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# The Case for Raising Top Tax Rates

By EDUARDO PORTER

The wealthy are feeling defensive about their taxes. Most Americans may think the rich pay too little but, not surprisingly, only 30 percent of the rich agree. More than two-thirds of families earning a quarter of a million dollars a year or more tell Gallup's pollsters that their taxes are too high.

It is true that high-income Americans carry the biggest tax burden. While fewer than 1 in 20 families make more than $200,000, they pay almost half of all federal taxes.

However they feel about the tax man, there is a case to be made that they can pay much more. The reason has nothing to do with fairness, justice or ideology. It is about economics and math.

The math is easy: the federal budget over the next decade cannot be made to square without raising a lot more money. The nonpartisan Congressional Budget Office estimates that if we stay on our current path, federal debt held by the public will grow from about two-thirds of gross domestic product today to roughly 100 percent in a decade and twice that much by 2040. It is unlikely that even the most committed Republicans could reverse the trend without higher taxes.

But an equally compelling reason relies on a new understanding of the economics of taxation. For 30 years, any proposal to raise taxes had to overcome an unshakable belief that higher taxes inevitably led to less growth. The belief survived the Clinton administration, when taxes rose and the economy surged. It survived George W. Bush's administration, when taxes were cut yet growth sagged.

But now, a growing body of research suggests not only that the government could raise much more revenue by sharply raising the top tax rates paid by the richest Americans, but it could do so without slowing economic growth. Top tax rates could go as high as 80 percent or more.

Admittedly, it seems inconceivable that our political system could stomach a tax increase that big. Today, the richest 1 percent of Americans pay a top federal rate of 29 percent, according to Emmanuel Saez, an economist at the University of California, Berkeley. That's because almost a third of their income derives from capital gains and dividends — which are taxed at a 15 percent rate — while the rest is ordinary income taxed at a top marginal rate of 35 percent.

Nonetheless, the research suggests there is much more money available to close the budget deficit

than we previously thought, if only we were willing to raise tax rates to where they were back in the early '70s, in the administration of Richard M. Nixon.

Taxpayers always want to pay less to the tax man. Still, there's nothing inevitable about low taxes. In the early 1950s, coming out of World War II, the top federal income tax rate exceeded 90 percent. In 1980, the top marginal rate was 70 percent for families making more than $215,400 — about $587,000 in current dollars. And these families pocketed a much smaller share of the nation's income than they do now. Today, people earning over $200,000 a year capture more than a third of national income.

How we got from that country to this one — where President Obama's attempt to raise the top federal rate to 39.6 percent from 36 percent sets off partisan warfare — had less to do with changing beliefs about fairness than with politics. By the mid-1970s, the Republican Party concluded it was probably more effective to counter Democrats' Big Government platform as the party of low taxes than as the party of budget discipline.

Economics helped them make their case. The sharp fall in tax rates that brought us to where we are today was buttressed by an economic proposition that has guided policy ever since: that raising taxes could backfire and harm the economy along the way.

Legend has it the idea entered the political mainstream during a meeting in Washington in 1974 in which the economist Arthur Laffer demonstrated the principle to Donald Rumsfeld, chief of staff to then-President Gerald Ford, and Dick Cheney, an assistant to the president. He drew a curve on a cocktail napkin — now known as the Laffer curve — to illustrate how tax revenues would increase less and less as tax rates rose until they reached a point where any future increase reduced the amount of money raised.

If taxes were too high, Mr. Laffer argued, people would come up with ways to avoid or evade them. They might postpone or cancel investments if the government were to tax away a large share of the rewards. They might work less, or put less effort into it. In this way, high taxes could reduce the total tax haul. More worryingly, this behavior would ultimately slow economic growth.

Economists today broadly accept this understanding of people's actions. This belief has supported big declines in tax rates around the developed world, from Japan to Britain and the United States to Sweden.

But something got lost in the rush to cut: the proposition does not support low taxes all the time, for everybody and at all costs. While raising tax rates beyond a certain threshold can reduce tax revenue, we don't know where the peak is. After decades of tax cuts, it is not unreasonable to think we are way below it. And though raising taxes will change taxpayers' behaviors in a way that could reduce economic growth, we don't know precisely how much. It turns out the impact of raising tax rates on the rich may be smaller than we thought.

The British went out of their way to shield income from the taxes after the Labour government raised the top income tax rate to 50 percent from 40 percent in 2010. High fliers asked for accelerated bonuses to get the money before the new tax rate went into effect. Then, they postponed income, hoping Labour would be kicked out of office. More than a thousand people moved to Switzerland.

This month, the new Liberal-Conservative government concluded that the tax increase had brought in too little new money and cut the top rate to 45 percent. Yet while the experience confirmed that taxpayers will do their best to avoid taxes, many of these tactics work only in the short term. Eventually, they'll have to pay what they owe.

There are several studies that suggest top rates paid by high-income taxpayers above a certain threshold of earnings could be substantially higher. A study published last November by Mr. Saez and Peter Diamond, the economics Nobel laureate from M.I.T., made the biggest splash.

Their study suggested the federal government could raise the top marginal rate to 76 percent without losing revenue if it closed all the loopholes to prevent taxpayers from reclassifying income on their tax returns just to pay less. The top tax rate could rise to 48 percent even if we kept the loopholes we have today, they found.

Perhaps the most controversial conclusion, made by Mr. Saez and two colleagues in another study published last December, is that while the rich would respond to a big tax increase by shielding income from the tax man and maybe working less, this would not slow the economy at all. That's because a lot of what the rich do does not, in fact, generate economic growth. So if they reduced their effort in response to higher taxes, the economy wouldn't suffer.

These arguments are not the mainstream view. Some economists really dislike them. And they are not absolutely airtight. The calculations rely on estimates about how higher tax rates would discourage the rich from working or investing over a couple of years at most. But we know little about how they might affect long-term decisions, like whether to become a brain surgeon or a hedge fund manager. We do know that in countries with higher tax rates, like France, people work fewer hours than in the United States.

But the new line of research has the potential to overturn contemporary thinking about government finances. And in one respect, it seems indisputable: three decades of tax cuts may have gilded the pockets of the rich, but they didn't provide much economic juice. Among developed nations, incomes per person grew no faster in countries like the United States and Britain that slashed their top tax rates than in countries like Spain, Germany or Denmark, which did not. If taxes didn't juice the engine of growth on the way down, there is little reason to fear they will stall it on the way back up.

American tax politics have not changed. Republicans act as if cutting is the only legitimate thing to

do with taxes. Their proposals to address the budget deficit thus rely on a mix of ambiguous commitments to close unspecified loopholes and the fairly radical assumption that voters won't mind losing a big chunk of what the government does. And Republican arguments to the contrary, President Obama's plan to raise $2.1 trillion in new taxes over the coming decade — mostly from high-income taxpayers — is comparatively modest.

Raising the top tax rates on the richest Americans could go a long way toward balancing the federal budget. Mr. Saez estimated that raising the top tax rate on the top 1 percent of earners to 67 percent would raise about $4 trillion over a decade. That's a start.

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