April 16, 2012

For Two Economists, the Buffett Rule Is Just a Start

By ANNIE LOWREY

WASHINGTON — High earners who are worried that this year's Tax Day will be the last one before their rates rise have more than just the White House and Washington to blame. They can also look to two academically revered, if publicly obscure, left-leaning French economists whose work is the subtext for the battle over tax fairness.

Emmanuel Saez and Thomas Piketty have spent the last decade tracking the incomes of the poor, the middle class and the rich in countries across the world. More than anything else, their work shows that the top earners in the United States have taken a bigger and bigger share of overall income over the last three decades, with inequality nearly as acute as it was before the Great Depression.

Known in Washington and the economics profession by the of-course-you-know shorthand "Piketty-Saez," the two have been denounced on the editorial page of The Wall Street Journal and won mention in White House budget documents.

Mr. Saez, 39, a professor at the University of California, Berkeley, has won the John Bates Clark Medal, an economic laurel considered second only to the Nobel, as well as a MacArthur Fellowship grant. Mr. Piketty, 40, of the Paris School of Economics, has won Le Monde's prize for best young economist, among other awards.

Both admire, even adore, the United States, they say, for its entrepreneurial drive, innovative spirit and, not least, its academic excellence: the two met while re-searchers in Cambridge, Mass. But both also express bewilderment over the current conversation about whether the wealthy, who have taken most of

America's income gains over the last 30 years, should be paying higher taxes.

"The United States is getting accustomed to a completely crazy level of inequality," Mr. Piketty said, with a degree of wonder. "People say that reducing inequality is radical. I think that tolerating the level of inequality the United States tolerates is radical."

As much as Mr. Piketty's and Mr. Saez's work has informed the national debate over earnings and fairness, their proposed corrective remains far outside the bounds of polite political conversation: much, much higher top marginal tax rates on the rich, up to 50 percent, or 70 percent or even 90 percent, from the current top rate of 35 percent.

The two economists argue that even Democrats' boldest plan to increase taxes on the wealthy — the Buffett Rule, a 30 percent minimum tax on earnings over $1 million — would do little to reverse the rich's gains. Many of the Republican tax proposals on the table might increase income inequality, at least in the short term, according to William G. Gale of the Tax Policy Center and many other left-leaning and centrist economists.

Conservatives respond that high tax rates would stifle economic growth, at a minimum, and cause some businesses and high-income workers to flee to other countries. When top American tax rates were much higher, from the 1940s through the 1970s, businesses could not relocate as easily as they can now, say critics of Mr. Piketty and Mr. Saez.

"I materially disagree with the idea you can raise a marginal tax rate to 70 percent and not have an impact on economic growth," said Ike Brannon, an economist at the American Action Forum. "It's absurd on its face."

But Mr. Piketty and Mr. Saez argue that history is on their side: Many countries have higher tax rates — and the United States has had higher tax rates — without stifling growth or encouraging the concentration of income in the hands of the very rich.

"In a way, the United States is becoming like Old Europe, which is very strange in historical perspective," Mr. Piketty said. "The United States used to be very egalitarian, not just in spirit but in actuality. Inequality of wealth and income used to be much larger in France. And very high taxes on the very rich — that was invented in the United States," he said.

Mr. Saez added, "Absent drastic policy changes, I doubt that income inequality will decline on its own."

The two economists' project of mapping income inequality started two decades ago, when Mr. Saez was teaching at Harvard and Mr. Piketty teaching down the road at the Massachusetts Institute of Technology.

Their innovation was to measure American income inequality historically. Existing data went back only to the 1970s. Tedious archival research at the Internal Revenue Service allowed them to stretch the data all the way back to 1913.

Once they had collected the data, the computation was easy. They figured out the benchmark for various income levels — the top 10 percent, top 1 percent and top 0.1 percent of earners, for instance — and calculated what share of income each group took each year.

What they found startled them. As in other industrially advanced countries, income inequality in the United States fell after World War II, a period that economic historians call the "Great Compression," and remained stable through much of the 1970s.

But then inequality started increasing again, with the top 1 percent of earners drawing a bigger and bigger share of overall income. Their graph showing the trend became well-known: a deep U, with inequality as acute today as it was just before the depression.

When they first published their work, income inequality was mostly off the political radar screen, thanks to the 1990s boom, Mr. Saez said.

"Growing inequality was not perceived to be an issue because the economy was growing fast and even the incomes of the 99 percent were growing significantly," he said.

But the deep downturn of the last few years, and Mr. Obama's election, brought the issue back to the fore. Peter R. Orszag, the former Obama budget director, has said the Piketty-Saez work “helped to point the way for the administration in its pledge to rebalance the tax code.”

Now living many time zones apart, Mr. Piketty and Mr. Saez update their work with frequent e-mails, Skype conversations and data-sharing through Dropbox.

They have found that the trends have mostly continued. From 2000 to 2007, incomes for the bottom 90 percent of earners rose only about 4 percent, once adjusted for inflation. For the top 0.1 percent, incomes climbed about 94 percent.

The recession interrupted the trend, with the sharp decline in stock prices hitting the pocketbooks of the rich. But the income share of 1 percent has since rebounded. Data that the two economists released in March showed that the top 1 percent of earners got nearly every dollar of the income gains eked out in the first full year of the recovery. In 2010, the top 10 percent of earners took about half of overall income.

That has led the two economists to renew their calls for higher rates on the rich. Along with Peter Diamond, an emeritus professor at M.I.T. and a Nobel laureate, Mr. Saez has estimated the “optimal” top tax rates for the wealthy — getting the most revenue from those most able to surrender it — to be between 45 and 70 percent.

In France, François Hollande, the Socialist who may well succeed Nicolas Sarkozy as president, wants to raise the top marginal income tax rate to 75 percent, calling earnings over a million euros “impossible.” A candidate yet farther on the left suggests a top rate of 100 percent.“The debate in Washington is between the Bush-era and Clinton-era tax rates,” said Mr. Diamond, whom Mr. Obama nominated to the Federal Reserve and Republicans blocked. “Our finding is that the debate should be between the pre-1986 Reagan tax rate, which was 50 percent, and the rates that existed from Johnson until Reagan,” which were higher.

“Thirty percent is three times smaller than the 91 percent of Roosevelt,” Mr. Piketty said, responding to the Buffett Rule proposal and referring to the presidency of Franklin D. Roosevelt, who engineered the New Deal. “And inequality is greater than in the time of Roosevelt.”