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## Jeffrey Sachs: Fairness and Efficiency in Taxation

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**T**he debate about federal taxes continues to boil, partly because people are looking at very different indicators of what is «fair» and «efficient» in taxation. Let me try to clarify some of the heated points of the debate.

Conservatives point out that the richest 1% receives around 20% of personal income yet pays 38% of total federal income taxes (All data may be found at the [Tax Foundation](#). To calculate average income in each income category, divide the total income in that category by the number of households). In this sense, the federal income tax is indeed progressive, meaning that the rich pay a higher share of income than the poorer households. The implication for conservatives is simple: the rich need not pay more in taxes since they already carry a large and disproportionate share of the federal income taxation.

Yet things are not so simple. The rich have enjoyed an unprecedented boom in their incomes in recent decades. Globalization has been exceedingly kind to them. Stock markets have boomed since the 1980s and investment and profits earned abroad have soared. The wages of American production workers have stagnated, under the pressure of labor competition from Asia. Lower wages of production workers have led to record corporate profits, while manufacturing jobs have been shed by the millions.

The result is a startling rise of income inequality. The (pre-tax) average household income of the top 1% has skyrocketed from \$386,900 in 1980 to \$1,203,600 in 2008 (using the 2008 price index in both cases). The (pre-tax) average income of the bottom 50% of households, by contrast, has declined slightly from \$16,100 in 1980 to \$15,400 in 2008, and that decline

occurred despite the rise of two-earner households struggling to make ends meet.

Despite much bellyaching about their high federal income-tax burden, the rich have actually enjoyed a declining average tax rate. In 1980 they paid 34.5% of their incomes in personal income taxes, and this fell to just 23.3% by 2008. The rich are certainly not suffering under an arduous tax burden. On the contrary, the average federal income tax rate paid by the rich has not been so low since the eve of the Great Depression!

Since the rich have enjoyed a surge in pre-tax income and a decline in the average tax rate, they can easily afford to pay more in taxes without seriously denting their booming incomes. The average post-tax income of the top 1% (subtracting off their federal income tax payments) rose from \$253,500 in 1980 to \$923,500 in 2008, while the post-tax income of the bottom fifty percent actually declined, from \$15,200 in 1980 and \$15,000 in 2008. With the bottom half of American society suffering from unemployment, foreclosures, crushing student debts, and falling earnings, why should we continue to bend over backwards to protect the low tax rates of the rich?

Many conservatives believe that raising tax revenues as a share of GDP would utterly cripple the economy. This proposition is incorrect for two reasons. First, the federal government can (and should) raise considerable added revenue by closing tax loopholes. Major loopholes include the low tax rates paid on capital gains compared with ordinary income; the absurdly low rates paid by millionaire and billionaire investment-fund managers; the complete deductibility of employer-paid health-insurance outlays, even for the highest-priced plans; and the de-

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ductibility of mortgages, including on second homes and mansions. Closing these loopholes could raise significant revenues even without raising the top marginal tax rate.

Second, and contrary to the claims of the supply-siders, the US economy would not be harmed by higher marginal tax rates. The economy thrived in the 1950s and 1960s when top marginal tax rates were over 90% in the 1950s and 70% in the 1960s. The steep cuts in the top marginal tax rates that began in 1981 did not deliver on the supply-sider promise of high employment and rapid economic growth. Instead, the thirty years of low top tax rates have contributed to large budget deficits and the exceptionally high inequality of income.

Most conservatives also believe that the government budget deficit can and should be eliminated by cutting «wasteful» federal spending rather than by increasing tax revenues as a share of GDP. In another [recent posting I've shown why this view is erroneous](#). A basic level of public services will require around 24 percent of GDP while our current tax system only brings in around 18 percent of GDP. If we try to close the budget by holding spending to 18-20 percent of GDP, we would end up shredding the social safety net and crippling America's global competitiveness.

Some conservatives object that the poor don't pay any taxes at all. This is simply not true. The poor pay federal payroll taxes, as well as sales and other taxes at the state and local level. It would be possible, of course, to collect personal income taxes from the poor as well, but the government would then presumably have to increase its transfer payments as well to keep these households above destitution. That is exactly why Milton Friedman supported a «negative income tax,» in which the poor would receive money rather than pay taxes. That is basically how the American federal income tax system currently works.

The bottom line is the following. The period since 1980 has been an era of exceptional gains for the richest Americans. They've enjoyed an unprecedented surge in pre-tax income together with a decline in the average rate of income taxation. Their net-of-tax incomes are at all-time record highs while the rest of American households suffer the stagnation or decline of real incomes. While it is true that the rich pay a high share of the total federal taxation, they can afford to do so, given the soaring incomes and declining average tax take.

We are at a time in our country's history when everybody needs to pull for America's recovery and long-term competitiveness. This is the time for the rich to step forward and assume their responsibility. Let's start hearing the responsible voices of those on Wall Street who have never had it so good and who therefore want to help rebuild the country. Let them reassure that rest of Americans that they are finally ready to respond to JFK's call a half-century ago to «ask what you can do for your country.»

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