

The politics of plutocracy

IN AN ordinary American presidential election, a candidate who had earned a fortune in business and then paid an absurdly low tax rate would barely raise eyebrows. Americans have long considered wealth something to admire and pursue, not vilify and redistribute. Alexis de Tocqueville said he knew "of no country...where a profounder contempt is expressed for the theory of the permanent equality of property."

But this is no ordinary election. That so much scrutiny has fallen both on how Mitt Romney earned his fortune (in the ruthless world of private equity) and his tax rate (15%, less than what some middle-class families pay) is a sign something has changed. For that, credit a decade in which the median family in America saw its real income fall by 7%, even as the top 1% grabbed a share of national income unseen since the 1920s (see article), and a level of unemployment that, though falling, remains troublingly high. Not many Americans like the tactics or fashion choices of Occupy Wall Street, but quite a few share the movement's opinion that the economy is tilted in favour of the wealthy.

And so the rich are now a campaign issue. Barack Obama calls for "millionaires and billionaires" to "pay their fair share": introduce a minimum tax rate on millionaires and return the top income-tax rate to 39.6% from 35%, and the other 98% of Americans would not have to pay more, he claims. Republicans shoot back that raising any taxes would destroy jobs and business confidence. They think you can fill the budget hole by spending cuts alone; many want to cut taxes further.

Neither side is talking sense. America's rich should indeed pay more tax; but marginal rates should not go up. History shows that deficit reduction works best when most of the burden falls on spending cuts. That means that middle-class entitlements will have to be reduced, no matter what Mr Obama tells his supporters. But, just as in every other budget squeeze, a portion must come from higher taxes, no matter what the Republicans say.

Democrats say only the top 1% need pay more; that's misleading. Others will have to pay too. But more of the increase should be shouldered by the rich who have done so well from recent trends. Technological change and globalisation have sharpened demand for the most skilled workers, in particular superstars, be they athletes or hedge-fund managers, thus sharply increasing inequality. Tax policy has exacerbated this trend instead of mitigating it. George Bush junior slashed top income-tax rates as well as rates on dividends and capital gains, which explains why Warren Buffett and Mr Romney have such low tax rates.

However, restoring the top income tax rates, as Mr Obama proposes, is not the best way of extracting extra revenue from the rich. It would raise revenues of about 0.3% of GDP and do nothing to make America's grotesquely complicated tax system more efficient. It would be far better to close or limit loopholes and deductions, currently worth up to 7% of GDP, which distort behaviour (by, for example, encouraging people to take out big mortgages) and mostly benefit the affluent. .../... The Economist Jan 21st 2012 |