

## Gilded Age Taxation

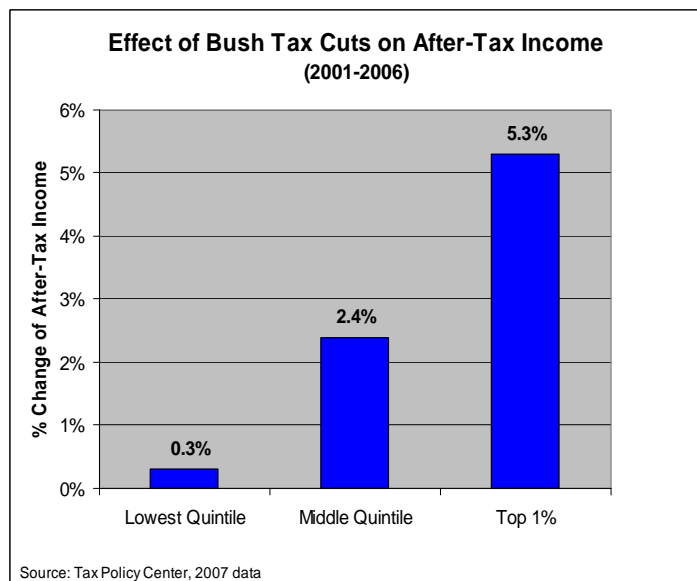
By Robert L. Borosage, Eric Lotke and Hillary Hampton

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**Taxes will always be with us.** The question is who pays taxes, and who gets the benefits.

Over the last decades, the federal tax code has become less fair. Thirty years ago, the tax code was broadly progressive, reflecting shared contributions to public investments and our common good. Loopholes were fewer and covered items like home mortgages that everyone could understand and appreciate.

Today's tax code is increasingly a scandal. Top tax brackets have been lowered, and lowered again. Loopholes have grown in size, complexity and exclusivity. Billionaire hedge fund managers pay taxes at lower rates than their receptionists.<sup>1</sup> Corporations get tax breaks for moving jobs overseas. Oil companies with the largest profits in corporate history receive annual tax breaks worth \$14 billion, roughly twice the budget of the Environmental Protection Agency. President Bush's tax cuts gave the top 1 percent of households a percentage reduction in after-tax income that was 17 times greater than that provided the lowest 20 percent households (5.3 percent vs. 0.3 percent). In dollar terms, the top 1 percent pocketed an average \$44,622 from the Bush tax breaks; people in the middle gained \$746 and the bottom 20 percent gained all of \$22.<sup>2</sup>



Piling up tax breaks on the rich is doubly perverse because they have been pocketing an increasing portion of the nation's growth. Adjusted for inflation, weekly wages were lower in 2007 than they were in 1979.<sup>3</sup> People are working harder but getting less of the benefit. Between 2000 and 2007, American productivity grew twice as fast as real hourly compensation for workers.<sup>4</sup> Thirty years ago, CEOs of S&P 500 companies made 30 times as much as the average worker; in 2007 CEO incomes had grown to 344 times as high.<sup>5</sup> That's why taxpayers in the top 1 percent brought home a greater share of the nation's income in 2008 than the bottom forty percent combined.<sup>6</sup>

This inequality is no accident. It is not the result of market forces, globalization or technology. Our new American inequality is the result of policy decisions that could have been made differently. Taxes, one might assume, would grow more progressive to counteract the increasingly regressive distribution of income. Instead it has been the reverse, with tax breaks increasingly lavished on the very wealthy.

## Taxes Tilting Wrong

This combination – increasing income inequality and decreasing tax progressivity – creates Gilded Age extremes. The latest available data from the Congressional Budget Office proves the trends.

In 1980, earners in the top 1 percent paid an average effective federal income tax rate of 22.3 percent, according to the CBO. By 2006, the average effective income tax rate on the top 1 percent had dropped to 19 percent (a decline of 15 percent).<sup>7</sup>

At the same time, income inequality has exploded. The top 1 percent (1.1 million households) brought home fully 16.3 percent of our whole nation's income in 2006, up from 7.7 percent in 1980. In contrast, the middle 60 percent (68.3 million households), brought home 44.1 percent of our nation's income in 2006, even less than the 50.9 percent they brought home in 1980.<sup>8</sup> In other words, according to the CBO data, the rich are getting richer, and the middle class is sinking. The tax code is making it worse.

The two figures below illustrate these tendencies. Income inequality is represented by a single line – the ratio of after-tax income collected by the top 1 percent of taxpayers compared to the after-tax income of the middle 60 percent of taxpayers. That line is rising. The other line shows the average effective federal income tax rate levied on the top 1 percent during the same time period. That line is declining.

**Figure 1** below shows all of the detail. Spikes rise and fall over the years, but income inequality overall is trending upwards and effective tax rates on the wealthy are trending downwards. **Figure 2** smoothes the spikes and highlights the punchline. The data are in the appendix.

Figure 1

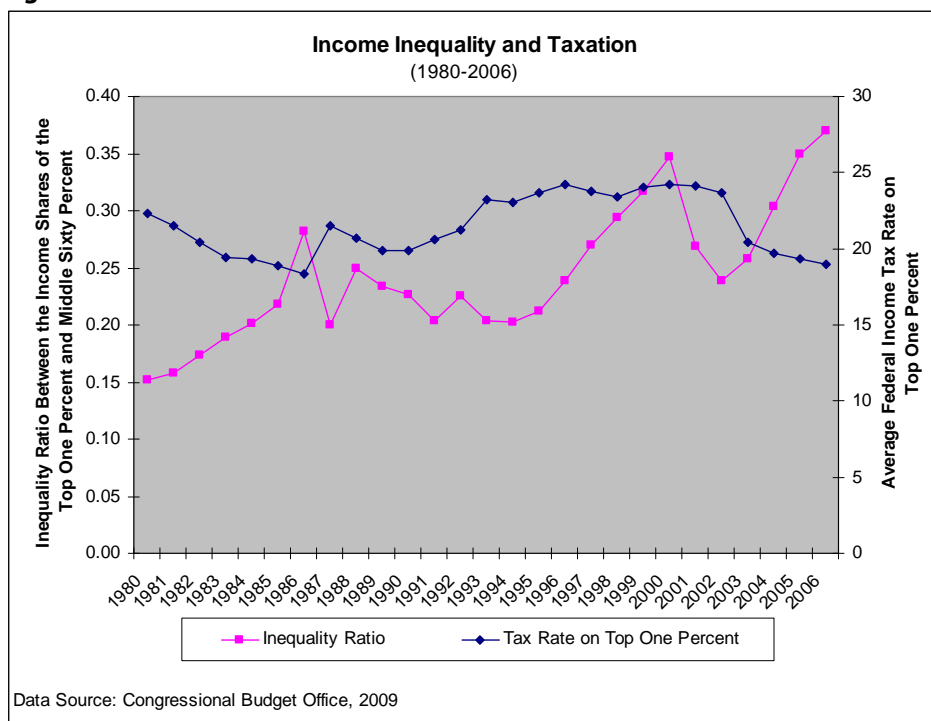
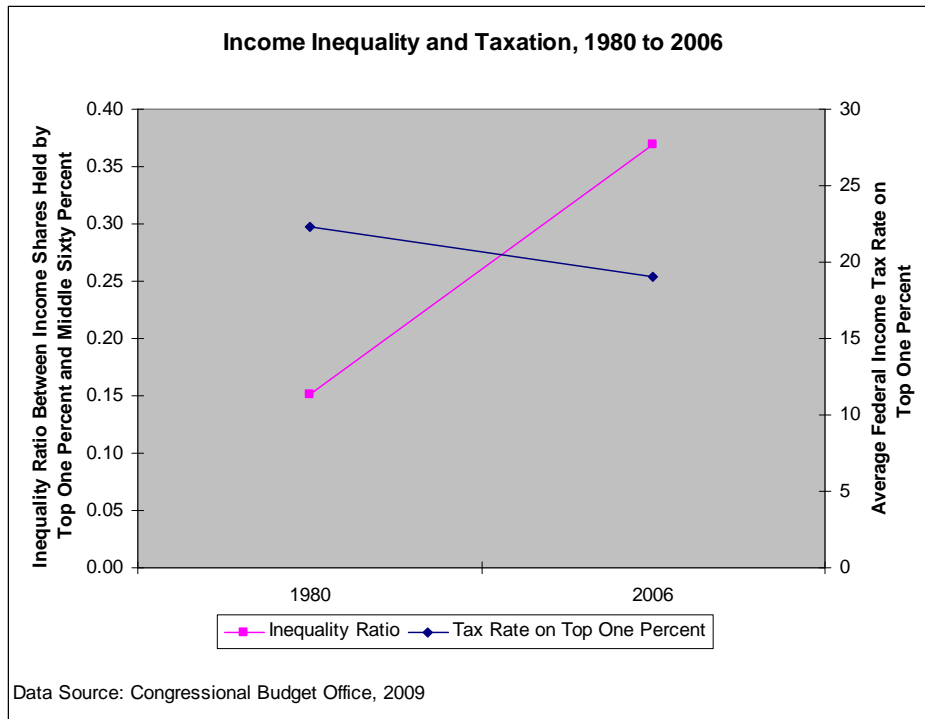


Figure 2



In short, as top-end tax rates have declined, inequality has risen. If we use the term *inequality ratio* to describe the proportion of after-tax income taken by the top 1 percent of taxpayers to after-tax income taken by the middle 60 percent of taxpayers, then our country's inequality ratio rose 144 percent between 1980 and 2005.<sup>9</sup>

- **Top end taxes: Down 15 percent**
- **Inequality ratio: Up 144 percent**

If this imbalance seems bad, the reality is even worse. Many earnings at the top end aren't classified as *income*, so they avoid income taxes of that kind. Compensation in the form of stocks and dividends is taxed as *capital gains*, at a 15 percent rate. Nowadays, executives often compensate themselves with stock options rather than salary, which reduces their taxes.

## Why taxes? You get what you pay for

Collecting tax revenue is not an end in itself. It is a means to an end. It is how we pay for our collective needs. As a society, we need roads and bridges, schools and hospitals. We need courts to settle disputes, parks for children to play, and inspectors to keep the lead out of their toys.

These functions aren't free. We need to raise revenue to pay for them. But we've been skimping for years, and our investment deficits have accumulated.

Our infrastructure is literally falling apart. Much of our infrastructure dates from the World War II era, and many water pipes date from the 19<sup>th</sup> century. Our trains are slow, our roads are potholed and our school roofs leak. America in the 21<sup>st</sup> century needs a 21<sup>st</sup> century infrastructure.

We remain addicted to imported oil. We need to develop new, renewable sources of energy and stop our toxic, destabilizing dependence on foreign oil. We can add energy by harnessing wind and solar power; we can conserve what we have with additional insulation and double-pane glass.

We're short-changing our children. America has a long tradition of public education, from kindergarten to land grant colleges. We need to restore our investment in education, and in the basic public research that created public goods like the Internet.

These are public goods that help us all; we need revenue to pay for them.

Revenue, however, has become virtually a taboo subject. Simply talking about paying for what we need leads to accusations about "soaking the rich" or killing jobs. "Tax and spend" is an insult designed to end debate and cow politicians. As President Obama has suggested, it is time to put away these childish games. We need an adult conversation about how to raise the revenue we need, and how to invest it wisely.

## Righting the Balance: Progressive Taxation

A progressive tax code shares the obligations of a civilized nation fairly. As Adam Smith explained in his seminal treatise on capitalism, *The Wealth of Nations*, "It is not very unreasonable that the rich should contribute to the public expense, not only in proportion to their revenue, but something more than in that proportion."

### What makes the federal tax code less progressive? Some examples.

- In 1980, the top marginal tax bracket was 70 percent.
- In 2009, it is 35 percent.
- In 1980, the maximum exemption on estates passed to heirs was \$162,000 (\$324,000 for a couple); the top rate was 70 percent.
- In 2009, the exemption is \$3.5 million (or \$7.0 million a couple); the top rate is 45 percent.
- Payroll taxes on wages (a regressive form of taxation -- although Social Security benefits are progressive) have risen. Combined employer-employee payroll taxes rose from 6 percent in the 1960s to over 15 percent in the 2000s. **Income over \$107,800 avoids Social Security taxes altogether.**

A regressive tax code can actually retard economic growth. When top tax rates were steep, executives had more incentive to leave money in the company — investing for future growth, sharing with staff or hiring more people. With taxes so low and loopholes available, CEOs have more incentive to pay themselves.

It is time to restore progressivity to the tax code. We don't attempt to provide all of the answers here, but we can begin with a collection of reform proposals for the federal tax code helpfully assembled by the Institute for Policy Studies.<sup>10</sup> The Progressive States Network is highlighting similar ideas in the states.<sup>11</sup>

- **Repeal the Bush tax cuts for the wealthiest individuals.** Once the economy moves out of the current downturn, tax rates on the wealthiest should return at least to where they were during the Regan era. The Institute for Policy Studies proposes an additional top bracket for the top earners, with incomes over \$2 million.

- **Institute a “transaction tax” on financial trades to discourage speculation.** Introducing a small tax on financial transactions, calibrated to discourage rapidly “flipping” investments, will promote stability and raise revenue. Stock trades can lose their privileged position and abide by the same rules as homes and hotdogs — a modest tax on sales.
- **Tax all types of income at the same rate.** Working Americans pay tax rates of up to 35 percent on the income they earn from doing their jobs. But stock brokers, who earn their income by trading stocks, treat their income like capital gains, subject to tax rate of only 15 percent. That’s why Warren Buffett pays taxes at a lower rate than his receptionist.<sup>12</sup> It’s wrong. Income from wealth should not be treated differently than that from work.
- **Save the estate tax.** Currently, wealthy households are permitted to pass up to \$3.5 million (\$7 million for a couple) to their heirs tax free; efforts are being made to raise the exclusion still higher and lower the top rate. The present limitation should be defended and probably lowered. Children of people that wealthy already start life with advantages. They don’t need millions more — tax free.

Adam Smith,  
*The Wealth of Nations* (1776)<sup>13</sup>

“The necessities of life occasion the great expense of the poor. They find it difficult to get food, and the greater part of their little revenue is spent in getting it. The luxuries and vanities of life occasion the principal expense of the rich, and a magnificent house embellishes and sets off to the best advantage all the other luxuries and vanities which they possess .... It is not very unreasonable that the rich should contribute to the public expense, not only in proportion to their revenue, but something more than in that proportion.”

- **Shut down offshore tax havens for businesses and individuals.** Every year, individuals and businesses evade an estimated \$70 billion and \$30 billion in taxes, respectively, by hiding income in other countries’ banks. The evasion is known, and it can be stopped.
- **End tax breaks for giant corporate interest groups.** Oil companies receive \$14 billion annually in federal subsidies, even during this time of high prices and record profits. Agriculture subsidies conceived to help family farms during the Great Depression now support giant businesses that crowd out small farmers and non-subsidized crops, at a cost of roughly \$30 billion a year. The Obama administration started a clean-up effort by ending a \$5 billion subsidy for bank in the student loan industry, but far more cleaning is needed.

None of these changes is radical. Indeed, they reflect traditional American common sense. Income should not be hidden overseas; wealthier people can afford to contribute more; wealth should be earned, not given; gilded age inequality undermines democracy.

## Appendix

### CBO Income Share and Tax Rate Data

Year	Middle Sixty Percent After-Tax Income % Share	Top 1 percent After-Tax Income % Share	Inequality Ratio for Middle Sixty Percent and Top 1 percent	Average Effective Federal Income Tax Rate on Top 1 percent
1980	50.9	7.7	0.15	22.3
1981	50.8	8.0	0.16	21.5
1982	50.1	8.7	0.17	20.4
1983	49.6	9.4	0.19	19.4
1984	49.3	9.9	0.20	19.3
1985	48.7	10.6	0.22	18.9
1986	46.9	13.2	0.28	18.3
1987	49.5	9.9	0.20	21.5
1988	48.2	12.0	0.25	20.7
1989	48.4	11.3	0.23	19.9
1990	48.5	11.0	0.23	19.9
1991	49.2	10.0	0.20	20.6
1992	48.5	10.9	0.22	21.2
1993	49	10.0	0.20	23.2
1994	49.3	10.0	0.20	23
1995	48.7	10.3	0.21	23.7
1996	47.8	11.4	0.24	24.2
1997	46.6	12.6	0.27	23.8
1998	46	13.5	0.29	23.4
1999	45.4	14.4	0.32	24
2000	44.6	15.5	0.35	24.2
2001	47	12.6	0.27	24.1
2002	47.8	11.4	0.24	23.7
2003	47.3	12.2	0.26	20.4
2004	46.1	14.0	0.30	19.7
2005	44.6	15.6	0.35	19.3
2006	44.1	16.3	0.37	19

**Source:**

Congressional Budget Office, "Data on the Distribution of Federal Taxes and Household Income," April 2009.<sup>14</sup>

## Endnotes

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- <sup>1</sup> Jenny Anderson, "Scrutiny on Tax Rates That Fund Managers Pay," *New York Times*, 13 June 2007. [http://www.nytimes.com/2007/06/13/business/13tax.html?\\_r=1&oref=slogin](http://www.nytimes.com/2007/06/13/business/13tax.html?_r=1&oref=slogin); Tom Bawden, "Buffett Blasts System That Let Him Pay Less Tax Than Secretary," *Times Online*, 28 June 2007. <http://business.timesonline.co.uk/tol/business/money/tax/article1996735.ece>
- <sup>2</sup> The dollar effects were: top 1%, \$44,622; middle quintile, \$746; lowest quintile, \$22. Tax Policy Center, "Table T06-0280: Combined Effect of the 2001-2006 Tax Cuts, Distribution of Federal Tax Change by Cash Income Percentile, 2007," Urban Institute and Brookings Institution, 13 Nov. 2006. <http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=1362>
- <sup>3</sup> Specifically, weekly wages fell 0.1% or about \$10. Lawrence Mishel, Jared Bernstein and Heidi Shierholz, "Table 3.4: Hourly and Weekly Earnings of Private Production and Nonsupervisory Workers, 1947-2007," *State of Working America*, Economic Policy Institute, 2009, p. 132.
- <sup>4</sup> *State of Working America*, Economic Policy Institute, 2009, p.162
- <sup>5</sup> Sarah Anderson, John Cavanagh, Chuck Collins, Sam Pizzigati and Mike Lapham, "Executive Excess 2008: How Average Taxpayers Subsidize Runaway Pay, 15th Annual CEO Compensation Survey," Institute for Policy Studies and United for a Fair Economy, 25 Aug. 2008. [www.ips-dc.org/getfile.php?id=262](http://www.ips-dc.org/getfile.php?id=262)
- <sup>6</sup> The top one percent (1.1 million households) held 15.4% of after tax income in 2008. The bottom quintile (37.7 million households) held 4.9%, and fourth quintile (32.8 million households) held 9.8%, for a combined total of 14.7%. Tax Policy Center, Table T09-0171, "Baseline Distribution of Cash Income and Federal Taxes Under Current Law, 2008." Urban Institute and Brookings Institution, 18 March 2009. <http://www.taxpolicycenter.org/numbers/Content/Excel/T09-0171.xls>
- <sup>7</sup> Congressional Budget Office, "Data on the Distribution of Federal Taxes and Household Income," April 2009. <http://cbo.gov/publications/collections/taxdistribution.cfm>
- <sup>8</sup> Ibid.
- <sup>9</sup> The inequality ratio in 1980 was 0.15 (7.7% after tax income to top one percent, compared to 50.9% for the middle sixty). The inequality ratio in 2006 was 0.37 (16.3% top v. 44.1% middle). The increase from 0.15 to 0.37 is 144%.
- <sup>10</sup> John Cavanagh, Chuck Collins, Alison Goldberg, Sam Pizzigati, "Reversing the Great Tax Shift: Seven Steps to Finance Our Economic Recovery Fairly, Institute for Policy Studies." 7 April 2009. <http://www.ips-dc.org/reports/#1207>
- <sup>11</sup> Progressive State's Network, Stateside Dispatch, "Current and Recent Campaigns to Raise the Income Tax," 6 April 2009. <http://www.progressivestates.org/node/22941>
- <sup>12</sup> Tom Bawden, "Buffett Blasts System that Lets Him Pay Less Tax than Secretary," *Times Online*, 28 June 2007. <http://www.timesonline.co.uk/tol/money/tax/article1996735.ece?print=yes>
- <sup>13</sup> Adam Smith, "Book Five: Of the Revenue of the Sovereign or Commonwealth," *An Inquiry into the Nature and Causes of the Wealth of Nations*, 1776. <http://www.adamsmith.org/smith/won-b5-c2-article-1-ss3.htm>
- <sup>14</sup> Congressional Budget Office, "Data on the Distribution of Federal Taxes and Household Income," April 2009. <http://cbo.gov/publications/collections/taxdistribution.cfm>