A THEORY OF TAX FAIRNESS

HIGHER TAXES ON THE RICH CAN SLOW THE GROWTH OF THE SOCIAL CANCER

Also by J. H. Moromisato

The Money-Sovereignty Recovery Act (2014)
100 Theses for the Reformation of Economics (2011)
The Denver Plan to End Unemployment (2010)
The Coming Age of Freed Money (2010)
The Origin of Wealth and Poverty (2007)

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J. H. MOROMISATO

ROGEM Press, 2014

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Higher Taxes on the Rich Can Slow the Growth of the Social Cancer

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Preface

The *A Theory of Tax Fairness* refers to a new understanding of taxes and their fair distribution. One of the most important new findings of the theory is the principle that, “Anyone earning more than his/her neighbor should pay a higher tax rate”. For example, one who makes $1.2 million in income should pay a slightly higher tax rate than one making $1.1 million, and the latter ought to pay a slightly higher rate than whoever makes $1 million. The biggest difference with the current U.S. tax scheme is that the new tax principle is open-ended; while the existing scheme stops being progressive for adjusted income above $400,000. Why is the new principle fair? Because in a highly skewed income distribution, such as that prevailing in the U.S. and many other countries in the world, a sizeable fraction of the population cannot really afford to pay their proper share of taxes; thus, in order to compensate for the fiscal revenue deficiency caused by these lower-than-average-income groups, those with higher-than-average income are obliged to pay an open-ended progressively higher tax rate.

The subtitle of the book, *Higher Taxes on the Rich Can Slow the Growth of the Social Cancer*, may shock many people who would never consider the rich a cancer on society. However, once one starts to think about what a cancer is, and compares it to the very rich in society, it becomes obvious that the presence of the rich in society constitutes a clear and present danger to our

survival. A cancer is a collection of cells that start growing independently of the rest of the organism; those cells cajole the neighbors into also growing in a disorderly manner, diverting nutrients from the rest of the organism toward their own growth needs. The rich, as a group, have being increasing their collective wealth at an accelerated speed, ever since the top marginal tax started to be lowered in 1964, from a height of 91% to the current 39.6%. The 1% top earners control half of all the financial wealth of the country, and every year receive over 20% of the national income; that income was as low as 10% during the high income tax era, but began to rise as soon as the top income tax started to drop. The Great Recession, in 2008, caused a temporary drop in the rich's wealth, which they recovered soon after the official end of the recession in 2009; there is now no foreseeable way to stop that pernicious growth.

One way to at least slow the growth of the rich's wealth is to apply a truly progressive tax, which could reach over 99% for extraordinary incomes—perhaps over $50 million or so; but this is very unlikely to ever occur, given the dominance of the rich on the political, economic, and social institutions of our country. Many people might consider such a tax outright confiscatory; in fact, it is not such thing. The proposed top tax rate is for incomes over $50 million, and would correspond to an effective tax rate of 93%—comparable to the prevailing marginal tax rate in the 1950s, which applied to all incomes above $2.8 million. Those earning over $50 million per year would have a take home income of around $3.5 million, equal to about a hundred times the median income for the nation. Such a high top marginal tax rate, which results from the extraordinary level of income attained by the very rich in this country (annual incomes of billions of dollars) is necessary to maintain the progressivity of the income tax; otherwise, those making billions of dollars a year would still be paying the same rate as those making a small fraction of such amounts; and the middle class would continue paying more than its fair share of taxes.

Where does the 99% number come from? Warren Buffett, reportedly one of the richest men on Earth, has publicly stated that he will donate 99% of his life earnings—after taxes, one presumes—and not even notice the difference. The proportion of Americans making more than $50 million could be less than 0.01% (about 15,000 taxpayers); although if one were to count non-realized capital gains as part of income, that fraction may not be too far off.

Recently (Nov. 2013), together with six other billionaires, Mr. Buffett was featured in a segment of the popular *60 Minutes* TV show. An article on Forbes.com, commenting on the event, took the opportunity to feed its readers the old canard about the rich paying more than their fair share in taxes:

> *Then there's the view that there'd be no need for philanthropy at all if the rich paid their "fair share" of taxes. The rich already do so—disproportionately, in fact. (The top one percent pay some 36 percent of all federal income taxes.)* (Forbes.com, 11/19/2013)

It is true that the rich pay a substantially larger part of all federal income taxes, but that is only because they have exorbitantly higher incomes than the rest. What is not mentioned in the article in question is that the effective tax rate on the rich (25% in 2008) is—including the total payroll tax, made up mostly of social security contributions—higher than that of the middle class. But the truly outrageous unfairness is the tax exclusion of unrealized capital gains—which constitute the bulk of the rich's income. When such earnings are counted as income, the real effective tax rate paid by the richest Americans becomes less than half their current "official" effective rate; and, in the case of the few hundred top earners, the real total effective tax rate—what they actually end up paying in federal and state taxes, could be even lower than one percent! Lower than the rate paid—mostly in sales taxes—by the poorest of the poor in this country.

The author of the article, Howard Husock, after showing the splendid record of well-known "big philanthropy" of the past, goes on to criticize the emphasis on such large-scale projects—

the message that it takes billions of dollars for a philanthropic project to make a difference. He fills the rest of the article with examples of small-scale projects whose worldwide impacts are noticeable.

From the TV show, I learned that there were, as of that moment, about 115 billionaires—out of an estimated total of over 400—whom Buffett, together with Bill and Melinda Gates, had convinced into signing what they call the "Giving Pledge." Only those—among the billionaires—who had pledged to donate at least 50% of their life earnings were included in this highly selected group. What truly caught my attention was that one of the 115 pledge signers—perhaps the only one?—was interested in solving the national debt problem; all others had a wide diversity of other charity projects.

At no time in the show, or anywhere among the comments it elicited, was there a mention that maybe, just maybe, the rich have some responsibility for poverty and unemployment, or at least for the fiscal deficits and the national debt. That, alas, remains a closely guarded secret. And the interest of one of the pledge signers in fixing the national debt problem did not merit any more attention than the other rather "practical" or socially praiseworthy projects.

What was not said in the show, nor in any of the subsequent reports, is that a substantial fraction of the rich's income is in the form of "unrealized capital gains," which are currently not considered income, and therefore not taxed. The extraordinary unfairness of this situation can be appreciated by considering the case of Warren Buffett, the "champion" of higher tax rates for the rich like himself. Mr. Buffett's total income in 2010 was, reportedly, $12 billion—plus or minus a few hundreds of millions of dollars—but his declared income was only $40 million, for which he paid $7 million in income taxes. Considering his real income of $12 billion, his actual tax rate was 0.058%—a bit over a half of one tenth of one percent; can anything be more patently unfair than that? Compare that with the 25% tax rate—on income

plus Social Security—that the poorest of the poor taxpayers are liable for, and the injustice is hardly bearable.

This book is not about inequality, although inequality is sometimes mentioned as a problem crying out for a solution. It is also not about redistribution of wealth. I believe income must be earned—and that everybody should have the opportunity to do so—and government assistance should be about temporary help and definitely not about redistribution. However, the book also speaks out against the social cancer—the accelerated accumulation of wealth by the rich—which is still confused with plain "inequality." Economic inequality characterizes the existence of a multiplicity of levels of income and wealth—which remains more or less stable, even though members of each class might move to others; the recently identified social cancer is anything but stable: it is now experiencing accelerated growth, at the expense of the rest of society, without any foreseeable countervailing force capable of even slowing its relentless growth.

The single most important, or urgent, issue that this book addresses is fiscal balance: that government should assess taxes in a progressive manner—much more progressively than it is today—with three main goals in mind:

1. To distribute the tax burden fairly, among those who can best afford it;
2. To achieve a permanently balanced fiscal budget; and
3. To slow the growth of the social cancer—the accelerated accumulation of wealth by a tiny minority—by establishing a limit to the amount of money a given taxpayer can receive in one year.

I believe progressive taxation is a question of logic and fairness. And I am also convinced that, as long as unemployment exists, especially among the youth, the economy will benefit from an increase in government spending—within a balanced budget. John M. Keynes reached the same conclusion about 70 years ago, but he paid little attention to the revenue side or to fiscal

balance—I believe that that was a crucial omission, which in the end doomed his economic theory to oblivion—even though his followers still constitute a sizeable portion of current economists in the world.

Regarding the income limit, I also believe that the growing wealth accumulation in the country, and indeed in the world—which I have now identified as a social cancer—can only end up tearing our nation apart, and must be stopped, or at least slowed down; and that one way to accomplish this is by imposing a near-100% tax rate on inordinate amounts of income.

In their recent, voluminous, book, *Fragile by Design*, 2014, Calomiris and Haber end their book by paraphrasing George Bernard Shaw:

> *Meaningful reform in a democracy depends on informed and stubborn unreasonableness.*

That sounds just about right.

Introduction

There are dozens of new books about taxes that are published every year. Most of them are about how to reform the tax laws to make them more “equitable”; to make them easier to comply with; or to make them more “economically efficient.” I was saddened to find that ALL of them—I failed to find a single exception—in one way or another, advocate a *more regressive* tax scheme. (Please read the Annotated References at the end of the book.)

Most people believe that in matters of taxation, “fairness”—just like beauty—lies in the eyes of the beholder. That is what most “objective” advisors also sincerely believe. They therefore seek other criteria to formulate their tax reform proposals, and naturally end up with truly unfair schemes. In truth, fairness must be at the core of any tax reform proposal, as it is in the one proposed here.

Every penny that government spends goes into the private sector—and ends up in the pockets of some rich people. The idea that people may have no money to pay taxes is absurd; in fact, every year, after paying their taxes, people in the U.S. save about $3 trillion, or 20% of GDP, which they did not want to spend—except during the recent Great Recession.

The rich are the top 1% of the population—more or less—and they have a combined income of over 20% of GDP, and own or control about 50% of all the financial assets of the country.

Contrary to popular belief, government does not run into deficits and debt because it spends too much. Government runs into deficits for one reason, and one reason alone: because the rich, who possess most of the financial wealth, as well as a disproportionate amount of the national income, refuse to pay their fair share of taxes.

The U.S. government spends about 20% of GDP in providing the level of services demanded by the people. If all taxpayers had more or less the same income, and the government had no other income, each taxpayer would pay 20% of his income. But as we know, the distribution of income is anything but flat. There are many who can barely make ends meet, not to mention those who cannot. And, at the other end of the distribution, there are those we call the super-rich, who can spend but a small fraction of their annual income. Given that the distribution of incomes is so lopsided, a fair distribution of taxes should be even more so.

Most would consider it only fair that those who can save a sizeable part of their income pay a larger proportion of their income in taxes; and those who cannot afford to save much should be called on to pay little or no tax at all. This is more or less the progressive taxation we should have. The tax distribution that we currently have is quite regressive; it is true that it could be worse; but it is also true that it should be better.

The tax distribution proposed in this book is based on the following simple principle:

Anyone earning more than his/her neighbor should pay a higher tax rate.

For example, if Joe makes $100,000 per year, and Mike earns $60,000, then it is only fair that Joe should pay taxes at a higher rate than Mike. And if Bill makes $45 million per year, and pays 98% of his income in taxes, Warren, who makes $50 million, ought to pay 99%. It is as simple as that.

You may ask, “But why should the tax rate be higher for those who make more money, instead of having them pay just a higher amount, keeping the rate the same?”

As mentioned before, if the distribution of income were more or less flat, that is, everybody made more or less the same amount of money per year, then a flat tax rate would be only fair. However, because the distribution of income is so skewed, there are many at the lowest level of income who can barely subsist on their income, and it would be truly unfair to ask them to pay 20% of their meager income as taxes. That means that someone else has to pay for the share of taxes "owed" by the poor; and that someone can only be one whose income is higher than average. Thus, if the average taxpayer should pay 20% of income in taxes, someone with higher than average income should pay a little higher rate, say 21%, and another taxpayer with still higher income, should pay, say 22%, and so on and so forth, until we get to the very top earner in the nation, who may have to pay 99% of his income in taxes.

That argument for a progressive taxation—based on the principle presented above—which is in turn called for by our lopsided income distribution, is, as far I know, a novel one. I may repeat it more than once in the body of the book, so you can get familiar with it.

Our current taxation is far from progressive, in addition to being utterly insufficient. The current tax rate for a single individual making less than $8,925 in adjusted gross income is 10%; while those making between $8,925 and $36,250 must pay a rate of 15%. Those tax rates may not seem too high; however, these people are also subject to a 15.3% Social Security tax, which pushes their tax rates to 25.3%, and 35.3%, respectively—while the average taxpayer, one with an adjusted income closer to $40,000, is supposed to pay only at a 20% rate—the fraction of GDP spent by government.

The actual tax rate on the highest income taxpayers—as you will see in Chapter 4—is closer to 25%; which is lower than the rate paid by even those in the lowest tax bracket.

Our fiscal problems are highly correlated with cuts in the taxes of the rich and super-rich. Because of the progressivity of the income tax—such as it is—cuts to the top tax rates have a greater

impact on the fiscal budget. Top tax rates have been gradually reduced from a rate of over 90%, which prevailed for two full decades from 1944 through 1963, to the current 35%—just increased to 39.6% in 2013; most of the super-rich pay even less than 16%, because their incomes come mostly from capital gains—e.g., Mitt Romney, Warren Buffett. Taxing capital gains—all of them, including the unrealized ones—at ordinary rates would go a long way towards balancing the federal budget.

Truly taxing the very rich would, in addition to achieving a permanent fiscal balance, slow the growth of the social cancer. It would also establish the rationale for a one- or two-percent temporary tax on financial wealth over, let's say, $1 million, with the specific purpose of paying off the national debt. The disappearance of the national debt would prompt the government to start issuing a new type of savings bond—paying interest no higher than the inflation rate, meaning zero or negative real interest rates—to accommodate the saving needs of the population.

The characterization of the rich as a social cancer is elaborated in Chapter 2. This new view, on the inherent danger to society from the accelerating growth of wealth accumulation, came to me as I was completing the final draft of the book. I considered it sufficiently important and urgent that I decided to insert a full chapter to present this new view.

Chapters 1 through 4 explain the rationale for taxes, the principles that guide their assessment, the particular importance of taxing the rich, and some of the problems associated with it.

Chapters 5 and 6 deal with the issues of fiscal balance and the national debt; they make it abundantly clear that the only way to achieve fiscal solvency is to recover, gradually, all the money the rich have neglected to pay in taxes all these decades.

Finally, Chapter 7 describes the potentially transformative power for the nation of maintaining fiscal balance through appropriate taxation of the wealthy segment of society.

1. Why Taxes?

Reasons to Pay Taxes

There are at least three realistic ways to view our obligation to pay taxes. The first is to think of the government as the management of a grand association to which all of us belong, and are obliged to pay membership fees; the second is to consider the flow of money between the government and the private sector; and the third is to view the government as the sole producer of public goods, and for which the beneficiary—the people—must pay in the form of taxes.

The Membership Fee

The first view on taxes is to consider government as the creator of an appropriate environment in which we, the inhabitants of the country, can live and engage in business activities that provide for our living needs. This environment includes the physical infrastructure that allows the transportation of goods and people—the communication, power distribution, etc.; the institutions for law and order; and of course the defense establishment. Each of us, producers of the economic goods that supply us with our income, must pay the government for our share of the benefits it provides us with. We make these payments in the form of taxes. If we all paid our share, the fiscal budget would be balanced: expenditures would be equal to revenues.

The Conservation of Money

The most realistic view on taxes is one based on the principle of conservation of money (see Appendix). Similar to the law of conservation of mass in physics, the principles of conservation of money state that money cannot be created nor destroyed in any ordinary economic transaction; and just like mass, in physics, can be created and destroyed in an atomic or nuclear interaction, money can also be created or destroyed in a financial transaction.

Government spending does, in general, preserve the amount of money flowing into the private economy. The money that government spends does not disappear; it is paid to the different providers of the input goods that the government uses to produce the public goods that the nation demands. And when those providers distribute and spend the money they receive from the government, that money goes to others who also spend it, and so on and so forth. Conventional economists believe that money continues circulating forever—as part of the total stock of money; but we now know—after Keynes—that the money in circulation is gradually stored in the financial system, until there is nothing to circulate. Taxes are paid mostly from the money stored, and some from new money.

When the government collects taxes, it is simply recovering the money spent, which is now in the hands of the people. This flow of money, from the government to the public and from the public to the government, generally increases with time, as the economy grows, even slightly. Therefore, the more the government spends, the more money the private sector receives, and the more money it can afford to pay in taxes.

Paying for Public Goods

Another way to view our obligation to pay taxes is the following: The government is a very large firm with millions of employees that produces objects and services—goods, in general—which help us to live and engage in businesses. These goods are unlike the ordinary goods produced by private firms, and are known as "public goods." By their nature, public goods cannot be sold, or

exchanged for money; they are distributed freely. We, the consumers of those goods, must pay taxes to refund the money that the government spent in producing them, so it can continue producing more of them.

Ordinary and Public Goods

Ordinary goods, such as shoes, toys, cars, and TVs, as well as haircuts, cable TV, house cleaning, and many others, are produced and sold by private firms. The more goods these private firms produce and sell, the more prosperous the nation is; that is, the higher the income of the people is. Conversely, if the total value of the goods produced by the private sector goes down, so does people's income.

The nation enjoys the benefit of private goods—the variety, the life-saving value, the convenience, or just the simple enjoyment—in addition to the income received by all those who in one way or another contributed to the production and sale of those goods. Which of the two is more important for the average individual or family, the benefit or the income? Without the income, we would not be able to get the benefit; so, both are equally valuable.

There are goods of another type, the so-called public goods, which by their nature cannot be profitably produced and sold by private firms. National defense and police protection are two of the public goods that only government can produce; although, perhaps the most important good is the protection of private property. Other examples of public goods are education, health care, unemployment benefits, transportation and communication networks, public housing, hospitals, national parks, courts of law, etc.

Ordinary goods may be acquired or enjoyed by some families and not by others, depending on their choice and on their purchasing power.

Public goods are made available to all, because, either no one can be practically excluded, or government—we, the people—has

decided that no one should be excluded from the benefit those goods provide.

Just as with ordinary goods, the more public goods are produced—by government—the more prosperous the nation is as a whole; people enjoy the benefit of the goods in addition to the income most of us receive for participating in the production of those goods—that is, for producing and selling to the government the input goods required to produce the public goods.

Public goods benefit everyone living in the country, regardless of choice or income; everyone benefits but not everyone can afford to pay for their production. That is the crux of the taxation problem.

To summarize: ordinary goods are produced and sold by private firms, and are paid for by those who chose to use them. Public goods are produced and distributed by government, and are funded by taxes which people are obliged to pay.

The two main problems with public goods are: first, how much of each of the public goods should be produced? And, second, who should pay the taxes and in what amounts?

The first problem is about total government expending—or the size of government; and the second is about fair tax allocation.

On the Economic Function of Government

The primary function of government, regardless of what anybody thinks, is the production and fair distribution of public goods.

Just like any other producer, government must first invest—in the production and distribution of said public goods—an amount of money almost equivalent to the total value of the public goods produced.

Unlike any other producer, however, and due to their particular nature, government must distribute the public goods, without charging for them. Taxes were invented as a way for government to recover the money it has spent producing the public goods, in order to produce again.

On Government Size

The super-rich, and most conventional economists, favor a small government—"the smaller, the better," is their motto. Political liberals, in contrast, favor more public goods, which of course means a larger government.

From the economic point of view—as we have seen above—the more public goods are produced, the better off the nation is as a whole; people benefit from a wider range of government services and facilities, and from the income their production makes available.

When government produces any public good, it must first spend money to pay for the cost of the input goods plus the income of the government employees. That is, the government, not unlike any private producer, spends the total value (sales price equivalent) of the public goods together with, or even before, the release of the public goods. This means that the people—mostly in the private sector, who participated in the production and distribution of the public goods—have received, in addition to their other income, as much money as the government will need to collect in taxes. The taxes they would be paying mean, essentially, that they would be working for the government for about 20% of their actual production time, on average, just to enjoy the public goods.

So the government spends a gazillion dollars; all that money goes into the pockets of the people, who are then able to pay, collectively, a gazillion dollars back to the government. And, on top of that, the people get to enjoy a gazillion dollars in government services! Quite a bargain, no matter how you look at it.

Because, the more government spends, the more money people will have in order to pay their share of taxes; it would seem that there are no actual limits to government spending!

Yes, I know, this is contrary to everything you have ever heard or read about government spending. Nevertheless, it is actually true, provided 1) there are people looking for work; 2) our foreign

trade is balanced; and 3) the additional public goods contribute to a commensurate increase in overall productivity.

Limitation #1, which corresponds basically to a situation of labor scarcity, is probably harmless, and we are quite far from reaching it. It can certainly be discounted, at least for a long time to come.

Limitation #2 refers to one of the possible effects of increased government spending, namely the increase in overall demand, which could easily spill over into increasing imports. Given the large U.S. trade deficit, and the even larger dollar overhang—dollar purchasing power in foreign hands—the danger of additional government spending exacerbating the trade deficit should not be discounted. However, our current trade deficit problem is a very serious problem for the nation—possibly the most serious of them all—and should be solved as soon as possible, and independently of any government spending considerations (Please see my related book, *The Money Sovereignty Recovery Act (A Proposal)*, 2014.).

Finally, limitation #3 means that if a particular government expenditure does not contribute to some meaningful economic improvement, other than the benefits and incomes mentioned above, then it will contribute to a faster accumulation of wealth, and to the inevitability of a violent resolution of the economic abuse of a tiny minority over the vast majority of the people.

In conclusion, the actual size of government spending has, if anything, a favorable effect on the nation's economy—provided government revenue keeps pace with spending; especially in times, like the present, of high unemployment. We must keep in mind that the alternative to higher government revenue is a decrease in overall demand, and therefore a slowdown of the economy.

Discussion of Government Size

Why do so many economists and politicians favor small government? To be blunt, because they are defending the interests of the rich, and ignoring those of the ordinary taxpayer. Of course, it is also possible that many of those who defend the

rich do sincerely believe that it is for the good of the country; they do not realize that they are going against their own interests, and society's well-being as well.

The rich are forever trying to maintain the low tax rate they are currently enjoying, but given the large fiscal deficit, they fear that their taxes must inevitably increase; reducing the size of government would also reduce the fiscal deficit, and, more importantly for them, the public pressure to increase their taxes.

There are certainly fringe groups that, mindless of the implications, want to reduce the power, and consequently the size, of government. Some of these groups, such as the Tea Party, are being used to advance the tax agenda of the rich.

Why Tax Rates Must Be Unequal

If everybody had a similar income, more or less, there would be no problem in the distribution of the tax burden: everybody would pay the same rate—after reasonable deductions, naturally. But, the distribution of incomes in the U.S. and in the rest of the world is far from equal.

Flat Income Distribution

If every taxpayer in the U.S. had pretty much the same income, there would be no question that everyone should pay the exact same tax rate—which, assuming no other source of government revenue, would be 20% of income.

But even in a flat income-distribution country, there would be some allowance for special situations, such as having small children, for temporary unemployment, illness, disability, etc., which would mean a slight increase in tax rates for the rest of taxpayers—to balance the fiscal budget.

Skewed Income Distribution

The reality is that the income distribution, in the U.S. and elsewhere, is tremendously skewed; the very rich receive an income which can be not just a few times the poverty level, but even a million times! The disparity is truly staggering. Few observers have noticed that the income disparity is concentrated

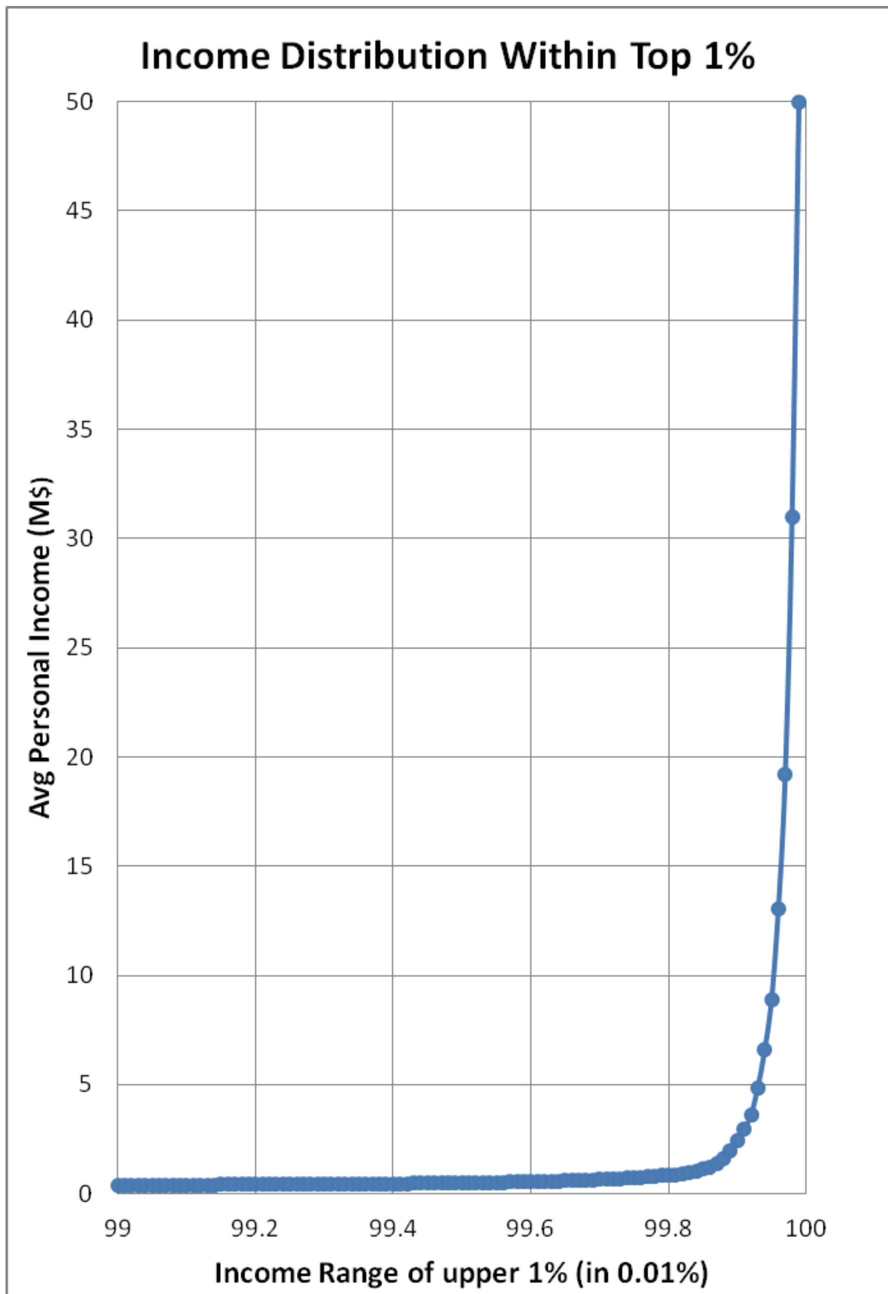
on the very top of the income distribution, as shown in Chart 1, on the next page. There we can see the income distribution of only the top 1% income earners in the U.S. There are about 1.5 million households reporting earnings of above $400,000 per year. Only the top 0.2% of taxpayers earn more than $1 million per year; while the top 0.01% have incomes higher than $50 million per year!

The data used in Chart 1 are rough estimates based on information readily available on public sources such as Wikipedia, for example.

As you can see, the most notable feature of the chart is how flat the distribution of incomes is, until it starts to break away, very sharply, when it reaches the incomes of the top 0.01 % of the taxpayers. Many observers, unaware of this fact, believe that the disparity of incomes is between highly skilled and educated labor, and those without much education. They, therefore, recommend boosting the training and education of the low income population, in order to even up the presumed income disparity. That will never solve the income distribution problem. Only a very progressive taxation, which substantially cuts the take-home income of the very rich, can have any effect in alleviating the income disparity, as well as in slowing down the dangerous growth of the social cancer.

The large majority of people would find it reasonable for the poor to be spared from paying taxes, which leaves the rich with the major burden of taxation, in the U.S. and in most other countries. This means that while the poor pay little or no taxes at all, those above the poverty line would be asked to pay a few percent of their income in taxes; those a little bit above in the income distribution would pay, say, one percent more; those with a little higher income would pay another percent more, and so on, and so on, until we get to the very top of the distribution of income. In principle, the tax for the very, very rich could be set all the way to 99%—although that may not be necessary.

Chart 1



The skewed income distribution in the U.S. makes the calculation of the fair tax-rate distribution more complicated, but still far from impossible. In the U.S., a minimum-wage employee would have an income around $15,000; at the opposite end of the income distribution, Warren Buffett and Bill Gates each reportedly earn about $10 billion ($10,000,000,000) per year; that is over 666 thousand times the minimum-wage income! Most of that money is in capital gains, which are only taxed, at the rate of 15%, if they are "realized"—that is, if the stocks are sold. If either of these two extremely wealthy individuals could manage to spend $50 million per year—which comes out to $137,000 per day—they would still leave 99% of their income untouched! It is quite obvious that in any badly skewed income distribution, such as the one that prevails in the U.S. and almost every country in the world, people with much higher income than others should, in all fairness, pay a much higher percentage of their income in taxes.

The current tax allocation contains regressive taxation—taxes on business and on employment—with insufficient progressivity in the income tax. In all fairness, the top marginal income tax rate should be increased until the federal budget is balanced.

The progressive tax rate

To begin, it is easy to demonstrate that a fair tax rate, in most countries, would be a progressive tax rate, where people with higher income pay a higher tax rate—which is quite different from just a "higher tax" with a flat rate.

For example, let us take two taxpayers, Joe, with an income of $50,000 per year, and Warren, with an income of $100 million. With a flat tax rate of say 20%, Joe would pay $10,000, while Warren would pay $20 million. Clearly, Warren would pay much more in taxes than Joe, even though their tax rates are the same. However, the impact of this tax on each of our two taxpayers would be dramatically different. Joe's $10,000 tax bite would be rather painful, and may even push him to the brink of hardship—a kid in college would take a big chunk of his income; while

Warren would hardly feel the effect of his $20 million tax bite—that would not affect his spending habits, but would reduce the amount he would be saving by a bit less than 0.4%.

A progressive tax rate means that the tax rate would increase together with the taxpayer's income. Currently, a low-income taxpayer would pay perhaps a 10% tax rate, while a very high-income taxpayer would have to pay much higher rates—currently, about $39.6 on income but only 15% on realized capital gain.

Nevertheless, the main argument for progressive taxation is the issue of fairness: low-income people cannot afford to pay taxes, and they are not asked to; so, who should pay in their place, and how much of it? The fair solution is that high-income people should pay for some fraction of the tax "owed" by the poor; and those with higher income should pay for a larger fraction.

Let us first assume—which is in fact close to the real situation—that 50% of the population do not pay any taxes. That means that each of the taxpayers in the other half of the population must pay their own share plus the share of a non-payer. Now, the lower half of the population earns about a quarter of the national income (or the country's GDP); therefore, the upper-income half of taxpayers have to pay a total tax equal to 20% of GDP, out of a total income of 80% of GDP, which is necessary to balance the fiscal budget. That means that the top half of the population must pay, on average, an effective rate of 25%.

Let us now consider a reasonable and fair distribution of taxes among the top 50% of population who pay taxes. The next 30%, of the people with income just above the 50% of non-taxpayers, with an overall income of about 30% of GDP, would pay a total tax equal to 4.5 of GDP—assuming a tax rate of 15%.

The next group of 19% of the population would pay a total tax of 6% of GDP, out of an adjusted income of 30% of GDP—assuming a tax rate of 20%.

Finally, the remainder 1% of the population with the top incomes, would have to pay the rest of the tax required to balance the fiscal

budget—20% of GDP; that is, a total tax of 9.5% of GDP, out of a total income of 20% of GDP—which means a tax rate of 45%.

In other words, in this hypothetical tax distribution, the top 1% of the population would pay a tax rate of 45%; the following 19% of the population would pay a tax rate of 20%; and the other 30% of the population would pay a tax rate of 15%.

Contrast this with the current effective tax rates of 28%, 25%, and 25% (including SS taxes) respectively.

In addition, because of the very skewed income distribution, especially among the 1% top income earners, the average tax rate of 45%, would mean a 30% tax rates for those between 1% and 0.1% of the income distribution; a 50% tax rate for those between 0.1% and 0.01; and a 90% tax rate for those in the top 0.01% of the income distribution. By the way, the average income of the later group of taxpayers is estimated to be above $50 million per year.

A true open-ended progressive tax would substantially lower the tax rates for people with income below those in the 1% top income, and rise the effective tax rate of those with income higher than those in the top 0.1%.

Bad and Worse Taxes

It is much easier to recognize what an unfair tax distribution looks like, than to tell when a tax distribution is fair.

For example, a national sales-tax scheme, in all its forms, is the most unfair; a flat tax scheme is also unfair; the current tax scheme—quasi-progressive, with substantial tax breaks for the rich—is also unfair. The only fair tax scheme is a truly open-ended progressive one; the one just described above.

All the bad tax schemes are based on erroneous economic considerations; one of the most widespread of these ideas is that of the benefits of lower taxes for the rich, based on the erroneous belief that the “rich are the ones that create jobs for the people”; or that the rich are the ones who save, thus enabling the flow of credit that sustains the economy; therefore, lower taxes for the

rich would end up benefiting the working class, as well as the entire nation. We will see, further below, just how wrong those economic assumptions are.

The National Sales Tax (NST)

The NST proposes a sales tax to replace the current income tax: it would tax only what people spend in stores, which constitutes about 70% of the nation's GDP. As with all other alternatives to the existing tax allocation, the NST favors the rich—much more than any other tax scheme, including the flat tax.

The NST is similar to the "value-added tax," or VAT, which is common in Europe. The great attraction of this type of tax scheme is that it is easy to implement and that very few people complain about them. Unaware of its implication, that the middle class suffers the brunt of the taxes, most people favor a tax they believe they have some control over.

The way people dispose of their income is quite simple: we spend as much as we have to, and save as much as we can. There are, perhaps, some people who spend beyond their means; but it is easy to see that they cannot keep doing it for long. The real tragedy is that those who have little cannot save much; that is, they spend 100% of their money, and sometimes more—they fall into debt. At the other end of the income scale, the very rich do not need to spend much—Warren Buffett writes often enough, that he will end up giving away 99% of his total income; this will mean that with the NST he would end up paying a fraction of 1% of his income in taxes, a lower rate than even the poorest American pays today.

To be fair, the proponents of some NST schemes—e.g., "The FairTax Book", by Neal Boortz & John Linder—would usually exempt the poor, by returning the taxes they would have to pay. But this only means that the middle class would shoulder the brunt of the taxes, and would have to pay over 22% of their earnings—assuming a "Fair Tax" of 30% on the purchase price. In fact, since the poor would be essentially tax-exempt, and the rich would be taxed very lightly, the middle class may have to

pay 50% or more in taxes—regardless of the promises by the peddlers of this ultra-regressive tax scheme—in order to balance the fiscal budget.

You can see the picture now: with the NST, the middle class would be taxed on almost 100% of their income; while the very rich would be taxed only on the few percent of their income that they spend. The NST is the most regressive tax scheme ever invented—and the super-rich would benefit enormously by paying a much lower tax rate than everybody else.

The Flat Tax

If everybody made enough money to make ends meet and nobody made much more than, for instance, a few times the average income, a flat tax would be the fairest way to distribute the tax burden. Each individual or family would be returning to government what the government paid them to help it produce the public goods the nation needs. In essence, as mentioned before, the average producer would be working for the government for about 20% of the time, in order to enjoy the public goods.

Those who think, even for a moment, that if they did not have a government, they would be able to keep those 20% of their incomes they are now paying in taxes, are dead wrong! If there were no government, everybody would be making at least 20% less in income—and probably much less—and they would not enjoy all the public goods they are getting now.

If income inequality only meant that there were low- and medium-income people in the nation—no super-rich—then the poor would be exempt from taxes, and the rest of the population would pay the poor's share of taxes in addition to their own; and the flat tax would still be a fair tax.

Unfortunately, the rich and super-rich—the fifth of the population with the top incomes—receive more than half of all the income generated in the nation; which would make it quite unfair that the middle class, 65% of the population above the

poverty line and below the wealth line, had to pick up the tax share of the poor, and of the rich, in addition to their own.

In a flat-tax scheme, both Warren, the richest man in the U.S., and the average Joe would pay almost exactly the same proportion of their income in taxes; while the poor would be exempt from taxes. In reality, the extra burden of the poor, whose taxes everybody must share, is proportionally much heavier on average Joe than on rich Warren.

In conclusion, the flat-tax scheme is quite regressive, although not as bad as the NST.

The Lower Marginal Tax Scheme

The Bush tax cuts, enacted between 2001 and 2003, which were finally allowed to expire in 2013, was the typical "tax-reform" idea "to stimulate the economy." They lowered the top marginal tax—the tax rate on earnings above a stipulated amount, and lowered the tax rates on lower income brackets as well. The speed of the recovery, after the 2000 recession—known as the "dot-com" recession—was not better than others that occurred without the benefit of similar tax cuts.

The Bush tax cuts made the tax allocation less progressive than it was before, and certainly much less progressive than it was in the 1950s—when the top marginal tax rate was 91%. Kennedy, Reagan, Bush Sr., and Bush Jr. were responsible for the tax cuts that reduced the tax rate on the rich by over two thirds from its postwar height.

The Bush tax cuts were repealed for 2013, returning the top tax rate to 39.6%—from its low of 35%. There was the expected outcry from the rich and their defenders, that the effective tax increase would worsen the current slow pace of economic activity; but the economy continued its slow recovery, as if nothing had happened.

For example, in the 1950s, a taxpayer making $1 million over the highest tax bracket would have to pay $950,000 out of the $1 million. In 2013, that same taxpayer would have to pay only

$395,000, a “savings” of $555,000 out of every $1 million over the top tax level. There is no doubt that lobbying to Congress is by far the most profitable activity in the land! And guess who has to make up for all the millions lost to government: of course, we, the ordinary taxpayers.

To make matters worse, most of the income of the rich comes from capital gains—gains from value increases on their financial assets. The capital gains taxes had also been drastically reduced from the 1950s, and it is currently 15%. Warren Buffett, the second-richest man in America, has publicly “complained” that his secretary pays a higher tax rate than he does. In addition, the capital gains tax only applies to the portion “realized”—sold and withdrawn—which is usually a minuscule fraction of the total.

Misconceptions about Taxes

The rich and the DORPs (defenders of rich people) have a diametrically opposed view of taxation—from those espoused in this book—which they have managed to convince most people of. They claim that since government, in its inception, had no money, it had to collect taxes first, and then spend them; the people produce more wealth and then the government comes again and takes the money it needs to function. In a more realistic version, they make it sound like the problem of “the chicken and the egg”; taxes came first and then the spending, they claim; and most people believe it. Even ignoring the fact that government, through its central bank, issues the money of the land and puts it in circulation, such claims are actually wrong: all producers must spend first—initially out of investment funds—in order to produce goods, and only later can they recover their expenses after they sell their goods. Government proceeds likewise; it must initially borrow in order to produce, and then recovers the money needed through taxes—and some other revenues.

The other misconception is that taxes are an imposition; that government uses its power to extract money from the people. In truth, we are actually paying for the public goods we get to enjoy. Why should the super-rich pay proportionally more than others?

Partly because they can best afford it; partly because those goods are more valuable to them; but mostly on fairness grounds.

That the rich can afford a higher tax rate than others is obvious because they save a much larger portion of their income. Warren Buffett has notably claimed that he will donate 99% of all the money he made in his lifetime.

The protection of property, one of the most important functions of government, is of course most valuable to those who have the most to lose. It is not just the police protection that deters wrongdoers, but the entire system of justice which would prosecute and indict anyone who violates the rights of others. And the same could be said about the other important function of government, national security, which guarantees the continuity of the system of law and order we enjoy from government—and the very rich more than anybody else.

Another important reason the rich should pay a higher proportion of their income in taxes, is that by luck or by crook they manage to extract a disproportionate amount of income from the economy, leaving next to nothing to the lowest ranks of society. Conventional economists have a different view, which not coincidentally agrees with that of the rich: that the rich are more productive, and are thus rewarded by the economy with a proportionally larger share of the income created by it. They fail to mention that business opportunities in most economies are limited and those who for whatever reasons and means—mostly legal to be sure—have taken advantage of the existing opportunities, including those newly created, are richly rewarded, while those less fortunate, or latecomers, have no way to participate in the economy. The idea that business opportunities are created by savvy entrepreneurs out of nothing is an illusion and a hoax: new businesses are created at the expense of older ones; and usually destroy more jobs than they create. The fact that millions of people are unemployed in the U.S. is due to natural productivity increases and to the general lack of demand—businesses cannot produce more than people want and can afford to consume. The general scarcity of demand has a

simple explanation: the rich do not want to consume as much as they can afford; and the poor cannot afford to consume as much as they would want—that is the tragedy of our civilization today.

The rich are obligated to pay the share of taxes owed by the poor and near-poor—who are in no condition to pay taxes—and relieve the middle class of this unfair burden.

The Inequity of Non-Progressive Taxation

In its *Policy Review*, No. 166, 2011, the Hoover Institute, a conservative think tank, published Kip Hagopian's "The Inequity of the Progressive Income Tax," where he claims

> *This doctrine of fairness uses sound principles of equity to reject […] the progressive […] tax system[…] At the same time, it establishes the affirmative case for a regressive system as being the least inequitable. Lastly, where the logic of the doctrine is flawed, in each case it errs on the side of taxing lower-income people less, regardless of the reason their income is lower.* (Ibid)

Hagopian is totally wrong! He discusses and dismisses all the usual arguments justifying progressive taxation, except for what should be the most important ones: an economic analysis of the determinants of the distribution of income in the nation, and the history of tax-underpayment by the very wealthy.

That a professional economist would display such blatant disregard for the truth, or perhaps simple ignorance, is nothing short of despicable. He is, unfortunately, far from alone in this.

Who Really Pays the Taxes?

The unmistakable hand of the rich is evident in Table 1, below, especially throughout the years of tax reductions that started in 1964, during the Kennedy administration. There we could see how the "powers that be" manipulated the top marginal tax rate, as well as the top income bracket, in order to substantially increase the take-home income of the very rich.

For all of two decades, starting in 1944, the top marginal rate was over 90%—94% up to 1946, and 91% after—but only incomes

above $2.3 million—in 2011 dollars—were subject to such high tax rates.

Table 1. Income Tax History [Ref. Wikipedia.org]

History of income tax rates adjusted for inflation (1913-2010)						
	Number of	**First Bracket**	**Top Bracket**			
Year	**Brackets**	**Rate**	**Rate**	**Income**	**Adj. 2011**	**Comment**
1913	7	1%	7%	$500,000	$11.3M	First permanent income tax
1917	21	2%	67%	$2,000,000	$35M	World War I financing
1925	23	1.50%	25%	$100,000	$1.28M	Postwar reductions
1932	55	4%	63%	$1,000,000	$16.4M	Depression era
1936	31	4%	79%	$5,000,000	$80.7M	
1941	32	10%	81%	$5,000,000	$76.3M	World War II
1942	24	19%	88%	$200,000	$2.75M	Revenue Act of 1943
1944	24	23%	94%	$200,000	$2.54M	Individual Income Tax Act of 1945
1946	24	20%	91%	$200,000	$2.30M	
1964	26	16%	77%	$400,000	$2.85M	Tax reduction during Vietnam war
1965	25	14%	70%	$200,000	$1.42M	
1981	16	14%	70%	$212,000	$532k	Reagan-era tax cuts
1982	14	12%	50%	$106,000	$199k	Reagan-era tax cuts
1987	5	11%	38.50%	$90,000	$178k	Reagan-era tax cuts
1988	2	15%	28%	$29,750	$56k	Reagan-era tax cuts
1991	3	15%	31%	$82,150	$135k	Omnibus Budget Reconciliation Act of 1990
1993	5	15%	39.60%	$250,000	$388k	Omnibus Budget Reconciliation Act of 1993
2003	6	10%	35%	$311,950	$380k	Bush tax cuts
2011	6	10%	35%	$379,150	$379k	
2013	7	10%	39.60%	$400,000	$388k	American Taxpayer Relief Act of 2013

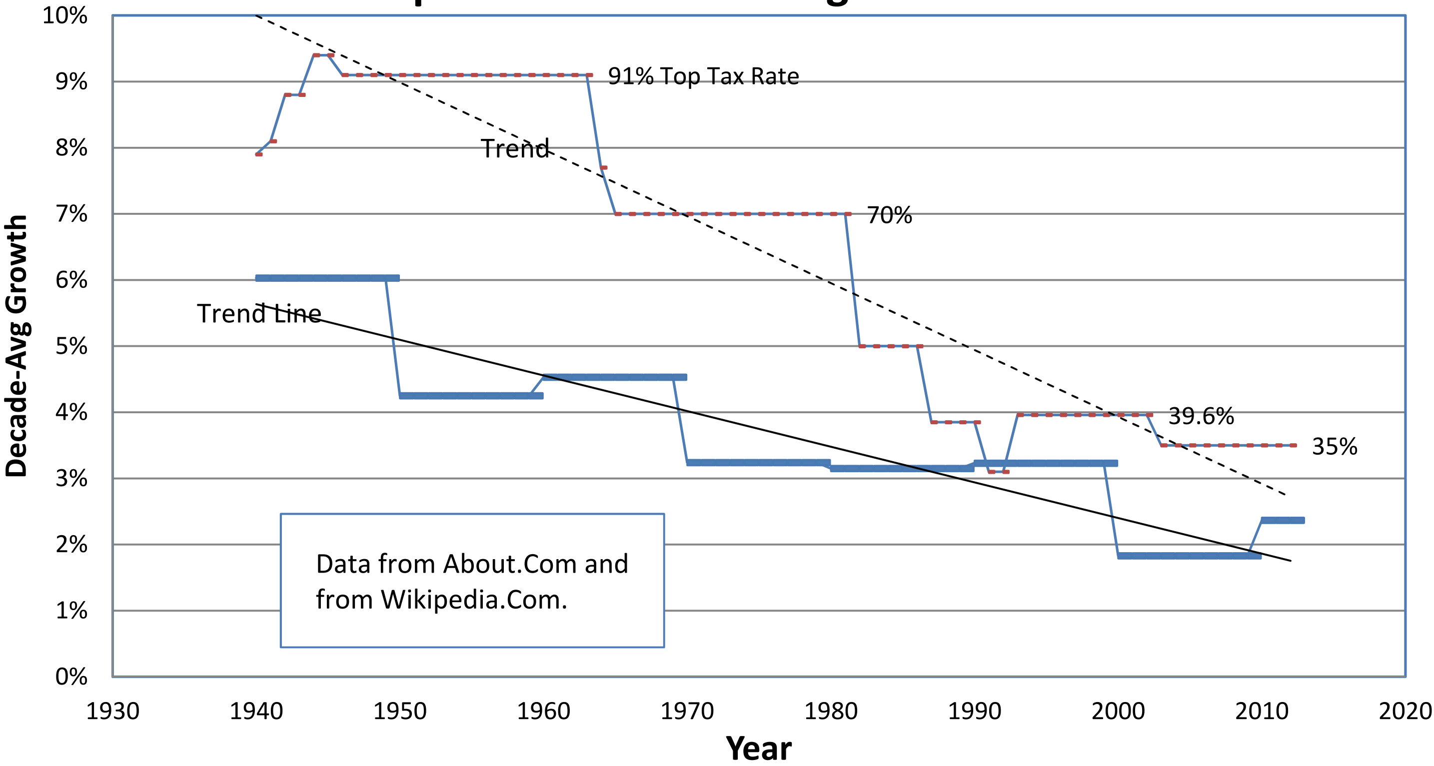


Chart 2
Top Tax Rate and Average GDP Growth
Decade-Avg Growth
10%
9%
8%
7%
6%
5%
4%
3%
2%
1%
0%
1930
1940
1950
1960
1970
1980
1990
2000
2010
2020
Year
91% Top Tax Rate
Trend
70%
Trend Line
39.6%
35%
Data from About.Com and
from Wikipedia.Com.

In 1964, President Kennedy dropped the top marginal tax rate by a whopping 14%—increasing the top income bracket a bit (to the equivalent of $2.85 million); a year later, in 1965, Kennedy dropped the top tax rate to 70%, but he also cut in half, to $1.4 million, the income subject to the top tax rate—the middle and lower classes were still paying reasonably low tax rates. By 1988, the top tax rate was dropped to the lowest ever after WWII, to 28%; the rich could keep most of their income, but what was worse is that the top tax rate applied to incomes above the equivalent of $56,000 dollars! That is, to incomes near the average national income—the middle class was taxed at the same rate as the ultra-rich!

Slowly, throughout the Bush Sr. and the Clinton administrations, both the top tax rate and the top income bracket were raised to what they are today: 39.6% and $400,000 respectively. But, counting Social Security taxes, the poorest of the poor are still paying—since the Reagan administration tax cuts—a higher tax rate than the richest of the rich. Shame on us all!

Tax Cuts and GDP Growth

The highest top marginal tax rate in the U.S. was set by Congress just a few years into WWII, and was 94%. Chart 2, on page 38, shows the actual data on economic growth through the many tax cuts that occurred since the 1940s. As the chart shows, the top tax rate started decreasing by the end of the war, and reached its lowest point at 28%, during the Reagan administration, in the early 1980s; it increased to 39.6% during the Clinton administration, only to be lowered back to 35% from 2003 to 2012; our current top marginal rate for 2013 is now the same as 10 years ago, 39.6%. This extraordinary sequence of tax cuts during such a long period of time—73 years—constitutes a real-life experiment on the effects of tax cuts on economic activity. As shown in Chart 2, and contrary to the predictions and expectations of the DORPs, the rate of economic growth not only did not increase, but decreased with every cut on the top tax rate, dropping from the 6% average growth during the 1940s, to the current below-2.5% average growth.

Chart 3

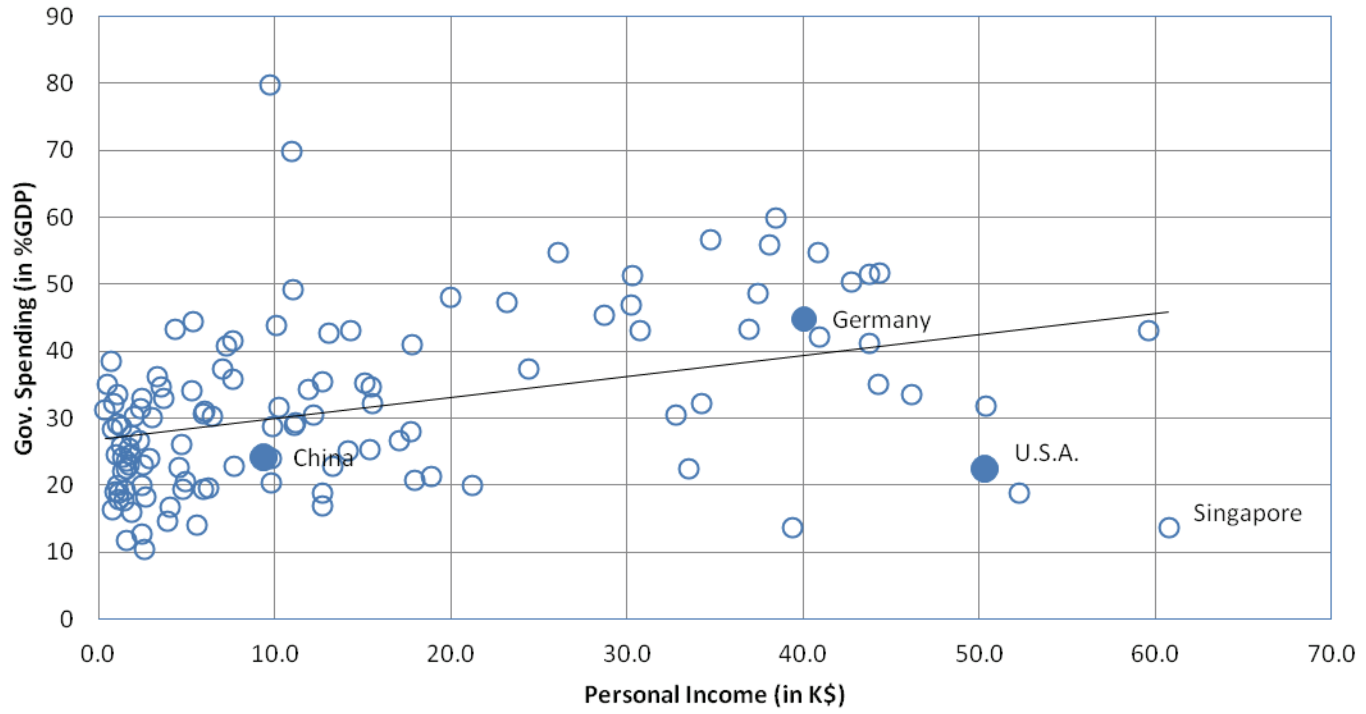


Chart 2 is a proof of the overwhelming failure of the DORPs' belief that tax cuts on the rich can ever be beneficial to the economy.

Of course, the DORPs would argue that many other things happened during the past half century, which would make any interpretation of the economic outcomes dubious, to say the least. My counterargument can be put in the form of a question: If such tremendous cuts in taxes for the rich, from 94% to less than 40%, within so many decades, could not cause even a noticeable improvement in the growth rate, how big of a tax cut would it take to show some positive effect? Perhaps the worst effect of the tax cut on the rich is the fact that during the past few decades, almost all the increase in incomes went to the rich; leaving the rest of the population with a stagnating income, and many without jobs.

The Social Cancer

Another reason to increase the taxes on the very rich is to slow down the accelerated growth in wealth accumulation, which is becoming more and more like the uncontrolled growth of malignant cells in a body. A more detailed discussion of this issue is presented in the next chapter.

Other Countries' Taxes

In closing this first chapter, I thought it would be illuminating to compare our tax situation to that of other countries. Chart 3, on the opposite page, contains data from *The CIA World Factbook* (2012-3), and shows how government spending varies according to the personal income of the countries in the plot—only countries with population greater than about 4 million people are included in the chart.

We can see from the plot that the U.S., with an average personal income of around $50,000, has a rather low rate of government spending (22.5%), compared to other high-income countries. Also noticeable is the fact that most low-income countries have government spending around 25%, which is rather low compared to the majority of higher-income countries.

The trend line of the data shows a correlation between government spending and personal income: the higher the country's personal income, the higher government spending tends to be.

If anything, Chart 3 shows that, contrary to the rich's propaganda, the economic performance of a country is not held back by the high rate of government spending. It also shows that low government spending is associated with economic backwardness—and not with fast growth. China, the fastest-growing economy in the last two decades, but with a low average personal income (less than $10,000), has a slightly higher rate of government spending than that of the U.S., even though it also has a comparatively low rate, showing—to the extent that a single data point can show anything—that fast economic growth is not associated with lower levels of government spending, as some economists would have us believe.

In any case, the message that comes through loud and clear from Chart 3 is that by no stretch of the imagination could government spending in the U.S. be considered excessive.

2. The Cancer Theory of Wealth Accumulation

Introduction

Healthy cells, within a human body, develop organically by taking nutrients and other necessary substances from the blood, and rendering a service that contributes to the well-being of the rest of the body. Cancerous cells, in contrast, are basically rogue cells that begin to grow inorganically, taking a larger and larger share of the nutrients produced by the body, and not providing much service to it. These cells weaken the entire organism and, if left undisturbed, can end in the death of the individual.

The small group of very wealthy individuals, less than 1% of the U.S. population, has accumulated about half the financial wealth of the country, taken over 20% of the national income each year, and increased its wealth at an accelerated rate; almost independently of what happens in the rest of the economy.

Some, perhaps many people, would object to comparing the rich to a cancer; they may accept the comparison to something less "malignant," perhaps something like "obesity"; "the rich are more like the fat in the body," they may argue. The reality is that fat is rather inert, and lacks the aggressive growth, at the expense of the rest of the body, that characterizes cancer. Fat, in truth, grows from excess nutrition; while cancer grows by diverting the

regular nutrition from other tissues and organs—from the otherwise healthy body.

Concerned economic observers refer to this phenomenon of concentration of wealth as “the problem of inequality”; but, the term “inequality,” I believe, fails to describe either the rather recent acceleration in the wealth and income accumulation process, or the fact that it is unsustainable. Just as a cancer in a body, the very rich grow stronger at the expense of the rest of the population, to the point that the final confrontation, when it takes place—unless, of course, the electoral process is allowed to operate fairly—will be resolved in favor of the rich. The naked tyranny of the rich will then be upon us.

Other writers, for example Kevin Phillips, believe that as in past similar crises, political solutions may emerge:

> *As the twenty-first century gets underway, the imbalance of wealth and democracy in the United States is unsustainable, at least by traditional yardsticks. Market theology and unelected leadership have been displacing politics and elections. Either democracy must be renewed, with politics brought back to life, or wealth is likely to cement a new and less democratic regime—plutocracy by some other name.* (Wealth and Democracy: A Political History of the American Rich, 2002, by *Kevin Phillips,* p. 422)

But plutocracy cannot be a lasting situation, just as it could not be in the many lesser developed countries that experienced it many decades before. In most countries where things had gone that far, a military coup restored at least the semblance of democracy. But these sequences of events have occurred in less developed countries, often in South America, and over half a century ago; and developed countries are supposed to be exempt from them. Could it be that the accumulation of wealth has been much slower in the developed countries—except for the recent decades—than in the less developed ones?

The Origin of the Social Cancer

In an individual human, cancer develops when the immune system, which protects us from diseases, fails us completely. Does society have an immune system as our body does? In other words, is there something in society that resembles an immune system? My answer is that human society does in fact have such a system, which we know as our social moral code.

The social moral code is the set of principles that allows us to reject and fight acts and beliefs that are harmful to society; in fact, our laws are based on the moral code that prevails in our society when those laws are enacted. For example, the legalization of slavery was a failure of our moral code; many lives were sacrificed to that institution; and just as many were lost to correct that failure.

For most of the history of our civilization, although moral codes would vary from one society to another, all of them were based on the rejection of vice and the love of virtue. The general belief was that just as a virtuous individual was worthy of praise and emulation, so would a virtuous society be blessed by prosperity.

Unfortunately, too much of a good thing can be even more harmful than the bad things. And that happened—or might have happened—with excessive virtue. By the end of the 17th century in England, a strong social-religious movement got underway, with the blessing of the Crown, to eradicate all manner of vice in the realm. The overt aim was to make England a virtuous society. But the understanding of virtue, at the time, was associated with the pursuit of asceticism, in all but name.

By the turn to the 18th century, a Dutch émigré, Bernard Mandeville, in reaction to the moralizing movement, wrote a fable in verse, which he republished 10 years later, with the title *The Fable of the Bees*. Mandeville described in those verses, in colorful and entertaining language, the fate of a beehive, resembling a human society, in which the active pursuit of pleasure and luxury prevailed, and where the bees lived contented and well. But when the gods, prompted by some malcontented

bees, eliminated all vices from the colony, their merriment turned into mortification, and after the hive fell into a state of disrepair, the bees had to abandon the hive and seek refuge in a tree hole. The moral of the fable, as Mandeville himself summarized, was that society had to choose between prosperity with vice, and poverty with virtue. He went to great lengths, however, to explain that government oversight was crucial to effect the transformation of "private vices" into "public benefits."

In 1724, twenty years after the first publication of the fable, Mandeville republished it once more, but this time included an essay condemning the then-ubiquitous and very popular "charity schools." And this time *The Fable of the Bees* reached an astounding notoriety: every philosopher then alive, it seemed, felt compelled to come to the defense of virtue, and to condemn the author.

Thirty years later, Adam Smith, then a professor of Moral Philosophy, wrote his *The Principles of Moral Sentiments*, in which, as was considered natural, he berated Mandeville, even though he had died two decades before, for defending vice and criticizing virtue. But a little over twenty years later, in his second book, *The Wealth of Nations*, Adam Smith, by then a famous moralist, proclaimed selfish behavior to be the foundation of prosperity, but only when free of government interference—what became known as his theory of "laissez-faire."

While Mandeville taught us that selfish behavior, moderated by government, was the key to prosperity, Adam Smith perverted this idea into the belief that selfish behavior, without government interference, was the only road to prosperity. Our social moral code has been corrupted ever since, and has failed to protect us from the social cancer.

Therefore, it is clear in my mind that Adam Smith's laissez-faire theory, accepted by all economists, dead and alive, to be the foundation of economics, also constitutes the modern origin of the social cancer, which, with some ups and downs throughout the centuries, has affected nearly all developed and developing economies of the world.

The Treatment of the Social Cancer

Once the accelerated accumulation of wealth is identified as a social cancer, our first reaction would be to try to remove it altogether, and as soon as possible. Unfortunately, as in the case of most types of cancer in the human body, the social cancer is inextricably linked to vital social organs and processes. In other words, the physical removal of the social cancer—akin to surgery—is an impossibility, and attempting it could be fatal for society. Does that mean that the social cancer is an incurable disease? Fortunately, not; we have made great progress in the fight against cancer, and some of the new cures may also be applicable to the social cancer.

Angiogenesis and Social Cancer

Some of the most effective cancer treatments nowadays attack the angiogenesis mechanism vital to the cancer's growth:

> *Angiogenesis literally means the birth of new blood vessels. (In Greek, "angio" means blood vessel and "genesis" means birth or beginning). Under controlled physiologic conditions it is a normal and essential process. For example, angiogenesis is a necessary part of fetal development, wound healing, and recovery from a heart attack. However, during the process of cancer growth and spread, angiogenesis allows the tumor to make its own blood supply in order to obtain the nutrients and oxygen it needs for survival. The result is a web of vessels that allows the tumor to grow even more and spread (metastasize) to other far away organs.* (http://www.oncolink.org/resources/article.cfm?c=&id=306, 1/12/2014)

The social cancer, just like its counterpart, the human cancer, connects to vital economic and social processes and taps into the monetary flow that sustains it, gradually draining the vitality out of the entire economy.

The similarity between the development of the social cancer and the human cancer is indeed uncanny. An anti-angiogenesis-like treatment against the social cancer would limit its capacity to continue its wealth accumulation process, and therefore its

growth. An example of such a treatment would be the application of highly progressive taxes on the very rich, as proposed in this book.

The Euthanasia of the Rentier

The only economist of renown who seems to have taken seriously the threat posed by the rich, against the well-being of modern society, was John M. Keynes. He wrote in the concluding notes of his *The General Theory*, written in 1936, in the midst of the Great Depression:

> *For my own part, I believe that there is social and psychological justification for significant inequalities of incomes and wealth, but not for such large disparities as exist to-day.* (Ibid, p. 374)

And then went on to propose his preferred "solution":

> *Thus, it is to our best advantage to reduce the rate or interest to that point relatively to the schedule of the marginal efficiency of capital at which there is full employment. […] In short, the aggregate return from durable goods in the course of their life would, as in the case of short-lived goods, just cover their labor cost of production plus an allowance for risk and the cost of skill and supervision.*
>
> *Now, though this state of affairs would be quite compatible with some measure of individualism, yet it would mean the euthanasia of the rentier, and, consequently, the euthanasia of the cumulative oppressive power of the capitalist to exploit the scarcity-value of capital.* (Ibid, pp. 375–6)

To the question of how to achieve this "euthanasia of the rentier," he answers:

> *Thus, we might aim in practice […] at an increase in the volume of capital until it ceases to be scarce, so that the functionless investor will no longer receive a bonus; and at a scheme of direct taxation which allows the intelligence and determination and executive skill of the financier, […] to be*

> *harnessed to the service of the community on reasonable terms or reward.* (Ibid, pp. 376-7)

In other words, Keynes was thinking of monetary and fiscal means to slow the excessive accumulation of wealth.

Notice the similarity between Keynes's "euthanasia of the rentier" and the anti-angiogenesis-like treatment, proposed earlier, to end the threat of what he referred to as simply "such large disparities," or what I call the social cancer.

Needless to say, Keynes's considerable wisdom was initially ignored and "misunderstood" and eventually all but discarded; while the social cancer revived with the end of the age of high taxes in the mid-'60s.

Who are the Rich?

The rich are the natural result of unrestrained competition and unfair taxation. I use the word "natural" not in the sense of "the way things are," but in the sense that given the privileges bestowed on them, even by a supposedly democratic political system, it is only preordained, or "natural," that they would become richer and richer.

Because of the many privileges they enjoy, most importantly their relatively low tax rate, the rich in the U.S. increase their income and wealth even when the large majority are just stagnating.

If present conditions persist, savings, and earning interest, dividends, and capital gains on them, are the guaranteed roads to wealth. If you manage to accumulate a small fortune, time will grow it into a large one—unless you try to rush things. Those who never manage to land a high-income position, or otherwise accumulate some wealth, will lead a losing struggle for survival.

Few, if any, of the rich recognize that their great wealth is the reason poverty and unemployment exist. Some may acknowledge that they owe their wealth to luck—a helping hand, a mentor, or more often a lucky break—but most have been brainwashed into believing that their hard work, cunning, and ingenuity have

allowed them to create their own opportunities for success, which nobody else would have been able to find. The reality is that business opportunities are scarce, mostly because the rich are already exploiting the best and most profitable ones; to make matters worse, they are seldom contented with one business, no matter how profitable it may be; they have the compulsion to go after other business opportunities, and another, and another, leaving little for others perhaps as hard working, as cunning, and as ingenious but not as lucky as themselves.

The Eye of the Needle

The well-known biblical precept, "Again I tell you, it is easier for a camel to go through the eye of a needle than for a rich person to enter the kingdom of God." (*Matthew* 19:24) tells us that the social problem of the rich is almost as old as civilization itself.

An even more ancient biblical reference is about the Jubilee Year—the year following the end of seven periods of seven years:

> *"This fiftieth year is sacred—it is a time of freedom and of celebration when everyone will receive back their original property, and slaves will return home to their families. "*
>
> *—Leviticus 25:10*

It would seem that the accumulation of wealth among the Hebrews must have reached a destructive point sometime in their distant past, prompting them to establish a time of redistribution of wealth, in order to restore fairness in society.

Another example of the accumulation of wealth getting out of hand seemed to have occurred in ancient Sparta. Lycurgus, a legendary Spartan hero took power there during a time of upheaval, and established a number of important reforms, credited with bringing peace and prosperity to the city-state. The following quote was taken from Wikipedia.com:

> *Plutarch, in his "Life of Lycurgus," attributes to Lycurgus also a thoroughgoing reassignment and equalizing of landholdings and wealth among the population, "For there was an extreme*

> *inequality amongst them, and their state was overloaded with a multitude of indigent and necessitous persons, while its whole wealth had center upon a very few. To the end, therefore, that he might expel from the state arrogance and envy, luxury and crime, and those yet more inveterate diseases of want and superfluity, he obtained of them to renounce their properties, and to consent to a new division of the land, and that they should all live together on an equal footing; merit to be their only road to eminence..." (Wikipedia)*

The problem of the accumulation of wealth must have started with the invention of money; before it, wealth was land. But the actual worth of land was limited by the labor the owner could command, hence the invention of slavery. However, land had physical limits, and the competition for it was a zero-sum game. Furthermore, land was a rather precarious possession, until law and order began to prevail.

Money was also limited, in available quantity, for over two millennia after it was invented; but it was always much easier to accumulate, and hide. Lending money (usury) became the preferred means of accumulation; hence the laws against usury in pre-industrial times in Western Europe.

The expansion of credit money broke all practical limitations on the accumulation of money; except for government oversight. And the industrial revolution started the era of unprecedented prosperity we are enjoying today.

In 1776, Adam Smith published his *The Wealth of Nations*, in which he perverted society's moral code by proclaiming selfishness, free of government interference, to be the only basis for prosperity. Wealth accumulation became a social virtue, and the rich were favored with special tax treatment.

The Civil War created great wealth in the victorious North, which led to the first age of great accumulation, with the "robber barons" at the end of the 19th century; this was cut short by financial crises, and by WWI.

The second age of great accumulation was equally cut short by financial crises and by WWII; and restrained by high taxes, afterward. The latest age of great accumulation, started during the last decades of the 20th century, was interrupted by the Great Recession of 2008; but, only briefly, and the great accumulation now proceeds with no end in sight. In medical terms: the social cancer may have metastasized, and become terminal.

The Cancer Self-Defense

The rich are surrounded by a coterie of defenders—whom I call Defenders of Rich People or DORPs—who may or may not be truly rich but who benefit, or expect to benefit, materially by their connection with them. They are the economists, and the financial analysts and writers, who do the heavy lifting in erecting and preserving the formidable barriers protecting the rich's wealth.

The mention of slavery above, as the only means open to the landowners to increase the value of their land, made me think about our Civil War: perhaps the correct way to view such bloody confrontation is as a war of wealth against the people. As President Lincoln clearly understood, the Confederacy was defending to the death their freedom to live off other people's labor.

The Psychological Barrier

Most ordinary people delude themselves—with some help from the DORPs—into believing that they are somehow smarter or more cunning than the rest; and thus naïvely expect that eventually things will go their way and they may even join the wealthy class they so envy and admire. This psychopathology is cultivated by a plethora of novellas and theatrical representations of the lives of the rich and powerful. Exceptional performers in most life activities, such as music, movie, theater, sports, business management, even science, become rich, and serve as inspiration for others who most likely will never attain such levels of perfection; but will never lose hope. The social benefit of these grand expectations is that only those who have them in some degree would actually strive to achieve them; but the large

majority, those who do not have them, would not. The old biblical truth, "Many are called but few are chosen," (*Matthew* 22:14) shall always prevail.

Given this mindset, one should not be surprised at the unpopularity of proposals to raise the tax on the rich—which the DORPs call "soak-the-rich" schemes.

The Role of A Magazine

While giving the last touches to the manuscript, I run into this amusing quotation, in *The Economist* magazine:

> *"Louis XIV's finance minister, Jean-Baptiste Colbert, believed that "the art of taxation consists in so plucking the goose as to obtain the largest possible amount of feathers with the smallest possible amount of hissing." It isn't just taxation that has rich-world companies hissing these days, but rhetoric and regulation as well." The Economist February 22nd-28th 2014*

The Economist is a British weekly magazine of worldwide circulation, which presents a liberal view of world affairs—political, social, and economic—while defending unwaveringly two positions: free trade and low taxes. Like in the "world-disarmament" tale, where the bear bids all animals to renounce all their offensive means, such as claws, teeth, poison, etc, but allow the fraternal embrace as a sign of peaceful intent, *The Economist* promote peace, good government, and inclusiveness everywhere, but only as long as Free-Trade and Low-Taxes, are respected—a highly profitable strategy, no doubt. *The Economist* is one of the most effective defenders of rich people; it also defends the poor, naturally, lest ordinary people get the right idea.

Having said that, and in all fairness, I find *The Economist's* articles to be the most in depth, of widest coverage, most thoughtful and informed, of all the weeklies in circulation today. I am a regular subscriber, and avid reader, while always mindful of the singular and consistent bias mentioned above.

The Doctrinal Barrier

Another effective protection for the rich's wealth is the teachings or "findings" of the economic and financial professions. These self-appointed experts promote self-serving "theories" that are demonstrably false, but that manage to confuse the people and convince policy makers of the social benefits of low taxes for the rich, and even of the economic benefits of investment and saving incentives for the rich.

At the bases of the theories defending the rich, there is the confusion of the causal sequence relating innovation and wealth; DORPs invariably start with the assumption, usually implicit, that wealth is what enables some singular individuals to come up with the ideas that have transformed our society for the better. It does not take much thinking to realize that it is always the other way around: that the innovative idea is what created extraordinary wealth for whoever took advantage of the idea first.

The most widespread "theories" in defense of the rich's wealth are, not surprisingly, those related to saving, investment, and capital accumulation.

The Fallacies About Saving

Saving, according to these fallacies, is the source of investment funding; and since investments are so important to the economy—not really!—saving should be encouraged rather than taxed. The reality is totally the contrary: saving diverts money away from the economy, and requires a corresponding flow of credit loans in order to maintain economic activity. This is the main reason a financial downturn has such a devastating effect on the rate of unemployment—there is insufficient monetary flow.

In addition, saving increases the already high income of the rich, and is a major factor in the growth of the social cancer.

Saving is a natural compulsion, associated with the preservation instinct. Therefore, it does not need incentives. People save to preserve their money, rather than to earn interest—although, naturally, interest gains are welcome.

Savings are a measure of earnings in excess of living needs.

In his most important book, *The General Theory*, John M. Keynes stated his newly discovered economic principle: “People with larger incomes spend proportionally less than others.” Which I prefer to write as: “The rich save proportionally more than others.” To illustrate, following Keynes, if people with an average income of $100,000 save, on average, $20,000, or 20% of their income, then people with $200,000 in income would save a larger percentage of their income, say 25%, or $50,000; and those making $500,000 a year would save perhaps 30%, or $150,000.

Keynes did not elaborate much on this important insight; and, to my knowledge, none of his followers did either. Just precisely how the rate of saving grows with one’s income has not been researched, as far as I know, and Keynes’s principle remains neglected by the economics profession.

The Fallacies about Investment

Investment is considered, by the above-mentioned experts, to be the foundation of the economy. They are not talking just about any investment; investment, for them, is what the rich presumably do, or what entrepreneurs do with the savings of the rich.

In reality, investment is one of the first steps in any production process; and as such, it is hardly the prerogative of the rich—everybody who earns an income must invest in order to produce-sell. However, investment is in general a risky undertaking, thus few people, especially among the rich, would use their own savings for investment: credit loans are the customary way to fund investments. The rich’s wealth gives them the upper hand in accessing credit for investing, and thus in production, allowing them a heads up in the competition for markets—or consumers. Ordinary people, with less access to investment money, cannot take advantage of business opportunities, because of a lack of wealth or credit. The rich are therefore more likely to win the competition for business and thus to become even wealthier, and to have even better access to credit or investment capital.

The idea that the rich use their money to invest is patently absurd. They, like anybody else in possession of money, would try to save as much as they can, and they would have to be desperate, or crazy, to invest their own money.

In summary, everybody must invest, in order to produce-sell; only those with enough accumulated wealth, or with reliable enough income, can have access to credit; those who do not, must find other sources of investment funding. Thus, facilitating investment by the rich would only contribute to making them richer, and the rest of us a little poorer.

The Fallacy of the Work Incentive

Another fallacy with which the DORPs try to dissuade us from imposing higher marginal taxes on the rich is that such taxes will certainly take away the rich's incentive to invest and work harder; and since they are the most productive elements of society, their reduced efforts would necessarily have a negative effect in the economy.

There are at least three ways to show that this argument is total nonsense. First, no one can control, with any degree of precision, the amount of money he would earn for a given effort; if one is an employee, his earnings are more or less independent of the amount of effort he puts in—although he may get a raise if his efforts become more productive, or get fired if he slacks off; and if he is an entrepreneur or an investor, his earnings will depend on many other factors in addition to his own efforts; and he would have as much control of his income as you and I have over the weather—I am exaggerating a bit here. Second, in the unlikely case that he decides to slow down production—to take it easy—the economic effect would be rather beneficial: it would open a business opportunity for a competitor, or for someone who is looking for such a possible source of income. And third, at that level of income, more money is not the real incentive for a person to remain in a particular business; there are other more personal motivations for a rich fellow to dedicate his efforts to a particular activity. In addition, for a substantial fraction of very high-income people, the money-making activity is in the

financial sector—trading stocks and securities—where the amount of effort is little related to the outcome, and where the uncertainty in the return makes it unpredictable and uncontrollable.

It is also generally known that status-seeking is the most likely driver for high-income people: that means that they care much more about their relative position among their peers than the absolute size of their income.

The Laffer Curve

The Laffer Curve shows the hypothetical relationship between government revenues from income tax and the rate of taxation imposed on the people. The curve shows that at a tax rate equal to zero, government revenues are also zero; at a tax rate of 100%, government revenues are again zero; and at some tax rate (let us call it T_M) between 0 and 100%, government revenues hit a maximum (please see the corresponding entry on Wikipedia). Since nobody knows the actual shape of the curve, it would seem that the whole thing is a waste of time; except that the DORPs, since way back in the 1980s, have used the Laffer Curve to argue that the current tax rate—whatever it was at the time—fell to the right of T_M, even thought there was no way to tell where exactly T_M was; therefore, the DORPs would insist, cutting the tax rate would have the effect of increasing total government revenues! Those who were pushing for a tax increase would argue that, on the contrary, the current tax rate was to the left of T_M and therefore the way to increase government revenues was to increase the tax rate.

No one, as far as I know, has ever pointed out that the tax rate only needed to be around 20% in order to balance the fiscal budget, and that there is not a single economist, not even Mr. Laffer himself, so "bold" (for lack of a better word) as to claim that T_M could be below 20%. That has not prevented some DORPs from invoking the Laffer Curve to "demand" a tax cut for the rich, in order to solve the fiscal deficits.

The alternative way in which the Laffer Curve is manipulated is to call for cuts on the top marginal rate—currently set to 39.6%, way below its level in the early 1960s. Here, the curve is supposed to relate government revenues, only from the top income bracket, to the top marginal rate. But then the assertion that government revenues would decrease to the vanishing point as the top tax rate approaches 100% makes no sense at all; why should revenues decrease? The argument is that the rich will do their best—or worse—to avoid paying those high taxes, or possibly resort to barter in order to reduce their tax liabilities! Clearly, those arguments have reached the limits of the absurd.

Are the Rich Necessary?

Periodically, there are people who feel obliged to remind others of the importance of low taxes to the rich. In 2007, Hunter Lewis, a financial analyst of some renown, wrote a book with the provocative title *Are the Rich Necessary?* There Mr. Lewis reviewed some arguments in favor and against some propositions regarding the rich. Of course the entire book was biased toward a positive answer.

Mr. Lewis starts by asking and answering the question "Why are we still so poor?" His answer is, basically, that we, humanity, have not been able to compound money—that is, allow money, through compounding interest, to multiply over the centuries—because "capital has been destroyed, over and over. Compounding has hardly had a chance to start, much less reach the magic of multiplying large numbers." And he continues explaining that there are many reasons for this, "natural disasters such as disease and weather related famine, war, and other human follies." Then he adds what is perhaps the most important truth in his book: "But there has also been almost complete intellectual confusion about how to organize ourselves to end poverty and deprivation." And he then proceeds to compound that confusion throughout the rest of his book.

The belief that compounding interest would increase the stock of money in a nation is totally wrong; but it sounds so logical and natural, that even the singular John M. Keynes, the greatest

economist of the 20th century, fell for it—he "explained" in some detail, how the compounded interest, over four centuries, on England's share of the treasure that the corsair Drake stole from the Spaniards corresponded to the then entire estimated wealth of the British Crown.

In reality, only financial institutions, such as banks and insurance companies—in addition to the central banks, of course—can create, and sometimes destroy, money. Interest payments are made out of the existing stock of money and neither add to nor subtract from it.

In the last chapter of his book, "Reconciling Opposing Viewpoints; Expanding the Non-Profit Sector," Mr. Lewis manages to include a proposal for his "ideal" income tax: "Everyone in the U.S. would pay a simple income tax, with only a few permitted deductions (including ordinary charitable deductions), to support the operations of the government. The threshold income required to trigger the tax would be set high, so the poor would not pay income tax at all. Above the initial tax bracket used to fund the government, there would be one or at most two brackets more for the rich, however defined. The rich could either pay these additional taxes to the government or receive a full tax credit by donating the same amount to registered social service charities […]" A very regressive tax scheme, where the rich pay the same rate as everybody else; and the middle class bears the brunt of the taxes. The fig leaf—to simulate some progressivity—is the provision that the poor would not pay any tax at all; and that the rich are obliged to donate a few percent of their income to charity.

It is amazing how Mr. Lewis could find a way to address the rich's primary concern, low taxes, and make it look as if that benefits society in an extraordinary manner.

The Educational Barrier

The rich have a special interest in transmitting the "right" information to potential supporters and voters, from early economic education all the way to graduate school. Teaching the

"right" theories is encouraged, while even mentioning other theories is discouraged, when not outright banned.

Students of economics, and financial and policy analysis, must learn and demonstrate appropriate understanding of the "right" theories, if they expect to graduate at all. And only those that can publish, and show interest in those theories, are allowed to teach and to pursue higher-level degrees.

Also, schools where the "right" theories are pursued can be sure of receiving endowments and grants, which enhance their prestige; others do not get those benefits.

The Political Barrier

The political barrier is hatched in a host of policy institutions, also known as "think tanks," where the "right" policies are elaborated and fed to the media, to Congress, and to the politicians in power.

Although tax policy is a major concern, other issues are also pursued as useful distractions for the voters.

For example, during December of 2012, the impasse over extending the Bush tax cuts for the high income bracket caused an effective tax hike on ordinary voters. The Republicans, who dug their heels demanding the extension of the tax cut on the highest-income taxpayers, argued that otherwise the economy would suffer from a slowdown in investment. Then in early October, 2013, the same Republicans in the House of Representatives refused to pass an extension to the budget resolution, causing a shutdown of a number of government services and the furlough of many government employees—all in an effort to force the Democrats to ditch "Obamacare." In the end, Republicans took advantage of their political imperative to extend the fiscal debt limit, to also extend the budget resolution and reopen government.

The control of Congress

Even before Will Rogers, a famous writer in the 1920s, made the comment that we have the best Congress that money can buy, it

was common knowledge that wealth influences, if not outright controls, our government. The rich's influence in government is exercised in three major ways: one, through campaign contributions; two, through continuous and well-organized lobbying; and three, through their direct presence in government—an overwhelming number of members of Congress are wealthy: the 1% representing the interest and aspirations of the entire nation! What a joke!

This political barrier is therefore the most formidable defense erected by the rich and the DORPs. Thus, if any of the reforms proposed in this book are to be enacted, there can be no realistic expectation that the current Congress would be of much help. It is up to the ordinary voter, to you and me, to gradually throw out all the DORPs from Congress and replace them with real representatives of people's interests.

The Scare Tactic

This is the rich's last line of defense; if everything else fails, their defenders would point out that with all the power at their disposal it would not be easy to extract much more money from the rich. The rich will surely try to avoid high taxes by whatever means necessary; they can leave the country, or simply move their wealth and their businesses elsewhere, or even renounce their citizenship.

Of course, if any of that starts to happen and in growing numbers, it would mean that the rich have lost control of government, or at least their influence and political power; therefore, the government can enact appropriate measures to prevent their actions from becoming harmful to the nation.

Perhaps, as a footnote to history, one could mention the literary output of Ayn Rand, whose central theme was the "rebellion of entrepreneurs" against the "intrusion" of government. The fact that Alan Greenspan—an avowed disciple of Ayn Rand—was able to occupy the all-powerful position of Fed Chairman for twenty years (1987–2006), should be a clear indication of the

tight grip exerted by the rich and DORPs on our national economy.

After coming up with a new view of the Civil War—near the middle of this chapter—I am no longer so sure that “the rebellion of the entrepreneurs” is an empty threat and that it belongs in a footnote. The Civil War demonstrated the terrible lengths to which great wealth would go in defense of their material interests, and of their misguided conception of freedom. If the cancer theory of wealth, and the theory of tax fairness, presented in this book, were ever to gain any credibility among political and economic observers, perhaps we should be wary of the possible reaction by the wealthy minority—those who control most of the financial resources of the nation.

3. New Principles of Taxation

Introduction

Taxation is the most maligned and the most misunderstood function of government. The common understanding of taxation is that government needs money to fund its activities—only some of them generally recognized to be for the common good—and therefore it imposes taxes on citizens. Since people do not know that part of their income is actually derived from government spending, they naturally resent having to pay those taxes, considering them excessive or arbitrary.

In a modern economy, the government produces public goods—that is, those goods that by their nature cannot be profitably produced privately—and in the process, it spends money. Part of this money goes to the public employees who work to produce and distribute the public goods. All the rest of the money goes to the private producers of the input goods necessary to produce the public goods, including the private employees.

Like any other producer, the government needs to recover all the money spent in the production-distribution process in order to continue producing.

Taxation is the necessary government institution that recoups the money that the government spends in providing the public goods demanded by the nation.

Taxation involves a variety of choices and procedures that confront the taxing authority, that is, Congress. The design of a proper tax code is subject to an array of influences, from preconceptions by the public and legislators alike, to pressure from interest groups on both sides of the aisle; and also to individuals' past experiences, misremembered and misinterpreted. It is puzzling, to say the least, that even the most advanced countries on Earth, including the U.S., lack a set of tried and true rules or principles that could be used as a reliable guide to tax legislation. The fault lies in the failure of conventional economics to truly understand the nature and the characteristics of economic activity.

Current taxation is based on "old" and erroneous economic understandings; such as that "the rich are the ones who create jobs for the rest of us," or that "the rich's savings allow the investment necessary for a prosperous economy." These and many other equally erroneous beliefs were used to drastically cut the tax on the rich, from a height of over 90%—which prevailed for almost two decades of prosperity after WWII—to the current 39.6%, after the Bush tax cuts were allowed to expire. Those tax cuts led to the extraordinary growth of the public debt, which to this date have overtaken the national GDP.

The new principles of taxation presented in this chapter are based on a more realistic understanding of the economy. For example, that "the rich's savings slow down economic activity"; that "the increasing wealth of the rich comes at the expense of the rest of society"; that "the poor cannot fill the demand gap left by the rich, because they lack purchasing power"; or that "the money spent by government does not vanish into thin air, but goes straight into the pockets of the biggest producers—which are, naturally, the rich."

The other limitation on taxation is the rather absurd belief, promoted by a vocal minority—the rich and the DORPs—that a smaller government means a more efficient economy. In fact it is totally the contrary, especially in a condition of high unemployment. Government spending creates economic demand,

which translates into additional production and lower unemployment than otherwise. Looking at Plot 2, at the end of the previous chapter, we can see that the U.S. government spends proportionally less than any of the other developed countries, and that only the poorest countries in the world have such a low rate of government spending.

The Issue of Fairness

Fairness in taxation is generally believed to be a subjective matter. A book that presents a sort of consensus on the issue is "Taxing Ourselves" by Joel Slemrod and Jon Bakija:

> *We are sure, though, that fairness in taxation is an elusive concept about which reasonable people with different values may disagree. How progressive the tax burden should be depends on values about fairness but also on the extent to which attempting to achieve fairness through progressive taxation discourages productive economic behavior and on the cost in terms of simplicity in achieving finer and finer degrees of fairness. (Ibid, page 74)*

The other considerations that conflict with the application of a fairness principle, in taxation, namely that "progressive taxation discourages productive economic behavior", and "the cost in terms of simplicity" to achieve "finer degrees of fairness", are also held by most conventional economists.

The argument for the new principle of tax fairness, described throughout this book, is a novel one, and I believe it is also unassailable in its logic of tax burden sharing. After all, who can disagree with the principle that it is only fair that a rich person pays a higher tax rate than another less rich?

The conflict between progressive taxation and its presumed effect in discouraging productive behavior is of course a "red herring", as pointed out before; the issue of degrees of fairness is also a distraction from the issue at hand. Applying the principles of tax fairness, presented here, will certainly not achieve a totally fair world; other types of unfair tax situations will always arise or

remain; but the most egregious unfairness will undoubtedly be eliminated.

Other Dimensions of Fairness

The type of fairness we have been describing is known as 'vertical fairness'; it addresses the tax allocation to taxpayers with different incomes. Another type of fairness, known as 'horizontal fairness', would refer to the tax allocation to taxpayers with the same income but facing different circumstances. For example if one of the taxpayers has more children, or one of his dependents suffers from a expensive disease; is it fair for this taxpayer to be taxed at the same rate as the other?

Clearly, those types of considerations are customarily made in establishing tax exemptions or allowances for most of the foreseeable circumstances.

Then, there can be differences in wealth status, for example, between taxpayers with the same annual income; should the tax rate imposed on them not be depended on the amount of wealth they may already possess? How about if one of those taxpayers was poor but happen to win a huge 'Mega-Millions' jackpot?

Cases of horizontal fairness can be unlimited, and they are the reason that tax legislation is so voluminous. But I believe that vertical fairness has the most important impact on the wellbeing of our society.

About the Principles of Taxation

What I consider the most important new principle of taxation—a "game changer," if you will—is the one elaborated in Principle 6, below: the principle of tax progressivity, justifying a higher tax rate for the rich. The argument contrasts the flat tax rate, which would be fair and reasonable if the distribution of wealth were more or less equitable, with a tax distribution that would be equally fair in the real-world situation of a much-skewed income distribution—where the average income of the top 1% is over a hundred times greater than the national median income. In this latter case, there is bound to be a large group of low-income

people who would be hard-pressed to pay their corresponding share of the fiscal budget—assumed to be, as an example, 20% of GDP—which means that in order for the fiscal budget to be balanced, those with higher-than-average income should pay the tax share of the poor. In other words, the rich are obliged to pay their own share of taxes (about 20%), plus the share of those who cannot pay. This also implies, for example, that those in the top 1% should pay a higher tax rate than those in the tax bracket immediately below; and the richest man in the land should be obliged to pay a higher tax rate than everybody else.

The set of tax principles presented in this chapter is based on the new economic understanding described in my previous books. Some of the new economic principles are described in the Appendix.

The principles are couched in everyday language, to avoid the stiffness characteristic of axiomatic statements; for that reason, there is some overlap in the scope of each of the principles. In addition, these principles are unlike scientific principles, which ascertain causations of effects; they are more like applications of new economic understandings to the issue of taxation.

The Principles

1. **Taxes are the price of freedom.**

Government, which we make possible with our taxes, creates the conditions for us to live in freedom: freedom from want; freedom from fear; freedom to exercise our unalienable rights; and freedom to pursue our dreams. Those who doubt the tremendous impact that government, and taxes, can have on our freedoms should open their eyes to the living example provided by the rise of China, and each of the other fast-growing economies in the world, which the action of government has transformed from an oppressed country into a flourishing modern society.

Conversely, the cost of paying insufficient taxes—starving the government of funds—is corruption; social disorder; unfulfilled wants; fear of being exploited or victimized; and having our

rights violated and our dreams shattered. Again, we have living examples of this in the poorest countries of Africa.

It is of course true that more taxes may not guarantee that our freedoms would be better protected; but it is also true that without them there can be no such guarantee.

Do we need to raise taxes in the U.S.? The answer is: only if there are too many Americans living in want, in fear and insecurity, unable to exercise their rights, and unable to pursue their dreams.

2. **Taxes on business activities, in general, are bad for the economy**.

Business activities are the source of income for everybody in the country; thus, if we do not want to deter such activities, we should not tax them. In addition, taxes on business profits are ultimately paid by consumers, who have to pay higher prices. Furthermore, taxes on business profits can never be truly progressive.

Taxes on big corporations, and on withheld earnings, may be justified by principle #3.

3. **Taxes on environmentally damaging or socially undesirable activities may be justified.**

Some business activities create what economists call "negative externalities," which are uncompensated damages to the environment, or to third parties. Taxes, or equivalent fees or fines, are appropriate to minimize those negative externalities. For example, the problem of carbon pollution—major contributor to global warming—can be brought under control by metering and taxing the amount of carbon released to the environment. There are other less conventional ideas, such as "pollution trading," where a permit to release a given amount of pollutant can be traded in a specially set up market; this should create a strong incentive for the biggest pollutant companies to clean up their act. I believe that a metering and taxing scheme, just mentioned, would create an equal incentive to reduce such pollution, and would be much simpler to implement.

Financial transactions, where no goods are actually sold, could also fall among the socially undesirable activities—which can have terrible consequences for the national economy—and therefore could be taxed as a way to limit their excesses.

On the other hand, the application of Coase Theorem [Ref. *The New Palgrave, A Dictionary of Economics*, (1987)]—that the free exchange of legal entitlements is the most economically efficient—could be, in many instances, a more efficient way to resolve a case of negative externality—but if, and only if, both parties to the dispute are more or less economically equal, which unfortunately rarely happens.

4. Sales taxes are bad for the economy.

Sales taxes are a serious deterrent to economic activity; especially in an economy where consumer demand is already restrained. In addition, the sales tax happens to be the most regressive of all taxes, because it falls mostly on the lower and middle classes. The reason for this is that, as pointed out by Keynes, the lower classes spend almost 100% of their income; while those with higher income spend a lower and lower percentage as their incomes increase—and those at the top of the income distribution can spend only a tiny fraction of their huge income. It is logical to conclude that while the poor would pay sales taxes on their entire income, the rich, at the opposite extreme, would pay sales taxes on only a very small percentage of their income—the complete opposite of what fair taxation demands.

5. An income tax is best when fairly applied.

Having ruled out taxes on ordinary business transactions—to differentiate them from the financial ones—we are left with income as the only legitimate target of taxation. The great advantage of the income tax is that it makes no distinctions among types or classes of business activities, or specific sources of income. It is also the broadest possible tax, because it is applied over most of the gross domestic product, or GDP—which is equal to the total national income.

6. **Anyone earning more than his/her neighbor should pay a higher tax rate.**

This principle is the basis for the principle that follows—regarding the fairness of highly progressive taxation. What this principle states, in addition, is that progressivity should not be limited to the relatively low level of income it is currently set to, for example—about $400,000, while the top income is over $10,000,000,000 ($10 billion); tax rates ought to grow, ever so gradually, all the way up to the highest income in the land. In other words, the tax rate for the top income ought to also be the highest in the land.

7. **When the distribution of income is highly skewed, the fairest income tax is one that is highly progressive.**

The distribution of income in most countries of the world, and particularly in the U.S., is highly skewed. The often stated comparison between the minimum wage income (under $15 thousand), and the biggest of all the incomes in the country (over $10 billion, including unrealized gains) is truly staggering. The other statistics often cited are that the richest 1% of the population receive over 20% of the total national income, and own or control about 50% of the total financial wealth of the country.

It is plainly unfair to tax away even a small portion from a minimum-wage income. Therefore, those who have a larger-than-average income should be obliged to pay their true share of taxes, plus part of the share of those who are tax-exempt. And the same argument applies to those with still-higher income, who would pay a higher tax rate than those with slightly less income than themselves; and so on and so forth, until we get to the highest-income taxpayer who should be obliged to pay taxes at a higher rate than everybody else.

Notice that the fairness argument advanced here makes no allusion to the affordability criteria; that is, the argument here is that the rich should pay a higher tax rate because it is only fair

that, in addition to their own share of taxes, they pay also for those who cannot afford to pay at all, or as much.

8. **The Fed should be allowed to lend directly to government, to fund temporary deficits.**

Public borrowing of private funds is altogether unnecessary in a regime of fiat money—non-convertible money. The Fed can create and lend money directly to government, at zero interest. Congress would regulate the conditions and limitations of such loans—not unlike the manner in which current public borrowings are regulated. (See Ref. Mor03). Current public borrowing has pernicious effects on the fiscal budget balance, because of the cost of servicing the public debt. Such borrowing also contributes to the increase in the economic inequality of the nation, due to the fact that interest on the public debt goes mostly to the wealthy class. In a fiat money regime, government borrowing, at interest, from private sources is an aberration, and should be ended.

9. **In situations of persistent unemployment, taxes, especially on the rich, must be raised in order to increase the money flow.**

As is well known, government revenues are reduced by unemployment. Unemployment is caused by reduced demand for ordinary goods; this reduced demand is in turn caused by both, the reduced spending in the upper classes and the lack of money in the lower classes. The lack of money in the lower classes is the result of unemployment and low salaries. One proven way to increase demand, and consequently to lower unemployment, is to increase public spending, as recommended by Keynes; a serious drawback of this solution is the increase in public debt; unless, of course, taxes on the rich are increased at the same time.

Taxes on the rich, while reducing their savings, and therefore the private funds for credit, also reduces the need for such credit, with consequent benefits to the economy.

10. **The rich benefit at least twice from a fiscal deficit: one, they pay less than their share of taxes; and two,**

they lend those savings to government and collect interest.

The rich benefit from government services—public goods—and, in underpaying their taxes, allow a fiscal deficit to occur, and the national debt to grow. They are also the ones collecting interest on the government debt, which allows their wealth to continue growing.

11. **Capital gain taxes should be assessed, as income, from the moment they are recorded, rather than when they are realized.**

Currently, capital gains are usually left untouched—unrealized—just to avoid paying taxes on them. That, of course, constitutes a glaring inefficiency in the monetary flow, and contributes to the excessive accumulation of financial assets—which is indistinguishable from money.

In addition, there is no reason whatsoever to grant tax privileges—which amounts to tax exemption—to unrealized capital gains, which are simply a privilege for the mere possession and accumulation of money. Allowing the untaxed growth of capital gains enables the development of financial bubbles, with the consequent disastrous effects. On the plus side for the rich, they may be able to capitalize on their losses.

Taxing capital gains when withdrawn, as is done now, constitutes a deterrent to spending on a class that consistently under spends; it is truly an anti-economic policy, which only benefits a tiny minority of people.

12. **Non-profit institutions should pay capital gains (including dividend and interest) taxes.**

The tax-exempt status of non-profit institutions has converted them into preferred vehicles for the accumulation of wealth. Exempting their capital gains from taxes allows them to profit from the sole possession of money. A capital gains tax, at the moment of record, would at least slow down the rate at which these institutions accumulate wealth.

Most people have a favorable opinion of non-profit organizations. Charity, education, medical research, social assistance, anti-poverty, and other such activities are supposed to fill in for government's spending limitations. These are in fact worthwhile purposes; but only as long as government spending is limited as it is today, mostly by the existing "taboo" of taxing the rich; and by the fact that all business opportunities are hoarded by the rich. Rather than encouraging the proliferation of non-profit organizations, which to some extent reduces the government's capacity to solve the very problems they pretend to address, one should strive to solve the fiscal problems that are nowadays limiting not only government spending, but also the prosperity of the nation.

Recently, *The Economist* magazine, in heralding the halving of world poverty—a goal promoted by some of the most important world charity organizations—noticed that such a feat was the consequence of economic growth in some of the poorest countries—notably China and India—and that the impact of the charity organizations was almost invisible.

13. **Government tax spending contributes to the national product and therefore to the national income.**

The money government spends in order to produce public goods creates a demand for private goods, both as input goods—to produce public goods—and as consumer goods, by the ordinary spending of government employees, and private producers as well.

In the U.S., the government produces—and consumes—about 20% of the GDP. When the government is forced to cut spending, the country's GDP drops by an amount corresponding to the cuts.

14. **Taxing the rich's financial wealth, in order to pay off the national debt, is only fair.**

A sizeable part of the rich's accumulated financial wealth comes from the material benefits they have already received from previous fiscal deficits. Since those benefits are the direct cause of the accumulated fiscal debt, it is only fair that such financial

wealth should be taxed in order to gradually eliminate the national debt.

On the other hand, the general idea that money—the real nature of financial wealth—is private property, and should not be taxed, is doubly wrong: first, even if money were private property, government has the right to tax it, just like it taxes real estate or cars; but, second, and most importantly, money is not property; money is the means of exchange, without which the economy would not function. Therefore, withholding it—saving it or converting it into financial assets—constitutes an obstacle to the economic activity of the nation, and it is the duty of government to discourage such withholding.

4. Taxing the Rich

Introduction

To understand the problem of taxation is to come to the realization that it is simply a problem of how to tax the rich.

The current ideology, that a lower tax rate on the rich allows them to stimulate economic growth through increased investment, is ludicrous. Even conventional economists are aware that the rich would spend or invest little of the additional money they may receive—through lower taxes, or tax cuts; on average, they would save most of any new money they receive. In contrast, government spending is done 100% on domestic products—assuming a balanced trade. Therefore, a tax cut on the rich may stimulate the financial sector—a parasitic sector of the economy; while a tax increase would stimulate the real economy.

Even a simple economic analysis would tell us that taxing the rich should greatly benefit the economy: taxes on the rich affect primarily their savings—the money that would be withdrawn from circulation, causing a reduction in overall spending. By taxing the rich, the government takes in money intended for saving; and by spending that money, the government puts it back in circulation, causing a corresponding stimulus in the economic activity of the nation—more demand for workers.

Some months ago, when the issue of higher taxes for the rich became a political issue, I read a statement given by an employee

in a small firm; it said that he opposed a tax increase on his boss because then the firm may have to close and he could be out of a job. The poor fellow had been brainwashed into believing that if his boss had to pay a few percent more on his income taxes, his boss would not have enough money to keep the firm going! He, like many others, do not understand that his boss's income is what remains of the firm's revenues after paying for operating expenses and employees' salaries and benefits; and little or none of his boss's income is spent on the firm. If the firm didn't make a profit, there would be no income tax for the boss. And if the profits were very small, this boss would not have to worry about being in the high tax bracket.

Most economists, and others who think they are knowledgeable about finances, tell us that saving—and there is no doubt that the rich do most of it—creates the funds that are lent out to business and consumers alike, and that maintain the economic activity of the nation; that without substantial savings the economy would slow down, with the consequent increase in poverty and unemployment. That used to be true, when the Fed—our central bank—was limited in the amount of currency it could create—by the amount of gold reserves it kept; but after 1971, when the U.S. dollar was declared a fiat currency—not convertible into gold or any other commodity—the Fed was free to issue as much currency as it saw fit—through 2013, for example, the Fed had been issuing about $85 billion every month—which adds up to about $1 trillion per year—to "stimulate" the economy. It certainly stimulated the financial sector, but hardly much of the real economy.

The belief in the usefulness—to society—of the rich is changing, ever so slowly; for example:

> *The traditional reply to critics of economic inequality has been that we need not only the rich, but also a comfortably off class, who are able to put some of their income into investments. In other words, disparities give some people more than they "need," which allows them to underwrite the new enterprises that benefit everyone. While there is obvious validity to this*

> *argument, it should be added that much of this outlay now goes to paper contrivances, which have only a remote connection with anything productive, if any at all. Nor are the rich as necessary as they may once have been, since institutions now supply most invested capital. Metropolitan Life, Merrill Lynch, Bank America, and the California Public Employees Pension Fund put substantially more into new production than do the 68,064 families with $1 million incomes.* (Andrew Hacker, *Money: Who Has How Much and Why*, 1997, p. 236)

If savings were reduced to zero—meaning that all new income was spent—the entire stock of money in the nation would circulate without much need of new credit loans, and the economy would prosper. Borrowers, businesses, and consumers would be able to pay their debts gradually; and the unemployment level would also drop gradually.

The truly rich constitute a very small fraction of the population; they are also a small fraction of the 1%, who reportedly own 50% of the entire financial wealth in the U.S. Being so greatly outnumbered, is it not a total puzzle that they are not more heavily taxed? It would seem that ordinary people could simply, through the democratic process, either limit the amount of income the truly rich could have, or tax most of it away. The fact that that is far from happening can only be understood by realizing that the rich have, throughout the centuries, created formidable barriers in order to protect their wealth and their privileged access to an ever-growing income.

These barriers, as we have seen, are, among others, doctrinal, educational, political, and psychological, such as the scare tactic. They are so insidious that few of us realize that they exist at all; and even those who suspect some foul play are hard-pressed to put their fingers on it. They are also so pervasive that very few are unaffected by these machinations. And they are so craftily implemented that the real losers—the middle class—even defend their victimizers.

Why the Rich?

Why target the rich for higher tax revenues? As the famous bank robber answered, "Because that is where the money is!" But more importantly, that is where the highest percentage of excess income exists.

The top 1% of taxpayers receive over 20% of the total U.S. GDP as income, and own or control about half of the entire financial wealth of the nation.

There are at least three other reasons the rich should pay higher tax rates than ordinary taxpayers: one (the fairness argument), the poor cannot afford to pay their share of taxes, thus, others must pick up some of that extra tax burden, and whoever is a little richer than his neighbor should pay a little higher tax rate; two (the affordability criteria), the rich can certainly afford to pay higher tax rates than the rest; and three (the ethical criteria), the rich, on account of their financial power, can and do outcompete the rest in the acquisition of income, thus they are responsible for the existence of the poor and the unemployed—the losers in the competition.

Another strong rationale for taxing the rich is to allow the circulation of at least part of the money saved by the rich; this would stimulate the economy much more than, for example, the current "quantitative easing" by the Fed, which has almost no effect on the economy, because it simply goes into buying existing debt, with the proceeds going to those who would keep the money in storage.

But, perhaps the most important reason to apply higher and higher tax rates on the rich, as mentioned before, is to slow down the growth of what can be identified as the social cancer—namely, the accelerated growth rate of wealth accumulation in the past several decades.

A Debate: Should We Tax the Rich More?

I have just read the book *Should We Tax the Rich More?* (2013), edited by Rudyard Griffiths. The book contains a transcript of a recent debate that took place in Toronto, Ontario (Canada), on

May 30, 2013, between two pairs of participants—Paul Krugman and George Papandreou, arguing the pro case, and Newt Gingrich and Arthur Laffer, for the opposition—as well as individual interviews with three of the participants (Papandreou was not interviewed). The proposition to be debated was just the title of the book, "Should We Tax the Rich More?" The moderator of the debate was Rudyard Griffiths, and the interviewer, Howard Green.

As in many debates of that style, the opinions of the spectators—3,000 of them—were polled before the beginning, with the following result: 58% were in favor, 28% against, and 14% undecided.

The positions of each of the four participants can be summarized as follows:

Paul Krugman:

He asks himself three questions at the outset, "Should we be thinking about raising anybody's taxes?"; "Can we, in fact, raise significant sums by taxing the rich more heavily?"; and "Should we really fear the economic consequences if we do raise taxes on the rich?" He then argues in the affirmative for the first two questions, and in the negative for the third one. He reinforces his third answer by citing historical data:

> *And, by the way, the post-World II generation had much higher tax rates. The United States had tax rates that would be considered inconceivable now, and that didn't stop those twenty-five years from being the best period of economic growth and the best period of middle-class rise in living standards that we've ever had in our history.* (Ibid, p.9)

George Papandreou (Greece's Ex-Prime Minister):

His own summary contains the following paragraph:

> *We have major issues we have to deal with going forward, like climate change and unemployment. In my country, there is a youth unemployment rate close to 60 percent. Now, is that a sustainable society? We need to give those young people*

> *training, hope, and job prospects. So, in relation to the rich, we're talking about them giving back a small portion of their wealth to their governments to make our societies more just, better, and more efficient, and to help us prepare for major challenges the younger generations will face.* (Ibid, p. 45)

Newt Gingrich:

In addressing the issue of youth unemployment—which is a terrible problem not just in Greece, but also in the U.S. and throughout the entire world—he says:

> *There are two key things to mention: practicality—what works—and whether you favor freedom or the state, which is the permanent tension in every society. […] And, while I have many, many problems with the Chinese dictatorship, there are few achievements since World War II that have helped more human beings than the implementation of Capitalism and the opening of markets in China. And I'd rather see those 600 million Chinese rise in a society with inequality than see them smothered in a society of absolute equality.* (Ibid, pp. 47–48)

But on the issue of "taxing the rich more," he equates it with "theft" and with "getting somebody else's," and asks himself the question, "Should we confiscate Bill Gates's wealth? After all, why does he need all those billions?" He then quotes the famous—or infamous—words by John F. Kennedy, "The rising tide lifts all boats." When asked about the prosperity during the Eisenhower and Kennedy days, with 90 percent and 70 percent in top marginal taxes, respectively, He answers:

> *The hidden fact is if your income is premised only on capital gains, you pay half the marginal rate […] You end up with a dramatically lower marginal tax rate legally […] Well, guess what? Really wealthy people can hire really smart lawyers. So, when you have a 70 percent marginal rate, people are looking for ways to conceal their money.* (Ibid, p. 57)

When asked directly, by the interviewer, Mr. Green, “What’s the right rate of taxations?” he answers:

> *I think the right answer is a flat tax that's very clean, very simple, and easy to administer. I also want it to be fair in the sense that if you are a millionaire, you'd pay dramatically more than if you were someone who earned a very small income.* (Ibid, p. 59)

Arthur Laffer:

In the debate, his concluding words are a criticism of Warren Buffett’s “complaints” that he was paying taxes at a “lower rate than his own secretary”:

> *But let me tell you what also happened to Warren Buffett in 2010, when he reported $40 million in income. His wealth, in unrealized capital gains, which is not taxed, rose by $10 billion. […] So, to me, his income in 2010 was $12 billion. And he paid $7 million in taxes, which is six one-hundredths of one percent [0.058% to be precise] of his income. That is not fair. But all the tax rates he wanted to raise were the ones he doesn't have to pay. […] We shouldn't raise tax rates as they currently stand. We should change the tax code and lower tax rates.* (Ibid, p. 44)

It would be fair to say that Mr. Laffer is not really against taxing the rich more; he is against raising tax rates. In the follow-up interview, he is much more explicit in his preference for a flat tax not much different from Mr. Gingrich’s preferred tax. Nevertheless, Mr. Laffer’s historical recollection is as faulty as Mr. Gingrich’s:

> *Then you go to the post-World War II period with Truman's [cut on] tax rates—again a boom. And again, tax rates on the rich went up as a share of GDP. Look at the period of Jack Kennedy—he cut the highest tax rate from 91 percent to 70 percent, and as a result, we had the go-go '60s, a beautiful period of expansion. Tax revenues from the highest one percent of income earners went way, way up as a share of GDP.*

> *Then we have the period I like to call "The Four Stooges"—Johnson, Nixon, Ford, and Carter—the largest assembly of bipartisan ignorance probably to ever exist in the United States. They raised taxes throughout the period and, of course, revenues as a share of GDP declined from the top one percent, the economy was in shambles.*
>
> *Then we had Ronald Reagan and Bill Clinton, two administrations that cut taxes dramatically. […] We cut taxes from everything that crawled, jumped, swam, flew, and dug holes—it didn't matter what it was—we cut their taxes. Revenues from the bottom 95 percent actually went down during this period.* (Ibid, p. 18)

Editor's Comments:

Mr. Gingrich made the argument (expanding on his "600 million Chinese" remark above):

> *The Chinese said, "We're going to go out, and we're going to create dramatic opportunities for people to become very, very, very wealthy." And in the process they've taken 600 million people into the middle class—the largest increase of the middle class in history. Now, are you willing to have a few billionaires if you're going to move 600 million people into the middle class?* (Ibid.)

None of the pro side addressed this, rather interesting, argument, which deserves a reply. Mr. Gingrich believes that "to move 600 million" people out of poverty it is unavoidable that "a few billionaires" are also produced. He is demonstrably wrong! Billionaires are a consequence of government ignorance—or complicity—in applying tax laws, which enables the obscene accumulation of wealth by a tiny minority, at the expense of the rest of the people. The 600 million Chinese would have been raised out of poverty even without the billionaires; but no billionaires could exist without the rise of the 600 million, and the complicity of government.

Conclusions on the Debate

The opinion poll taken of the spectators at the end of the debate gave results somewhat different from the initial one: 70% in favor, 30% opposed, and zero undecided. General opinion polls in the U.S. give comparable results. Those voting in the U.S. Congress are quite at odds with the opinion of the people.

What can we learn from the debate?

1. That the opposition to higher taxes on the rich is still based on a misinterpretation of our own history: tax cuts do not help economic growth; they definitely hinder it. (Please see Chart 2 in Chapter 1.)
2. That neither the pro-tax nor the anti-tax groups understand the fairness argument: that it is only fair that those with above-average incomes should pay a higher tax rate than those who have lower incomes.
3. No one seems to be aware of the existence of, nor of the danger posed by, the social cancer.

Chapter Conclusions

The necessity to fund WWII forced the U.S. Congress to increase the tax rate on the rich to the historically high 94%. That ensured almost two decades of prosperity, albeit at a slightly lower rate, until one of the most beloved presidents in modern times, John F. Kennedy, began the reduction of the rich's taxes that continued until recently. Kennedy was the scion of one of the wealthiest families in Massachusetts, but few, if any, observers at the time mentioned the extraordinary gift to the wealthy that the tax cut represented. Naturally, most political and financial commentaries praised the President for providing such a meaningful incentive for economic growth. And just as naturally, no one noticed, at least in writing, that, contrary to expectations, economic growth started to slow down ever since, for the following half century.

The Great Recession of 2008 has not been able to change the mind of the populace, at least not enough to change their voting patterns. They still support congressmen opposed to raising taxes

on the rich. Nevertheless, the trend of starving the government, and the poor, cannot go on forever. What will it take to loosen the rich's grip on the economy?

I have argued in this chapter that the rich must be taxed at higher rates than those less affluent because it is the fair thing to do; and that extraordinary income should be taxed at a marginal rate near 100%—akin to establishing an income cap—as a means, perhaps the only possible one, to slowdown the growth of the social cancer.

Somehow, I have faith in the biblical promise that the truth shall make us free. It may not happen in my lifetime, but it will happen; it must happen, if our society is to survive; if the social cancer is to be stopped from overtaking our society.

5. Balancing the Fiscal Budget

Introduction

For the government to recover all the money it spent in producing the public goods we demanded, we must pay taxes.

Current principles of taxation are based on questionable—truly wrong—economic assumptions. For example, the belief in a "broad-based" tax—meaning a tax applied to a larger proportion of the population—is a self-serving idea promoted by the rich—as well as by their defenders, including conventional economists. Margaret Thatcher, in the 1990s U.K., tried to impose her ill-conceived "poll tax"—a most extreme form of broad-based tax, which would have forced a uniform tax on every British subject (regardless of income!)—but, due to extraordinary public opposition, had to withdraw that government mandate on the very eve of its enactment.

How much in taxes each of us should pay would be a trivial calculation, if only everybody in the nation had more or less the same income. That is, unfortunately, far from the case. In fact, the distribution of income, in the U.S and elsewhere, is terribly skewed, and it is prompting calls to end such inequity. Even Pope Francis joined that chorus some months ago.

About Marginal Tax Rates

A tax rate is simply the percentage of the base amount—usually the taxable income—to be paid as tax. For example, if you make $100,000—after deductions and allowances, and must pay a tax rate of 20%, it means that your tax amount is $20,000.

To apply a progressive tax rate, the IRS establishes a series of income brackets, from the lowest taxable income to the highest. Currently, there are seven income brackets, each with a different tax rate, from $0 to $400,000. Your marginal tax rate—everybody has one—is the tax rate applicable to one additional dollar of income. That means, if your taxable income is the highest amount in your income bracket, then your marginal tax rate would be the rate applied to the next higher income bracket; otherwise, your marginal tax rate is the rate applied to your current income bracket.

For 2013, the seven tax brackets* start from an adjusted or taxable income of less than $8925 (with a corresponding tax rate of 10%), to $400,000 and over (with a tax rate of 39.6%). Your total tax obligation is the sum of the taxes applied to all the brackets that are lower than or equal to your taxable income.

Table 0

Tax Year:	2013
Filing Status:	Single
If your taxable income is between...	your tax bracket is:
$0 and $8,925	10%
$8,925 and $36,250	15%
$36,250 and $87,850	25%
$87,850 and $183,250	28%
$183,250 and $398,350	33%
$398,350 and $400,000	35%
$400,000 and above	39.60%

* These tax brackets are periodically adjusted for inflation.

However, most incomes of the truly rich are from capital gains, which are taxed at a flat rate of 15%.

That means that a person with an income of, say, $100 million would pay the same marginal tax rate as one making a little over $36,250. To illustrate the different tax effect on these two taxpayers, we can calculate the total tax paid by each of these two taxpayers. The multi-millionaire would end up paying about $15 million in taxes, keeping $85 million to dispose of in a year—he would probably save over $70 million; while the less wealthy taxpayer would pay $4,000 in taxes, and keep about $32,000, to dispose of in a year—out of which he may save less than $5,000—in Social Security—if he is lucky. And the government would be left with a budget deficit of about $680 billion, and an outstanding debt of $17 trillion—about 103% of GDP.

The Current Taxation is Mostly Flat

Most economists favor a flat tax—where everybody pays the same rate, after some exceptions and allowances—and promoted incessantly; I do not know whether they do it out of ignorance or just to cover up the fact that our current tax allocation, as shown in Table 0, is mostly flat. In fact, the marginal tax rate for incomes above $400,000 also applies to the highest income—estimated to be in the billions of dollars; while only for incomes below around $120,000—where the income distribution is fairly flat—the overall tax rate is truly progressive.

The income distribution in the U.S.—and in most countries with low income tax rates—is most unequal at the high end. For example, the ratio between the low end of the top 1% of incomes and the average income is about 6; while the ratio between the very top income and the average income is well over 1,000. This is quite obvious in Chart 1, displayed earlier.

The current taxation is quite progressive for the lowest income ranges—from below $9,000 to below $400,000; where tax rates increase from 10% to 35%—a tax jump of 25 percentage points, over an income gap of a factor of 45. There are six marginal tax brackets covering such income gap; while everybody who makes

over $400,000 per year gets to pay income tax at the same 'flat' rate of 39.6%; thus, even though the highest earners make billions, they pay tax at the same marginal rate as those making a bit over $400,000.

In reality, as will be described below, the rich pay at substantially lower tax rates any ordinary taxpayer, because most of their income comes from capital gains, which pay only at a 15% rate, if at all—they pay no tax on 'unrealized' capital gains.

Tax on incomes

Now that we know where the money is, it is simple common sense to devise a balanced budget.

If the government spends 20% of GDP—or national income—then it must collect 20% of GDP in taxes. This means that every bit of income, except for the customary standard deductions, and that which goes to the poor, must be taxed; this includes incomes, rents, and capital gains—or appreciation. Naturally, because of all the tax deductions—which benefit the middle class the most—the average tax rate, required to balance the budget, would be several percentage points higher than the 20% mentioned above.

The tax on income ought to be very progressive; with the tax on the poor almost zero, tax rates could go up by 1% every $10,000, and that on the super-rich could reach almost 100%—perhaps 99% for incomes above $50 million, for instance. All income, regardless of its source, should be taxed at the same rate as ordinary income.

One of the many objections to taxing the rich is that they are so few that it would be unrealistic to extract much more money from them. This is easy to disprove by examining the federal tax revenue and outlays for the years 2000 and 2008. The year 2000 was just before the "Internet bubble" collapsed, and before the Bush tax cuts went into effect; and the year 2008 was the last almost-full year before the start of the Great Recession (Oct. 2008). There are many observations that can be made on the basis of Table 1.

a) In the year 2000, before the tax cuts, individual income tax amounted to 10.1% of GDP; In 2008, after the tax cuts, individual income tax was only 8% of GDP.

Table 1

Federal Revenue (In $ Billions)				
Year	2000		2008	
	Tax Collected	% GDP	Tax Collected	% GDP
Individual Income Tax	1004	10.1%	1146	8.0%
Corporation Income Tax	207	2.1%	304	2.1%
SS and Retirement	653	6.6%	902	6.3%
Excise Tax	69	0.7%	67	0.5%
Other	92	0.9%	106	0.7%
Total Gov Revenue	2025	20.3%	2525	17.6%
Outlays	1789	18.0%	2982	20.8%
Balance	236	2.4%	-457	-3.2%
GDP	9952		14370	

b) There was little difference in the other relative contributions to total government revenue.

c) The fiscal balance went from a $236 billion surplus to a deficit of $457 billion. The big turnaround in the fiscal balance was due partly to excess expending—due to the financial collapse—and to the revenue loss due to the tax cuts.

d) In the eight years between these two tax statistics, the GDP increased by over 44%[†], while tax revenue went up only about 14%, and spending went up by 67%. In other words, incomes went up by 44% but government revenue went up only by a third of the income increase!

[†] These comparisons are in nominal values—not corrected for inflation; the real changes are correspondingly smaller.

Table 2, below, shows the actual tax rates paid by the middle class, and by people in the three top tax brackets in 2000 and 2008.

Table 2. Individual Income Tax Rates

Year	2000		2008	
Size of adjusted income	$B Tax Collected	Tax Rate %	$B Tax Collected	Tax Rate %
30,000 to 39,999	40	9	26	7
---	---	---	---	---
200,000 to 499,999	146	24	194	20
500,000 to 999,999	76	28	94	24
1,000,000 and more	226	28	249	23

Among other things, Table 2 shows that:

a) The effective tax rate for the wealthy classes went down by 4 to 5 percentage points between 2000 and 2008, while the reduction in tax rates for the middle class was only 2 points.
b) The rich paid a tax rate of only 23%, in 2008. That may be up to about 27% now that the Bush tax cuts have been repealed.
c) Even 27% would be too small to close the fiscal deficit; but this means that the rate can be increased by quite a lot, in graduated steps, in order to balance the fiscal budget once and for all.
d) It can be estimated that if the top tax rates for the wealthy class had been increased from 23% to 65%, the fiscal deficit would have been closed in 2008. And 65% is still low compared to the rates prevailing in the 1950s and early 1960s, when the top rates were over 90%.

The Capital Gains Tax

Perhaps the most important reason the rich pay such low effective tax rates is that most of their income comes from unrealized capital gains—that is, capital gains that have not been withdrawn during the year. The most egregious case, as mentioned before, is

that of Warren Buffett, reportedly the richest man in the U.S. Mr. Buffett's total income in 2010, including all his unrealized capital gains of that year, amounted to about $12 Billion—12 thousand millions of dollars. Even at the low current capital gains tax rate—if the unrealized gains were included—he would have had to pay at least $1.8 Billion; instead, he got off scot-free by paying only $7 million. To get an idea of how ludicrously low the real tax rate that Mr. Buffett paid in 2010 is, you can calculate that an average American taxpayer—with an annual income of $50,000—if subject to the same tax rate, would have to pay only $29 in income tax (not including the $7500 he had to pay in Social Security taxes).

If one were to assume that at least 50% of the real income, of those making over $1 million in currently taxable income, comes from unrealized capital gains, then we could expect to almost double the tax collection from just that .01% of the taxpayers (presently about $300 Billion). The total amount collected, from just this tiny group of wealthy taxpayers, would easily reach $1 trillion if total capital gains were taxed as ordinary income (39.6%).

Taxing total capital gains would moderate the growth of the social cancer, as discussed before, and most likely eliminate forever the possibility of future financial bubbles.

A Proposed Tax Reform

A more progressive taxation, which can balance the fiscal budget without much change in the tax table is the one proposed in Table 3. The major differences from Table 1, which contains the current tax table—for 2013—consist of lower taxes for the income brackets below $87,851, and the addition of more income brackets up to $50 million and above, with a marginal tax rate of 99%.

The last column of Table 3 shows the effective[‡] tax rate corresponding to each of the marginal tax rates. The effective tax

‡ The effective tax rate is the percentage of the adjusted income actually paid as income tax.

rate for the 99% bracket is only 83% and over. Warren Buffett would still be able to donate 6% of his lifetime earnings—still a very substantial amount—while helping to restore the fiscal solvency of his home country.

Table 3. A Tax Table For a Balanced Budget

Tax Year Filing Status	2015 Single	
If Your Taxable Income Is Between	Your Marginal Tax Is	Your Effective Tax Is
$1 and $8,925	5%	5%
$8,926 and $36,250	10%	8.8%
$36,251 and $87,850	20%	15.4%
$87,851 and $183,250	24%	19.9%
$183,251 and $398,350	28%	24.4%
$398,351 and $400,000	34%	24.3%
$400,001 and $450,000	32%	25.4%
…		
$1 Million and $1.1 Million	50%	39.5%
…		
$5 Million and $6 Million	66%	54.7%
…		
$50 Million and above	99%	83+%

The actual determination of the tax brackets would be made by government accountants charged with the task of ascertaining a balanced fiscal budget, under the constraints of a fair tax distribution.

Yes, I know that the DORPs will criticize almost everything about the proposed reform, from the "confiscatory" rates, to the "confusing'" number of tax brackets, and they will cry "Why punish success?" They will never tell you that if the rich do not

pay their fair share of taxes, you, the ordinary taxpayer, will have to pay for them; in fact, you are already doing it, and have been doing it for almost half a century.

Unfair Tax Rates for the Great Majority

If the total revenue received by the government, with the recommended tax table, exceeds the total outlays, then the best way to reduce revenue would be to reduce the tax rates for the first four tax brackets. Why only the first four tax brackets? Because the first $110,000 in income—indexed for inflation—must pay 15.3% in Social Security taxes; while incomes above that amount are exempt from such taxes. Thus, those in the first three tax brackets, and part of the fourth one, would still pay substantially higher tax rates than even those with higher incomes.

A Gradual Implementation

My suggestion would be to apply the lower rates on the first four brackets, and gradually, throughout a period of five to ten years, raise the top marginal rate.

Yes, I realize that Congress, the way it is constituted now—while most of its members belong to the "1% privileged minority"—will never, in a million years, pass the suggested rate increases. So, it is up to you and me, those in the lower income brackets, to fight to keep more of our hard-earned income, by either changing Congress's minds, or Congress itself.

In Conclusion

It is clear from the above that the main cause of fiscal deficits, and the consequent national debt, is the tax privileges enjoyed by the wealthy class. After the enactment of the Bush tax cuts, the wealthy were rewarded—for what?—with a tax cut equal to 5 percentage points from the previous low tax; while the middle class only got a tax cut of 2 and 1 points, in addition to their share of the national debt that increased by over $1 trillion per year in the last four years.

A look at the effective tax rate paid by the rich in the U.S. shows that there is plenty of scope for tax increases on this group of privileged individuals, to easily balance our fiscal budget, and also to make the tax assessment fairer to the majority of the population.

The other two consequences of more progressive taxation may be more important than the achievements of fiscal balance and tax fairness: the reactivation of the national economy and the slowdown in the growth of the social cancer.

6. Paying the National Debt

Introduction

We have learned several important monetary lessons from the previous chapters. For example, we now know that there is a law of conservation of money—just as there are laws of conservation in physics. This law tells us that the money spent by government does not vanish. "Where does it go?" you might ask. It goes into the pockets of the producers of goods, including the owners of big corporations and of financial institutions, and executives of big companies. Essentially, a wealthy minority receives most of the money spent by government, and they do most of the saving that takes place in the country.

The government goes into debt every time it has a budget deficit; that is, whenever the rich minority fails to pay its fair share of taxes. You do not have to be an Einstein to realize who owns the national debt—currently about $16 trillion; of course those who benefited the most from the many tax cuts and government largesse of the last half century or so. As we saw earlier, whatever the government spends goes into the hands of the people, and ultimately into the pockets of the rich. A deficit in the federal budget means that the rich and super-rich have kept some of the money spent by the government. In fact, every dollar of deficit in the federal budget is at least one dollar saved in taxes, or earned in interest from those savings, by the super-rich.

Therefore, it is only fair to demand that they pay the national debt and return at least part of the money they owe the government.

How to Pay Off the National Debt

The national debt is simply the accumulated federal deficits throughout the years. Therefore, the value of the entire national debt, including interest, is now in the private sector—mostly in the pockets of the rich. I propose here three different ways to temporarily increase government revenues: one, apply a tax surcharge of one to two percent on all financial assets above $1 million; two, apply a one- to two-percent tax on financial transactions; and three, to issue zero- or negative-yield inflation-adjusted bonds in replacement of the higher-yield bonds outstanding.

Taxing Financial Wealth

The simplest way for the government to start paying off the national debt is to apply a temporary tax surcharge of one to two percent on all financial assets above, let's say, $1 million. That should yield between half a trillion and one trillion dollars a year.

Why tax large financial wealth? Because that is where most of the savings from tax cuts, and most of the interest on the national debt, normally end up. With a tax rate so small, there cannot be any expectation that the government could recover a substantial fraction of the money lost to tax nonpayment; but in time, it could recover enough to make the exercise worthwhile.

Financial wealth can be defined as any financial asset that could be converted into cash on short notice. For example, bank accounts, shares of stock or mutual funds, money market certificates or accounts, government securities, and negotiable debt instruments.

Taxing financial wealth, temporary as it may be, will have a stimulating effect on the economy, because otherwise that wealth would remain outside of the economy indefinitely. The reason for this persistence of savings is that people save for "rainy days"—it is a natural survival mechanism, not unlike the "instinct" that

moves animals that live from foraging to maintain a cache of food. In the case of saving, we may never, or at least try to never, deplete our savings, and they usually survive us. This means that spending that could have stimulated production was postponed for so long that when it finally happens, the economic effect arrives too late to compensate for the dearth of demand during the saving period.

The effect of taxing financial wealth would be to allow for a small part of the rich's savings to circulate in the economy, thus stimulating consumption and production. However, since most of the revenue from those taxes would be used to pay off the owners of government securities—overwhelmingly part of the savings of the rich—they will be put back into savings. In other words, taxing financial wealth to purchase back government securities may have few other economic effects than to reduce the national debt—in itself a worthy cause.

Taxing financial transactions

Financial markets started as sources of investment funds for industry, but they have morphed into casinos for the rich. The most egregious example is the foreign exchange market, which started as a way to facilitate foreign exchange transactions for international trade, but which has totally outgrown its purpose, and is nowadays used to extract profits from the changes in valuations between the different world currencies. It reportedly has a daily transaction volume of $5-6 trillion per day!—by contrast, the world trade volume is less than $40 trillion per year! (or $0.02 trillion per day).

The foreign exchange market is nowadays more a destabilizing factor than a facilitating one. Only wealthy "investors" can afford to risk large sums in the expectation of tiny reward. Ordinary transactions earn fractions of a percent in such games. Big profits, such as the fabled killing by George Soros on the British pound, have not happened since the reduction in national currencies due to the introduction of the euro in the year 2000.

The large and growing financial transaction volume mentioned above means that, for instance, a one- or two-percent tax on every transaction on the foreign exchange market can hypothetically produce $10 to $20 trillion per year. There are a couple of reasons why the tax yield on such transactions will be much smaller than the hypothetical amounts. First, although a majority of exchanges involve U.S. dollars, not all of them take place in the U.S., where they can be taxed. And second, obviously, such large trade volumes cannot persist on the face of even such a small transaction tax; but even if it were to decrease by a factor of ten, the revenues from just this market would be pretty substantial.

Transactions in the stock market and in the commodity markets are smaller in volume than those in the foreign exchange—average daily stock trading volume is estimated at $30 billion. A one-percent tax on each transaction may yield around $200 billion per year.

The effect of the small tax on financial transactions is to diminish the attractiveness of activities that have little economic value, but that can create—as they have already done on several occasions—very destructive imbalances in the entire economy.

Issuing Zero or Negative Yield Bonds

A third prong of attack on the national debt would be the issuance by the U.S. Treasury of zero-yield inflation-adjusted bonds, in replacement of existing treasury bonds. Those zero-yield bonds do not need to be repaid ever, and can be safely eliminated from the national debt.

Why would people buy these zero-yield bonds? Because, once the fiscal budget is balanced they would be the safest savings vehicle around.

The main reason to pay the national debt is really to avoid paying interest on it; thus, any debt that can be held at or below zero real interest, does not need to be repaid, ever.

The great advantage of creating the low-yield Treasury bonds is that they satisfy an important need for the population: the need to save with utmost security. The benefits for the country are equally clear: the government can, in a relatively free manner, have a new source of funds for public investment.

The Foreign Debt

It is well known that a sizeable portion of our national debt is in foreign hands; that is a consequence of our extensive and continuous trade deficits. Our cumulative trade deficit during the last thirty years is around $6 trillion. That debt can only be eliminated by reversing our trade deficits (see for example my previous book, *The Denver Plan to End Unemployment*, 2010). Reversing our trade deficit means precisely that, to increase our exports while decreasing our imports to those countries with which we have large accumulated trade deficits, such as China, Japan, Saudi Arabia, and Germany, among others. A program to achieve this trade reversal is presented in my *Denver Plan*.

A transitional way to manage that debt would be to gradually exchange the current bonds, in foreign hands, for the new low-yield savings bonds described above, which, as mentioned there, would require a balanced budget.

The Fed's "Quantitative Easing"

The Fed's purchases of government securities is called "quantitative easing" (or QE), which is a euphemism for "money printing" by the government. The government debt purchased by the Fed remains on the government's books—it does not officially decrease the national debt, at all. However, since the government now pays interest, on those securities, to the Fed, which sends most of its earnings back to the government, it turns out that those securities are actually interest-free.

QE would be more profitable for the federal government if the Fed were to buy municipal bonds instead; these bonds' interest is tax exempt, meaning their holders—mostly the rich—pay no tax on their interest earnings.

However, the Fed's purchase of government securities, using newly printed money, is potentially inflationary, and should be avoided by any means[4].

In Summary

The most important findings from this essay are:

1. Current taxation in the U.S. is truly regressive!
2. Those in the middle and upper-middle income ranges are being penalized—Even if your income is as high as about $500,000 a year, you are being overtaxed!
3. The very-rich pay relatively little taxes, if at all! They are the cause of fiscal deficits and also of the national debt. Everybody else is forced to pay taxes at an unfairly higher rate.
4. The very-rich—because they experience an accelerated growth in financial wealth—constitute a social cancer that imperils the survival of our society.
5. What can you do about it? You can write to your Congressmen, or send them copies of this book!

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[4] I describe a good alternative in my recent book *The Money Sovereignty Recovery Act (A Proposal)* (2014).

7. A More Prosperous Country

Introduction

The U.S. was once the most prosperous and genuinely admired country in the world. It had the most modern cities, the most elegant airports, the tallest buildings, the most amazing highway network, and, most importantly, the most forward-looking people. I cannot really say that all that was ever true, but it did certainly look like it to me when I arrived in New York—on my way to Boston, to start my graduate studies in physics—from Lima, Peru, almost 50 years ago.

Today, the U.S. has outmoded cities and airports; while many cities, even in poorer countries such as China, have become more modern, with taller buildings, high-speed trains, and elegant subway systems. Even Americans are coming to the realization that the U.S. is decaying, not only in the material sense, but even in the optimism of its people. And it can all be traced to the era of austerity that started in the 1980s and continues to this day.

Economic austerity is a self-sustaining condition that starts with spending cuts by the government, causing a slowdown in economic activity, followed by persistent high unemployment, which causes fiscal deficits, which triggers another bout of austerity. Austerity also aggravates political infighting in Washington, which causes a slowdown in the economy with the consequent government deficit, which prompts more austerity, and so on and so forth.

Our economic experts do not seem to know how we can ever get out of this vicious cycle. It is even worse, because those experts have the wrong views of the economy and try to fix it by applying the wrong remedies. For example, our economists believe that tax cuts for the "producers" are the only way to help the economy out of this rut. In fact, those tax cuts make things worse, because, by allowing the rich to increase their savings, they lower the overall demand in the economy, which results in a lowering of production in the country, thus maintaining the high unemployment that has fallen on our lower classes, and on our youth, since the 1980s, with only brief periods of relief.

Keynes's solution to economic recessions, namely "deficit spending," is not just impractical, it also aggravates the fiscal crisis that usually accompanies those recessions. However, his idea of expanding government spending could have amazing results if it were accompanied by corresponding increases in government revenue. A tax increase on the rich, for the purpose of increasing government spending, would put into circulation money that has been put in storage—into savings and other financial assets—and therefore taken away from the economic activity. Just spending these funds would enable the government to create new sources of employment, which would in turn increase economic demand and reinvigorate the nation's economy. But the main effect of increased government spending would be to fund public investment on, among other things, infrastructure, technological innovation, scientific and medical research, education, energy generation and conservation, environmental preservation, disaster prevention and relief, weather mitigation and possible control, and general exploration of our planet and of space.

Expansion in government spending would create new areas of economic activity, promoting faster and more balanced economic growth. But most importantly, it might restore the forward-looking spirit and the self-confidence that were the hallmark of our nation not long ago.

Boosting Economic Activity

As mentioned in previous chapters, the slowdown in our nation's economic growth is a reflection of a decrease in general economic demand, which occurs at both ends of the income distribution: those at the high end save a larger proportion of their growing income; while those at the lower end go into debt and have less and less money to spend. High taxes on the rich would allow the government to spend the money otherwise destined for savings, thus increasing overall demand.

A more effective way to increase overall demand, with a corresponding increase in economic activity, is to eliminate, gradually—say, within a five year period—the Social Security taxes on both employee and employer: the employee's contribution would be decreased by one fifth every year, while the employer contribution would be paid to the employee, and would decrease by one fifth per year starting a year after the enactment of the corresponding law. For the first five years, employees would have their take-home pay increased by nearly ten percent. By the end of the tax reduction period, every employee would have a 7.5 percent larger paycheck, employers would have no payroll taxes, and products would be from five to ten percent less expensive than before—because of lower production costs. The Social Security Administration would continue to pay retirement benefits as usual, out of the government's general funds.

The idea of compulsory saving for old age may have been considered sound under a gold-standard regime, when the Fed was obliged to limit the creation of new currency to the amount of its gold reserves; it was, however, a totally regressive tax scheme, where the poorer you were the higher the effective tax rate you had to pay. Now that the Fed can create as much currency as the economy requires, and if taxes on the rich can be increased appropriately, there is no good economic reason to continue such compulsive saving; on the contrary, such saving is sapping the economic vitality of our nation. To understand why this is so, we must simply remember the meaning of saving: to

save is to avoid spending today, in order to spend at a later day. Since our spending is what provides the income for the rest of the people, it is clear that not spending—that is, saving—will lower production, thus slowing the pace of economic activity.

The proposed phase-out of SS taxes would boost demand, as well as investment, among the lower income classes; it would also reduce production costs and therefore prices. The boost in demand will have two strong drivers: the increase in the purchasing power of the bulk of the population, and the simultaneous drop in prices. That would revitalize economic activity and bring prosperity to the people that need it the most. As a consequence, many welfare programs, including unemployment benefits, may be allowed to shrink, reducing their overall impact on the national budget.

The prosperity of the lower classes would also benefit the upper income classes; and all that would broaden the taxable income base, thus improving the financial capability of the government.

The Great Projects

From time to time, in the not-too-distant past, the productive potential of the nation has been focused on some extraordinary government undertakings that still represent turning points in our history. Besides the wars in which the U.S. has engaged, many of us can name the Manhattan Project, the Marshall Plan, the building of the Interstate Highway System, and Project Apollo, which sent a man to the Moon. The economic benefits, to the nation, of the last two projects in particular are certainly incalculable; most of us would attribute the decisions to undertake those big projects to the prosperity of the times; but more likely, it was the other way around—the spending on those big projects caused the prosperity.

To understand how a big project can foster prosperity, one has to realize that any additional spending calls for additional production, which in turn requires additional labor—that is, the creation of new jobs—especially when there is unemployment in the nation.

The great projects, beckoning our idle resources, are (in my humble opinion) in no particular order:

- The renewal of our country's infrastructure.

Our bridges and dams are in dire need of repair and upgrade; mass transportation, bus stations, and airports in our main cities, and even the cities themselves need modernizing. Public schools in the poorer cities have been starved of funds for many decades now, contributing to lowering of the quality of education in the nation. Much has been written about the problem, and most of us are aware of it.

- Development of an ultra-high-speed transportation system.

We all know that the U.S. is behind many other countries in the development of high-speed trains. It seems to me that such a technology may not be economically viable, given the relatively low population density, even in the high-density corridors, that prevails in most of our country. Air travel is sufficiently well developed that high-speed trains may never become competitive enough.

An ultra-high-speed train is something else altogether. It can travel at speeds ten times faster than commercial airplanes; thus substantially reducing travel time.

I believe the transportation system of the future is one based on vehicles moving in a vacuum. Anybody who understands a little physics knows that air friction, or air resistance, is the main limitation to increasing the speed of transportation—air resistance increases as the cube of the velocity; that is, a vehicle moving at ten times the speed of another would have to overcome an air resistance 1000 times larger than the second one!

As anybody can see, by just reading the entry for "vac-train" on Wikipedia, the idea of an ultra-high-speed vehicle is not just an old one, but there are many people and institutions currently dedicated to developing and even testing such a concept. The bad news is that China, still a less-developed country—in terms of per capita GDP— and a potential world power contender, is at

the forefront of R&D in vac-train technology; while the U.S. government is still too preoccupied with its limited finances to even think of entering the competition. No one, apparently, has pointed out the strategic value, not to mention the tremendous economic potential, of such rapid transport. In contrast, the national advantage of the Interstate Highway System was never lost on the "greatest generation"—during the era of high taxes on the rich.

- Increased funding for medical research.

There are many diseases without a cure, and even without appropriate treatment—for example, autoimmune diseases, genetic disorders, diabetes, and organ failure; public funding is essential in order to carry out the necessary research and foster effective cures.

The study and treatment of rare diseases may never be profitable enough for private undertaking; public funding seems to be the only realistic way to alleviate the suffering of those affected, regardless of their numbers.

- Increased funding for public education.

As is generally known, funding for public education in the U.S. is dreadfully unequal: prosperous cities and towns can afford a good quality of education for their children, who will therefore grow to become prosperous residents; poorer cities and towns will increase their economic disadvantage as their children grow up without proper education and skills; virtuous cycles for the prosperous cities and vicious ones for the poor cities. Only funding from the federal government could help poor cities and towns to break the vicious cycle.

- Solving global climate change.

Lacking an economic advantage, the development of clean energy sources may never succeed to the point of replacing our current carbon-based system. And political forces oppose the use of our government's power to limit carbon emission. The obvious solution is for the government, in addition to supporting the

development of clean energy sources, to also fund the cost of reducing carbon emission in power plants, through tax incentives, and through fines for those who ignore such opportunities—until carbon emission reach acceptable levels. Currently, the idea of the government paying for the reduction in carbon emission is quite unpopular, because of the precarious financial situation of our government; thus, once the fiscal budget becomes balanced, and the economy resumes the growing trend of the '50s, the renewed efforts to control carbon emission would be beneficial not only to our environment, but also to our economic and general well-being.

On the other hand, the search for renewable energy sources seems to be oblivious to one of the greatest principles of physics, the conservation of energy: "Energy cannot be created nor destroyed, only transformed." Global warming is just a sign that the Earth is receiving more energy from the sun, and from non-renewable conversion, than it can dissipate. Can we not develop appropriate technologies to convert ambient heat into usable energy? Since usable energy must turn back into ambient heat, the latter would be a truly inexhaustible source of energy. And in the process, it may solve the problem of global warming.

There are also many ideas being written about mitigating the excess of global-warming gases in the atmosphere, which would naturally require public funding. These ideas may get more traction once government finances improve substantially.

- The control of the weather.

The idea of controlling the weather has always seemed so far away from the capabilities of mere mortals, that even today it is subject to ridicule. The often-quoted joke that "everybody talks about the weather, but no one does anything about it" is funny only because everybody thinks that there is nothing anyone can do about the weather. But is that really true? We, as a civilization, have certainly affected the weather—granted, in a negative way—even without really trying! Can you imagine how

much bigger the effect could be—and in the right direction—if we really put our collective minds, and money, to it?

One of the most destructive aspects of the weather is fast wind. Fast wind comes in the form of hurricanes, and tornadoes; both are terribly destructive and, so far, unstoppable. But we may have the technology to at least reduce their energy, and therefore their destructive power: it is called the windmill generator. Windmills extract energy from the wind and convert it into electricity, reducing the wind speed in the process. It is therefore a question of scale: the largest wind farms—collections of wind turbines for electricity generation—consist of a few hundred wind turbines. Increasing the number of those turbines, by large factors, could allow their use in taming the winds. Collections of thousands or even tens of thousands of wind turbines may lower the wind speed sufficiently to minimize destruction. For example, a flotilla of tens of thousands of floating wind turbines could reduce the wind speed of a tropical storm in its very early stages, enough to prevent it from becoming a full-fledged destructive hurricane. The electricity generated by the wind turbines could be used either to decrease the use of carbon-powered electric generators inland, or to create countervailing wind currents to make the decrease in wind speed more effective.

Tornadoes could also be tackled in a similar fashion, by lowering wind speeds in places known for the occurrence of tornadoes. Or perhaps different approaches may be required here; but whatever they are, they may involve the erection of structures so large in size or in number, that it was always thought to be beyond human capability.

- The Control of our Environment.

Another approach to controlling the weather, would be to prevent the creation of high-speed winds at an even earlier stage: by finding a means of lowering the water temperature where hurricanes and weather fronts originate. For example, deserts reach higher temperatures than the surrounding areas, and thus create, by convection, wind currents that, on reaching the sea, are

accelerated, becoming tropical storms, and even hurricanes. Seawater, made fresh through large-scale desalinization projects—perhaps using forced-air evaporation— could be used to make deserts bloom, and even to make them habitable. The recovery of the world's deserts may reduce the rate of temperature increase due to climate change. And, it is also possible that those desalinization projects could take out enough seawater to prevent, or at least reduce, the expected sea level rise caused by climate change.

The problem of droughts, and of their opposite, floods, may also be solved by projects of a scale not even dreamed before. The creation of huge water reservoirs, and refilling exhausted underground aquifers, could maintain adequate water reserves in dry areas; digging large and long water canals, laying down enormous water pipelines, and widening and straightening existing rivers, could move water from the wet North and East to the dry South and West; the Rocky Mountains, that mark the continental divide, is not an impenetrable obstacle if the national will exists.

Forest fires can also be controlled—without destroying the forest, naturally. Those fires are a natural mechanism for destruction of diseases and parasitic species, as well as for enriching the soil; but they release substantial amounts of carbon into the atmosphere. The destruction of houses, and sometimes human lives, should perhaps be taken into account as well. In any case, new techniques of fire control should be developed. For example, I am not aware of the use of very large fans to pre-burn parts of the forest near residential areas; or the use of large quantities of dry-ice, with or without water, as fire extinguisher; or …

If the melting of the polar caps becomes a big concern, we can find ways to stabilize, and even reverse the situation by, for example, covering large areas of exposed ice with a reflective film—only during the winter months; snow making technology, used in large scales, could also make a dent on the problem. And perhaps wind control technology, applied to reduce the air

exchange between the poles and the rest of the planet, may help stabilize the polar caps.

All of that takes only human effort and ingenuity; remember, we have, just in the U.S., well over ten million unemployed adults asking for a chance to apply their labor and their talents to some productive activity.

- Space exploration and colonization.

I can think of three reasons to explore space: one urgent, one medium-term, and the third a very long-term reason.

The urgent reason is the undeclared space race started by China.

Almost exactly fifty years ago, the U.S. made the decision to contest the ultimate strategic high ground, represented by space, against the Soviet Union. Many marvelous technological advances resulted from that successful national effort. Now the Chinese are trying to gain, and possibly control, that strategic high ground. And this time it is the U.S. that may not know how to mobilize the vast resources at its disposal, to contest that vital strategic arena.

The medium-term reason is the threat of asteroid collisions. The more we know about asteroids colliding with planets, the more real the threat becomes. A medium-size asteroid, many of which are seen wandering our outer space, is capable of destroying the entire human race, as it did with the dinosaurs many millions of years ago. The exploration and colonization of space will give us, eventually, the technology necessary to protect our planet against asteroid collisions.

And the third, and long-term reason, is the ultimate survival of our species. Earth has been our cradle and our habitat ever since our species emerged out of other life forms; but we know it is vulnerable. There are some catastrophes we could foresee, and almost certainly many others we can not. For example, is global warming unstoppable, and if so, is it a threat to life on Earth? Or, will there be a new ice age? And if so, will our species be able to survive it?

Colonizing the Moon

Space travel will, almost certainly, require colonizing the Moon, not only as a habitat, but also as the natural site for the development of space exploration and colonization technologies; as well as the ultimate space station—the launching pad for more ambitious space colonization projects.

A lunar colony would open up new horizons to our spirit of adventure, to our natural exploratory instincts, and to our wanderlust. I can imagine the lunar colonials creating Earth-like environments inside enormous bubbles; where they would live off familiar and also new crops. They may even be able to fly using their muscle power—taking advantage of the much weaker gravity of the Moon; solar power panels would be much more efficient in the airless lunar environment; and the almost perfect lunar vacuum may enable ultra-fast transportation between colonies. Perhaps, within a generation or two, there may be lunar cities that rival those on Earth, in many aspects that we cannot even imagine today.

The development of space travel will allow our species to spread out to other planets, making space our more secure and permanent habitat.

To Boldly Go …

Perhaps the ultimate motive to conquer space is more about our psychological vitality than our physical survival. Wars, even in the not-so-distant past, were matters of national survival; but now, they have become matters of national and sectarian obsession. Perhaps the end of our species may not come with a bang, but with a whimper, as some humorists predict: we will die, or most likely kill each other, out of sheer boredom; for lack of anything more exciting to do.

Making the conquest of space the great project of humankind could just concentrate the world's attention away from petty quarrels, and onto the greatest adventure of all times. The world-unifying value of such a grandiose enterprise is indeed incalculable.

All We Need Is Labor

Again, in order to tackle such great projects all we need is human effort and talent, of which we have plenty. Money should never be an issue: the Fed can create as much money as needed—not all at once, certainly—and lend it to the government, which would fund the great projects, and tax the people to balance the fiscal budget and to pay back the Fed's loans. The government should think about reining in the fiscal budget only when a true labor scarcity begins to develop.

We also need the wisdom to organize the people, and the courage to undertake those great projects. But we need first and foremost to understand and to control the technology of money and taxes.

References

Annotated References

Not-as-Bad Books

Taxing Ourselves: a Citizen's Guide to the Debate over Taxes (2004), by Joel Slemrod and Jon Bakija.

Slemrod and Bakija are economists publishing under the MIT Press label. After admitting the inherent unfairness of any sales-tax scheme, the authors are left with a "graduated flat tax," which they then undermine by calling it "untested" and still containing some "regressive" changes. They conclude with a rhetorical question followed by their own answer: "Can the income tax be fixed enough to be worthy of saving? The base can certainly be thoroughly cleaned, eliminating substantial complexity and inefficiency. By so doing, the tax rates can be lowered, which reduces the cost of those bugs that remain. And remain they will, because any system based on income contains inherent difficulties that have no simple solution." Their hearts are obviously set on lowering the tax rates, but they cannot find a fair way to accomplish it. All in all, this book is fairly balanced and also thorough in it analysis of the various claims about the effects of lowering or raising the tax rates on the rich.

The FairTax Fantasy (2009), by Hugh Hewitt and Hank Adler.

This is a critique against *The FairTax Book*, by two non-economist writers. They consider the FairTax idea "dangerous"

to any genuine reform of the tax code—which they favor. I hope that any of my readers who is interested in the FairTax idea reads this book as well.

The Benefit and the Burden (2012), by Bruce Bartlett.

Bartlett is an influential writer in economics and finance, who has spent many years in government. The central focus of his book is tax reform; he presents a rather moderate description of the effect of taxes on the economy, the political pressures on each of the two main parties to reform the tax system, and the different reform proposals in existence.

He summarizes the current situation in this way:

> *In practice conservatives have completely dominated the tax reform debate since the 1980s. Consequently virtually all major tax proposals of the past twenty or so years—especially those with the deepest support, the flat tax and the FairTax—have proposed moving in the direction of a consumption-based tax system. […] It may be that there is a consensus around the idea that taxing consumption is preferable to taxing income. What no one has yet figured out is how to get from here to there.* (Ibid, p. 182)

However, his limited economic understanding shows through in his description and preference for a low capital gains tax, and in his nostalgia for the Reagan-era flat-tax achievement.

Bad Books

Income and Wealth (2006), by Alan Reynolds.

A treasure trove of erroneous thoughts, mostly focused on demonstrating that the growth of inequality during the last few decades is either unproven or, if it did actually occur, was the price of prosperity. The author—then a Senior Fellow at the Cato Institute—is also strongly against high tax rates on the rich: “There is more to economic growth than tax policy of course […] Yet lowering the highest tax rates is one thing all ‘economic miracles’ had in common.”

The FairTax Book (2005), by Neal Boortz & John Linder.

This book, which was followed by a few others from the same authors, and which has gained a number of followers who have written their own books describing and expanding on the same issue, was written to promote an actual bill proposal in the U.S. House of Representatives. The idea, called "FairTax," is, as mentioned in my book, the worst possible form of taxation. It has, unsurprisingly, many followers, most of them agreeing with the authors in seeking the elimination of the IRS, and of the income tax—in addition to the SS tax, corporate taxes, the "death tax," self-employment tax, etc.—and replace them with a single sales tax, of about 30% of the sale price. A follow-up book by the same authors is dedicated to arguing that "technically," the proposed tax is only around 22% of the total purchase.

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Appendix

About Economic Principles

The new principles of taxation are based on a new understanding of economics—see my previous books on the subject, especially "The Denver Plan to End Unemployment", 2010. As I have explained elsewhere, and also throughout this book, the current economic understanding is fundamentally flawed; for example:

- The source of wealth in any society, is not just Labor—nor Labor plus Land, as Adam Smith described; In reality, no society can prosper without sound Money and good Government, in addition to an enlightened population. One only needs to examine the current state, and the historical experience, of each of the about 200 different countries in the world, to become convinced of the new truths.
- By the same criteria, the notion that the economy is an autonomous system, guided only by an 'invisible hand', is erroneous; the economy by itself cannot create currency, or good government.
- The idea that the rich, having the wealth of the nation, are the ones who invest and create jobs for the rest of the people, is certainly erroneous. The rich savings were important, during the gold-standard age—when the Fed was not able to increase the monetary flow initiated by bank lending. Today, the Fed can issue as much money as the economy needs, even if the rich were to stop saving. In fact, up to the end of 2013, the Fed

had been issuing about $1 trillion, per year, in new money, just to prevent the economy from sliding back into recession. One trillion dollars is actually an extraordinary amount of currency: it is equal to the entire amount of currency issued by the Fed since its creation in 1913, up to the day before the start of the financial collapse of 2008.

- The idea that government spending is the cause of fiscal deficits is completely erroneous: None of the money spent by government ever disappear: it all goes to the pockets of the people who either work for the government or who produce the goods that the government purchases in order to create the public goods demanded by the people. Therefore, fiscal deficits are really caused by insufficient taxation—or rather, by the resistance of the rich to pay their fair share of taxes.
- The idea that Free Trade benefits the consumer, even if there is a trade deficit, is terribly wrong, for the simple reason that consumers are also producers—alone or together with others within firms; a trade deficit means reduced demand for domestic products, which translates into increased unemployment, which in turn means a lower national income; that can never benefit the consumer.
- The new economic principles are based on the simple premise that an adequate flow of money and enlightened government and population are the foundations of the national prosperity.

New Economic Principles

The new principles of taxation are based, naturally, on relevant economic definitions and principles. These are some of the main ones:

1. The economy, or economic activity, consists of all the purchase/sales that take place in the country.
2. A purchase/sale consists of the exchange of some good (an object or service) for money.
3. In a purchase/sale, the seller receives an income from the buyer, which is equal to the sale price minus the cost to the seller of conducting the sale.

4. The sum of the incomes collected, from all the purchase/sales that take place in the country, is equal to the national income, also known as the GDP.
5. Money is the lifeblood of the economy; the level of economic activity is proportional to the flow of money into the economy.
6. In any purchase/sale operation, the total amount of money in possession of the two parties remains constant. (The principle of conservation of money).
7. There are two types of money: currency or cash, and bank money.
8. The Fed issues currency or cash; commercial banks and other financial institutions issue bank money.
9. Currency is issued by the Fed in exchange for government securities in private hands.
10. Bank money is issued by banks and other financial institutions as loans to private or public borrowers; and it is balanced by money deposited by their customers.
11. Cash in the vaults of the Fed is called "base money"; cash in the vaults of a private bank is called "reserve."
12. Most of the money circulating in the economy is bank money.
13. The flow of money into the economy begins with a financial loan, which is spent, goes from hand to hand, and ends up being deposited in a financial institution.
14. A balance trade is the only way to benefit all trading partners.

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He lives in Denver, CO, with his wife.

About the Back Cover Table

- “Plain Joe” is an ordinary taxpayer;
- “Joe the Plumber” is the small business owner, making about $250,000 per year, who became the bone of contention in the last presidential election.
- The “Now” numbers are the current marginal taxes plus the Social Security Taxes (15% for ‘”Plain Joe”; neither “The Plumber”, nor ”Warren” pay any marginal S.S. Tax)
- The <1% is the tax rate paid by Warren Buffet (in 2010), if his total capital gains were included in his income, as it should.
- The “Now” ‘True’ Jobless rate (>15%) is a conservative estimate that includes the jobless people not officially counted.
- The “New” ‘True’ Jobless rate is an estimate considering the new prosperity to come with the new taxation.