pay 5 percent more of their income to the Social Security system.

Those who earn annual incomes between \$35,000 and \$75,000 represent 32 percent of the population, 37 percent of all Asians, 34 percent of all whites, 23 percent of all blacks, 22 percent of all indigenous people and 11 percent of all Hispanics.

The people in the best position because of the changes are ones who make \$150,000 and more a year. The additional they pay adds up to just a percent or less.

The Census Bureau only reports this income bracket as \$100,000-plus, but that's 4 percent of the population, 7 percent of all Asians, 5 percent of all whites, 2 percent of Hispanics and 1 or less percent of

everybody else.

People with an annual income of \$25,000 and less also bear the least of the Social Security burden. They pay 2 percent more of their income to the system.

This group represents 42 percent of the population, 59 percent of all blacks, 59 percent of all indigenous people, 39 percent of all whites, 34 percent of all Asians, 23 percent of all Hispanics.

Income taxes

The income tax system has changed the most radically. It used to be that very poor people and married couples earning less than \$5,000 a year paid no income taxes. And the very rich and single earning \$150,000 or more paid 62 percent of income to the government. Today the same people give, respectively, 15 percent and 32 percent of their income to the Treasury.

The hardest hit are those who make \$5,000 and less a year. They keep 15 percent less of their incomes.

That's 6 percent of the general population, 15 percent of all blacks, 12 percent of the indigenous population (American Indian, Eskimo and Aleut), 9 percent of Hispanics, 7 percent of Asians (Asian or Pacific Islander) and 5 percent of all whites.

Those who fared best are singles who make \$125,000 and more because 30 percent less of their incomes go to taxes, and heads of households who earn \$150,000 and more because they pay 29 percent less.

The Census Bureau lists this bracket only as \$100,000 or more income.

For heads of households with \$10,000 to \$15,000 annual incomes; for married couples with \$15,000 to \$20,000; and for singles making \$10,000 to \$15,090 the changes in the income tax code brought little or no change.

There was disparity within income groups as well. If you were married making \$15,000 to \$20,000 a year, things have remained the same. But if you filed as a head of household in the same group, you kept 9 percent less of your income.

It's important to remember that the people who were in the various income groups in the 1980s before the tax changes may not be the same people in those groups today. What the changes reflect is a tax philosophy that affects certain classifications of people.