

WHY THE RICH HAVE AN INTEREST IN PAYING HIGHER TAXES

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During the past four decades, virtually all income growth in the United States has gone into the pockets of top earners – not only to the top one percent, but to the top one-tenth and one-hundredth of one percent. Because money speaks in politics, a disturbing side-effect has been to give wealthy campaign contributors a much bigger megaphone. Research shows that U.S. politicians of both parties pay careful attention to what millionaires and billionaires demand.

What America's wealthiest seem to want, and have been brilliantly successful at getting, are policies that boost their take still further. Taxes on their incomes, investments, and estates have been reduced, and regulations on their businesses loosened. Such policies, in turn, make donors ever richer and amplify their ability to hold the attention of politicians. America may be caught in an endless feedback loop, linking growing inequality to democratic decline.

Most voters tell survey researchers that taxes on the wealthy should revert to the higher rates in effect during the Clinton administration. But will politicians listen if almost all wealthy donors remain adamantly opposed? Some wealthy political players, at least, will need to grasp why they, too, have an interest in greater tax equity. America's plutocrats have managed to capture a larger share of national income, yes; but compelling evidence suggests they are worse off in important ways.

What the Wealthy Have to Gain

Beyond some point – which the United States has surely already passed – burgeoning inequalities and increases in private income produce little gain in satisfaction. For example, some of the fruits of upper-end tax cuts have been used to build ever-larger mansions. But when 30,000-square-foot mansions grow ten percent larger, the primary effect is just to raise the bar that defines “adequate” housing in elite circles.

In contrast, higher spending on public necessities produces clear gains for everyone, including the wealthy. A simple example helps make the point. If a rich family pays slightly higher taxes, they may have less to spend on their next luxury automobile. But which wealthy person is happier: the one who drives a \$150,000 Mercedes on well-maintained roads, or the one who drives a \$200,000 Bentley on roads riddled with foot-deep potholes?

Misreading Their Own Interests

If wealthy taxpayers would be happier to drive slightly less expensive vehicles on better roads, why do they lobby so vehemently against the higher taxes needed to fund improved infrastructure? Many people – including the rich – suffer from a simple cognitive illusion about the cost of higher taxes. If you pay higher taxes, you obviously have less money to spend on what you want. So the prospect of a tax increase naturally inclines people to think that they'll be

less able to satisfy individual desires. Yet once incomes rise beyond a modest absolute threshold, many of the things that people want are what economists call “positional goods” – scarce things like gorgeous waterfront property and precious paintings, or top-ranked goods that, by definition, only a few can win.

People often overlook this highest-bidder reality when thinking about the effects of higher taxes. The cognitive illusion occurs because most financial setbacks in life stem from idiosyncratic events. A person may have a health emergency or a problem at work. Marriages may fail, jewelry may be stolen, and floods may damage homes. In each case, income is reduced, limiting the person’s ability to outbid others for positional goods.

But the income bites taken by taxes are different from individual financial setbacks, because taxes reduce the incomes of peer group members simultaneously. Because everyone facing a higher tax has a little less money to bid for scarce positional goods, the end result of the bidding does not change. The same paintings and the same marina slips end up in the same hands as before, just at a slightly lower price.

It would be one thing if lobbying against taxes and regulation brought wealthy Americans a world more to their liking. But if their goal is to use the money not spent on taxes to buy a home with a more spectacular view, for example, most will be disappointed. There are only so many such homes to go around, and they’ll be bought by the very same people as before, since everyone will be bidding more.

Ironically, then, wealthy opponents of any and all tax increases may be wasting a lot of money. By contributing to anti-tax politicians, they are buying only the deeper potholes and dirtier air that inevitably result when tax revenue is too low – without improving their chances to bid for attractive positional goods.

Reductions in top tax rates have harmed America’s wealthy in myriad ways, ranging from weakening the country’s defenses against terrorism to limiting U.S. efforts to save energy and fund environmental improvements. Tax cuts have fed higher federal deficits, and the resulting fiscal strains have led Washington to starve funding for basic scientific research – even as America’s share of global patents granted continues to decline, undercutting the very basis of long-term U.S. economic prosperity.

Self-Interest Properly Understood

As long as America’s very rich believe that lower tax rates serve their interests, they will continue to shovel contributions to politicians willing to do their bidding. The pernicious loop of burgeoning inequality and insufficient public investments will spiral onward.

Moralists often urge privileged people to imagine how easily their lives could have turned out differently, to adopt a more forgiving posture toward those less prosperous. Well and good. But a more promising approach may be to help wealthy citizens to more clearly understand their own interests. Evidence and logic show that rich Americans will be better off, in purely practical terms, without the misguided tax cuts pushed by politicians they have funded. Like all citizens, the wealthy have an interest in a society in which money now squandered in fruitless bidding wars can be used to reduce government debt and pay for important shared needs.