

July 21, 2011

The Patriotic Millionaires
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Speaker John Boehner, et al.
By Facsimile Transmission

Dear Speaker John Boehner, Senator Mitch McConnell, House Majority Leader Eric Cantor, and all other Republican House and Senate Members who refuse to even consider raising taxes on people making more than one million dollars per year:

Since November of last year, we have urged you to put your country ahead of personal political interests and to increase taxes on people with incomes over \$1 million per year. We have made this request as responsible and patriotic citizens who now or in the past have earned an income of \$1 million or more per year.

Despite our willingness to provide additional support to the country financially to ensure its continued well being, despite the overwhelming support of the idea among the American public, despite the reality that millionaires like us are paying lower taxes now than at any time in the last 60 years, and despite the fact that the Bush tax cuts are the single, largest cause of the current federal deficit, you have repeatedly refused to consider this limited and reasonable step to address our country's fiscal challenges.

Now, as our country approaches a potentially catastrophic impairment of our financial obligations, we are writing to reiterate our demand.

Moreover, because of the corrosive role misleading - even intentionally dishonest - arguments have played in this critical debate, which you continue to present, we have enclosed a detailed analysis summarizing the reasons supporting our position.

Tax Fairness, Economic Growth and the Truth About Taxes on Millionaires and Billionaires

By
The Patriotic Millionaires

First, to be clear, our position is not for or against taxes or the accumulation and/or distribution of wealth in America *in general*, but *instead and only* whether or not the Bush tax cuts of 2001 and 2003 on incomes over one million dollars per year should be discontinued.

Currently, under the Bush tax cuts, the highest marginal federal income tax rate is 35%. The Patriotic Millionaires' proposal is that the tax rate for incomes above \$1 million per year return to the previous level of 39.6%, which applied from 1993-2001. Our proposal will not impose any *additional taxes whatsoever* on any income below \$1 million per year. The implementation of our proposal would technically involve the establishment of a new tax bracket of 39.6% which would apply only to incomes over \$1 million per year.

A 13% tax increase on persons making \$1 million or more per year can hardly be viewed as "confiscatory" or, in any way, unreasonable. Among other things, due to the current tax structure, statistics reported by the IRS and the CBO indicate that no taxpayer would pay (or currently pays) the rate of the highest tax bracket on all of his or her income. In fact, persons earning \$1 million or more pay, on average, 22% of their income in federal income taxes - - far below either the current or the proposed highest marginal rate. In fact, even if they paid the full 13% increase - - which would almost never be the case because of various deductions and other tax loopholes - - the total amount paid would be no more than 25% of taxable income, not 39.6% - - again, hardly unfair.

Thus, given the fiscal emergency we purportedly face, the PM proposal is eminently reasonable. This conclusion is supported by two basic arguments:

1. This proposal offers a **fair allocation** of the burden born by taxpayers of the federal income tax.
2. This proposal is sound on policy grounds and will **reduce the deficit without adversely affecting economic growth**.

We support each of these conclusions at length below:

Fair Allocation of Tax Burden

An assessment of the basic fairness of the PM proposal involves an analysis of the incidence of the federal income tax. The soundest way to assess the fairness of the federal income tax system is to compare the tax burden imposed on average taxpayers earning \$1 million a year or more to the burden of average taxpayers in other income classes, taking into account both tax rates and differences in income. This comparison reflects what is known as the "*relative burden*" of the federal income tax. In other words, it takes into account the tax burden carried by average taxpayers in one income class compared to average taxpayers in other income classes, considering both their incomes and differences between tax rates and income.

Relative Burden Analysis

Taxpayers with incomes of \$1 million or above correspond roughly to the top 1% of income earners in the U.S. As a group, persons with \$1 million or more in income per year pay, as noted, approximately 22% of income in federal income taxes. This compares to other groups based on income as follows:

- After the top 1%, the next 4% of taxpayers, who earn on average \$245,000, pays (on average) 21%;
- The next 5%, who earn on average \$141,000, pays 20%; and
- Rounding out the top 10%, the next 5%, who earn \$100,000, pays 19%.

This compares to taxpayers at the lower end of the income scale as follows:

- The lowest 20% of taxpayers, who have an average income of \$12,400, pays (on average) 3.6% in federal income taxes;
- The second 20%, who have an average income of \$29,000, pays 8.7%;
- The middle 20%, who have an average income of \$40,400, pays 13.9%; and
- The fourth 20%, who have an average income of \$66,000, pays 17.2%.

First, these statistics reflect a sharp degree of income concentration in the top 10% of income earners who account for 45% of all income earned; the remaining 90% of the country accounts for a little more than half of all income earned in the U.S. (55%). Second, they reveal that persons in the top 10% pay higher rates than average taxpayers in the remaining 90%. However, while the top 10% pay 70% more in federal income tax than the average of the remaining 90%, they earn, on average, 1,200% more. Accordingly, a comparison of the tax rates and income of the top 10% and the remaining 90% significantly favors the top 10%. This is a clear indication that the relative tax burden on the affluent is actually less than on the remaining 90%.

The disparity is even more pronounced for the top 1% - - corresponding to persons earning \$1 million or more per year - - and the focus of the PM proposal. The average taxpayer in the top 1% makes 30 times the average of the first 90%, and 15 times that of the average of the remaining 99% - that is 3,000% and 1,500% more respectively. More startling still is the disparity between the top 1/10 of 1% who earn on average \$38 million per year, which is almost 543 times the average of the remaining 99%; or between the 400 highest income tax payers in the U.S. (approximately the top 1/1,000 of 1%) with an average income of \$270 million per year who make almost 1,100 times the average of the remaining 99%, (including the millionaires up to 1.3 million!).

Thus, while it is true that tax rates on the wealthiest Americans are higher, this difference is offset entirely by the corresponding income disparities. A wealthy lifestyle in the U.S. may be expensive, but it is not 500-1,000 times more expensive than the cost of living for the other 99% of the U.S. population.

In conclusion, assessment of the fairness of the relative tax burden of affluent taxpayers must take into account not only the differences in the tax rate which they pay compared to the rest of the country, but also the differences in their income vis-à-vis the rest. Because of staggering

disparities in income between the top 1% and the rest of income earners, the top 1% earns far more in income than it pays in taxes compared to other income groups, even when taking into account that it pays proportionately more taxes. In other words, income differences that favor the top 1% far outweigh the differences in tax rates even though the top 1% pays proportionately more than other classes of income earners.

Disparities in income between the top 1% and 1/10 of 1% and the rest of the public accelerated significantly during the Bush years - - in considerable part because of the Bush tax cuts - - and as previously demonstrated, as income levels rise, the relative burden of taxes decline. As such, fairness would require that those who benefited the most from the Bush tax cuts and whose income grew the most during those periods - - a combination of circumstances that reduced their relative tax burden substantially in comparison to their fellow citizens - - pay a little more during a fiscal emergency.

Reducing the Deficit and Supporting Economic Growth

The fate of the Bush tax cuts and the issues of increased taxes on the top 1% of income earners in the U.S. raise two basic policy considerations:

- The first involves the **fiscal effects** of eliminating the Bush tax cuts for the top 1%; and
- The second involves the **macroeconomic effects** of taxing the rich on economic growth, jobs, interest rates, capital formation, and inflation.

The Fiscal Impact

The fiscal impact of eliminating the Bush tax cuts on the top 1% is considerable. Reliable estimates indicate that allowing the Bush tax cuts on the top 1% to expire will reduce the deficit (and resulting debt) by \$500-600 billion over 10 years consisting of \$400 billion in increased revenues and \$100-200 billion in saved interest payments on the debt. This represents a significant contribution to deficit reduction.

Macroeconomic Effects

In standard, accepted modern macroeconomic analysis, tax cuts are generally regarded as a temporary counter-cyclical policy tool which can stimulate economic growth in the short-run business cycle - - if the economy is contracting and/or operating at below-full employment levels. Both the purpose and effect of below-full-employment tax cuts are to stimulate aggregate demand and are viewed as “demand side,” that is, having effects on aggregate demand. (As we will see, accepted macroeconomic analysis conflicts with conservative dogma which views tax cuts as having primarily “supply-side” or aggregate supply effects.)

In general, tax cuts bolster aggregate demand by stimulating consumer spending. Bolstered consumer spending then dampens or reverses the effects of a cyclical downturn (including job losses) resulting from an unexpected contraction in private sector demand which cannot effectively recover in the short-run and which leaves a gap in aggregate demand (known as an “output” gap) as an impediment to reaching higher or full employment levels of economic activity.

Tax cuts of this nature are designed specifically to stimulate personal consumption. Their effectiveness can be judged on the degree to which the money from the tax cuts are put back into the economy through increased consumer spending and vary according to the income of the recipients. Studies have shown that tax cuts on wealthy people are not effective in stimulating the economy, because tax savings of the affluent taxpayers are saved, not spent. Thus, the stimulative effect of tax cuts is greater when they are directed at the less affluent - - not at the wealthy. The differences are dramatic. Tax cuts to the top 1% of income earners - - the specific target of the Bush tax cuts - - are particularly ineffective as economic stimulus. Sixty percent of the income of the top 1% is concentrated in the top 1/10 of 1%. With an average annual income of \$38 million/year, the savings rates of these individuals dwarf their personal consumption rates.

Once the economy has recovered to or near full employment levels, standard macroeconomic policy requires the cessation of tax cuts to avoid creating imbalances in the federal budget and/or to prevent the economy from over-heating through a build-up of inflationary pressures. Tax cuts should never be utilized or permitted to persist when the economy is at or near full employment (or has recovered cyclically to full employment) without being paid for.

Supply-side Economics: Decades of Experience with a Discredited Theory

For much of the last 30 years, the Republican Party has believed in a theory called “supply-side economics.” Supply-side economics holds that tax cuts stimulate extra economic growth which, in turn, generates additional tax revenues which will exceed the size and cost of the tax cuts and, in so doing, pay for themselves. Importantly, there are currently no reputable economists in the country who support the central premise of supply-side tax cuts. In fact, even the chairmen of Reagan’s and George W. Bush’s Councils of Economic Advisors, Martin Feldstein and Gregory Mankiw (both dyed in-the-wool political conservatives), have both repudiated its central premise.

Evidence shows that not only do such tax cuts NOT pay for themselves, they also produce serious deficits proportionate to the size of the tax cuts.

In the last 30 years, there have been two extended experiments in supply-side tax cuts, both of which were initiated in the wake of economic downturns and then continued even after the economy had recovered to at or near full employment: 1) the Reagan tax cuts in the period after 1983, and 2) the Bush tax cuts in the period after 2003. Both experiments failed ignominiously and provoked difficult and painful fiscal crises. The first crisis was not resolved until 10 years after it had begun in 1993 and after a second business cycle produced the recession of 1989-91. The resolution did not occur naturally but only after the budget compromise of 1990 in which then President George H.W. Bush and Congress agreed to cut both domestic and military spending equally and to raise taxes and President Clinton and Congress raised federal income taxes, eliminating the Reagan tax cut of 1981.

The second crisis is ongoing and has not as yet been resolved. The fiscal and budgetary mismanagement associated with the Bush tax cuts was even more egregious than during the Reagan years. From a macroeconomic policy standpoint, because the recession of 2001-03 was much milder than the counterpart of 1980-81, and because monetary policy was effective in

supplying the necessary economic stimulus to restore full employment levels, the theory of the Bush tax cuts was even more questionable than that of the Reagan tax cuts. Moreover, they were intentionally geared to the top 1% and, for reasons previously stated, were particularly ineffective as an economic stimulus. Indeed, under the circumstances, they could be considered as little more than a gift to the wealthy.

Additionally, the Bush tax cuts produced substantial deficits and were principally responsible for converting a projected \$5.3 trillion surplus when Clinton left office into \$4 trillion of current public sector debt. Moreover, by running full employment deficits from 2003-2008, Bush deprived policy makers of a multi-trillion dollar surplus which could have been used to contain the economic collapse and job losses caused by the financial crisis of 2008. It is worth noting that China paid for its stimulus package out of its existing fiscal surplus. Additionally, despite the Chinese economy being only 2/3rds the size of the U.S. economy, the successful Chinese stimulus package was substantially larger than the U.S. stimulus package. Within 18 months of implementing its fiscal stimulus, China had restored employment to pre-collapse levels. Using the China package as a rough benchmark, the U.S. stimulus should have been \$1.2 trillion instead of the \$750 billion.

Given the disastrous aftermaths of both the Reagan and Bush experiments in supply-side tax cuts, it is now beyond argument that continuing large, unpaid-for tax cuts after the U.S. economy has recovered from recession - - as Bush did from 2003-2008 - - will result in either significant fiscal imbalances or inflation or both. The effects of the full-employment tax cuts in the Reagan and Bush years were disastrous. The Reagan tax cuts produced structural deficits of \$250-\$350 billion per year for 10 years and the buildup of \$3 trillion in public sector debt. The Bush tax cuts produced even larger structural deficits and are responsible for adding \$4 trillion to the national debt. Notably, this contribution to public sector debt is more than the cost of the bank bail-outs (“TARP”), and more than the cost of the federal stimulus that dealt with the 2008 financial crisis and the ensuing economic emergency. Indeed, 2/3 of the deficit and subsequent public sector debt are attributable to the Bush tax cuts (1/3) and to the unpaid-for wars in Afghanistan and Iraq (1/3), another example of gross economic mismanagement. By creating structural deficits of this magnitude and by depriving policy makers of a budget surplus to contain the financial crisis and reflate the economy after the economic downturn, the Bush tax cuts represent the greatest single instance of economic mismanagement in the history of the country.

Other Justifications for Tax Cuts to the Wealthy

The Republican Party and conservative ideologues no longer even attempt to justify tax cuts to the wealthy in terms of normal macroeconomic policy or principles. Instead, they contend that tax cuts to the wealthy are necessary to encourage work and to stimulate “entrepreneurial risk-taking.” According to the Right, taxes reduce economic growth because they tax “job-creators,” “work,” and “entrepreneurship” thereby reducing “economic incentives” to “create wealth” and “jobs”. However, despite the empirical evidence to the contrary just reviewed, the proclaimed direct connection between taxes and work and taxes and economic growth presents a serious conceptual problem: It is not derived from any obvious economic theory or economic principles. In fact, no credible economic study has ever been undertaken or relied upon to establish these connections in any remotely scientific fashion.

Wealthy people receive two kinds of income: 1) earned income from their occupations and 2) unearned income from investments and inheritance. Studies show that, contrary to conservative rhetoric, for people who receive earned income, taxes may actually encourage work because such people may have an after-tax income target which causes them to work harder to make up the income lost to taxes. Moreover, because, by definition, ‘unearned income’ is received without working, taxes would have no effect one way or the other on their incentives to work.

At best, it seems that the direct relationship posited by the Right between taxes and work is indeterminate or may exist only under special circumstances or with the caveat of “all things being equal.” But in the real world, general conditions overwhelm special cases and all things are never equal. As we have seen, whatever positive or negative relationship exists between taxes and work and taxes and economic growth, it is likely to be overwhelmed by other effects such as economic conditions of the business cycle or other economic relationships.

It is similarly unclear that taxes have any effect on individual entrepreneurial risk taking. As we have seen, at some point wealthy people save most of their income rather than consume it. Saving leads to investment. However, wealthy people do not as a rule invest their savings (and, hence, their incomes) directly in new businesses or in job-creating activities. They may invest some of their wealth in this fashion; but most of their wealth is invested in financial assets (including U.S. government obligations (!)), not in new businesses, and is invested globally rather than in the U.S.

In general, the only conclusions which economic thinking supports are: 1) tax cuts stimulate personal consumption expenditures and 2) tax cuts stimulate investment in financial assets. As we have seen, for the wealthiest Americans, the effects of tax cuts on personal consumption expenditures are minimal, if any, and increased investments are typically in financial assets not directly in “job-creating activities.” Again, even if there were minimal job creation effects due to the increase of investment in financial assets, these would - - if they exist at all - - be overwhelmed by changes in economic conditions in the business cycle affecting capital investment and other economic relationships. In conclusion, because work, risk-taking and job creation are affected by a multitude of factors, at best, the effects of taxes on incentives is indeterminate without clear scientific findings to the contrary - - systematic study of which has never been attempted.

Whatever the alleged effects of taxes on “incentives,” the incentives have nothing to do with or have no appreciable effect on aggregate supply, so-called “supply-side” effects. In economic thought, ***aggregate supply*** is the conceptual counterpart to ***aggregate demand*** and has a very precise meaning in the economic literature: ***Aggregate supply*** relates to the economy’s overall potential to produce goods and services and to produce economic growth. It is usually expressed as a potential growth rate of the economy at full employment levels of activity - - of which principal interest is the long-run, non-inflationary potential growth rate of the economy. Normally, determinations about the potential growth rate of the economy assume constant technology and are dependent on two factors: growth of the labor force and growth of labor productivity. Thus, if the labor force expands by 1% and labor productivity increases at 2 ½%, the economy can grow in real terms at a non-inflationary, long term rate of 3 ½%. The goal is to

keep the growth of labor productivity as high as possible, so that the potential rate of growth is as high as possible (as the growth of the labor force changes slowly and is dependent on demographic factors over which there is little control). Labor productivity is a function primarily of the level of training and education of the labor force and of capital investment. Capital investment, in turn, is a function of interest rates, returns on investment and aggregate demand growth.

Tax cuts, in theory, can increase the pool - - and, therefore, the supply - - of investible funds flowing to the financial markets which, also in theory, could affect interest rates. Such effects on interest rates, if any, through individual tax savings would likely be highly diluted by the myriad uses which would be made of such funds. Accordingly, in general, the effects of tax cuts on interest rates would be small in comparison to the other more traditional (and dominant) influences on interest rates including general credit creation of the financial system and actions by the central bank to control interest rates. Other than small, indeterminate effects on interest rates, nowhere do tax rates - - and associated cuts - - to the wealthy figure, even in an inconsequential way, in the labor productivity story. Moreover, since, by definition, supply-side tax cuts are never paid for, the money necessary for the government to finance them must be borrowed, thereby off-setting entirely any interest rate reduction effects. Thus, it is difficult to see how taxes and various incentives attributed to them can affect aggregate supply. The so-called supply-side connection between tax cuts and growth, let alone job creation, is dubious at best.

The above analysis demonstrates that “supply-side economics” or “supply-side” tax cuts as applied to the top 1% are, at best, ineffective policies for stimulating economic growth either on the aggregate demand side or on the aggregate supply side of the economy and, at worst, are disastrously counterproductive because of unwanted - - but entirely foreseeable - - negative feedback fiscal effects. On the demand-side and as a policy for stimulating the economy, they are ineffective because the top 1% saves an overwhelming proportion of their income, rather than spending it on personal consumption and, hence, adds nothing to aggregate demand.

On the supply-side, other than interest rate effects, proponents of supply-side tax cuts lack even any conceptual framework in modern economic thought which explains the relationship between tax cuts and the potential full employment growth rate of the economy and how changes in taxes change labor productivity or capital investment. Interest rate effects would be completely off-set by borrowing necessary to pay for the tax cuts. Moreover, and in any event, the top 1% invests a disproportionate amount of what it saves in financial assets and not directly in “entrepreneurial” or “job creating” activities or invests in financial assets outside the U.S.

In sum, the conservative economic orthodoxy that trumpets the value of tax cuts for the very wealthy borders on an intellectual fraud of the highest order.

Conclusion

In light of the nearly non-existent empirical and conceptual support for supply-side economics and supply-side tax cuts, allegiance to these ideas transcends rationality. Tax cuts to the top 1% produce little or no economic growth and disastrous budget consequences. It is critical that we

end the propagation of economic policy falsehoods which have led the country to the brink of economic ruin.

We repeat: In light of the economic emergency created by the financial crisis and the squandering of the surplus which could have been available to cushion both the costs and fall-out of the financial crisis of 2008 and subsequent economic collapse, the Bush tax cuts may be considered the greatest single act of economic mismanagement in the history of the country.

A Word About History

Although beyond the scope of the specific policy position of the Patriotic Millionaires – it is important to put the current debate in a broader historical context. In the history of ideas, knowledge should progress while out-of-date or clearly disproven ideas should fall to the wayside. Much of the country’s political, economic and social history in the 20th century has consisted of rejecting the adverse societal and human effects of laissez-faire capitalism and free market fundamentalism - - a dominant ideology in this country in the 19th century and the early part of the 20th century - - and grappling with some of the more obvious flaws and deficiencies of market capitalism. Thus, in the history of ideas, the revival of laissez-faire capitalism as an ideology is somewhat surprising.

Today, “laissez-faire” (under its modern, American rubric “trickle-down economics”) posits that concentration of wealth in the hands of an elite few is both inevitable and socially positive. It is inevitable, because most capital now resides in the hands of the few and capital markets are far less competitive than labor markets and, therefore, the economic returns to capital are far greater than to labor. It is seen as positive, because wealth concentration is believed to be the principal “engine of progress” and all economic progress due to the efforts of the wealthy. In other words, wealth created by, of, and for the top 1% will ‘trickle-down’ to the remaining 99%.

Today, we seem to be immersed in a Second Gilded Age and a “cult of wealth” in which everything in society, politics, popular culture, (and yes, tax cuts) is by, of, and for the top 1%. You and your political colleagues are the principal proponents of trickle-down and the cult of wealth - - despite the overwhelming accumulation of knowledge in all social scientific fields (including the economics field) linking wealth inequality with every social pathology and dysfunction in modern society, and despite the fact that the history of world civilization has shown such societies to have only one inevitable - - and bad - - end.

We ask that, in this moment of reflection, in the name of decency and reason, and for the sake of the country, you do what is right.

Sincerely,

The Patriotic Millionaires