Buffett is Right: Raise Taxes on the Wealthy

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Abstract

In a contribution to the CNN.com, Bill Gale discusses the need to raise taxes on the wealthy.

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Buffett is Right: Raise Taxes on the Wealthy

In Sunday's New York Times, Warren Buffett discusses the need to raise taxes on the wealthy. He's absolutely right. Tax increases, in general – as well as tax increases on the wealthiest households, in particular – need to be a part of the solution.

Past major budget agreements, such as the 1983 Social Security reforms and the 1990 and 1993 budget deals, ultimately included both revenue increases and spending cuts. It's not hard to see why: Cutting deficits from both sides of the budget provides a sense of fairness, shared sacrifice and political equilibrium.

Also, raising taxes to pay for current spending has proved more effective at restraining spending than allowing the government to finance its outlays with deficits. Every time we have tried to cut spending by restraining taxes, we have failed. In the 1980s under President Ronald Reagan and in the past decade under President George W. Bush, taxes fell, but spending rose. The only time in the past 30 years when spending fell was in the 1990s, under President Bill Clinton, when taxes were also raised.

Even the massive tax increases during and after World War II – amounting to a permanent rise of 10% to 15% of gross domestic product – and the much smaller tax increases in 1990 and 1993 did no discernible damage to U.S. economic growth.

If we are going to raise taxes as part of the fiscal solution, the tax burden on high-income, high-wealth households needs to rise. The recently enacted debt deal contains only spending cuts and has little or no impact on high-income households. Rather, it puts the entire burden of closing the fiscal gap on low- and middle-income households. High-income households should not be exempted from helping resolve the nation's fiscal problem.

Households in the top 1% of the distribution can afford to contribute. They have done enormously well during the past 30-plus years. In 1979, their income accounted for 10% of total income. According to the most recent data (from 2008), their share of total household income more than doubled to 21%. In contrast, real income for middle-class workers has remained roughly constant over the same time frame.

There are, of course, better and worse ways to raise taxes. A general goal would be to broaden the tax base – reduce the use of specialized credits, deductions, loopholes and so on – and minimize the extent to which tax rates need to rise.

One good place to start? High-income households: Limit the rate at which itemized deductions can occur to 28%. This would affect only households in the highest income ranges, it would not raise their official marginal tax rate, and it would raise $293 billion over the next decade, relative to how much money would be raised according to current law, according to the Congressional Budget Office. This would be a small move in the right direction.

Of course, sticking to current law revenues – that is, either not extending the Bush tax cuts after their scheduled expiration date of 2012 or paying for any extension with a reduction in various tax expenditures – is even more important. Extending the Bush tax cuts would reduce revenues by about $2.5 trillion over the next decade, relative to current law. Counting net interest savings, it would cost $3 trillion. Letting the cuts expire could actually help economic growth since the lower deficits would more than offset the effect of slightly lower marginal tax rates, and it would be progressive. That would be a big move in the right direction.

Eventually, the nation will need to deal with the ballooning costs of Medicare, Medicaid and Social Security for an aging population. Even if substantial cuts are made to these programs, the combination of a greatly expanded elderly population and higher federal net interest payments than in the past (because of the higher public debt/GDP ratio) will create a need for additional revenues. There are good options there as well, including a value-added tax – the equivalent of a national consumption tax and a feature of the tax system of every industrialized country except the U.S. – and higher energy taxes, to promote a cleaner environment as well as raise revenues.

None of this means that the U.S. needs to move to European taxation levels. But between the depleted tax revenues we raise now – the lowest share of the economy in six decades – and the high taxes experienced in European countries, there is plenty of room to raise revenues in an economically sound manner to support a reasonable level of government.

The opinions expressed in this commentary are solely those of William G. Gale.

Other Publications by the Authors

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