Exchequer

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Let's Give Wall Street a 70 Percent Pay Raise

By Kevin D. Williamson
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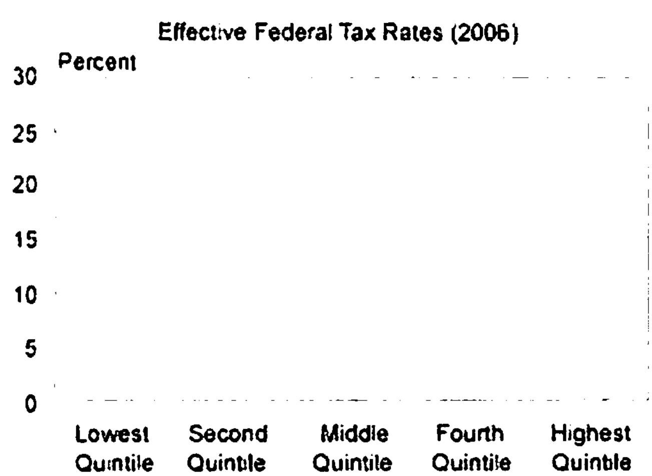
It is time for the myth of Warren Buffett's secretary to die a quick death. If it is true that Mr. Buffett pays a lower effective tax rate than does his $60,000-a-year secretary — and I am not sure that it is — that is anomalous. The average effective tax rate for people making more than $10 million a year is nearly 21 percent; the average effective tax rate for people making $60,000 a year is 8.4 percent. If anything, the people who should be complaining about Buffett's tax rate are those lowly $1 million–$10 million guys, who do pay a higher rate on average: 24.5 percent.

Warren Buffett is of course a poor example. He is the second-wealthiest man in the country, the third-wealthiest man in the world. There is a very large difference between his gross income and his taxable income, largely as a result of the fact that he gives away so much money. As Arthur Laffer points out in the upcoming issue of NATIONAL REVIEW, we could remedy that by taxing gifts from billionaires at 50 percent. But then we'd simply be transferring money from philanthropic purposes to government purposes. I'm not sure I agree with everything the Gates Foundation does, but I suspect that its money is put to better use than it would be if it were channeled into the Department of Education or Medicaid.

Here are the average effective tax rates by quintile:



Does that look like the rich are paying lower rates than the middle class? No, it doesn't, and they're paying those higher rates on much higher incomes, making their total tax burden very large.

Some people are scandalized, or pretend to be scandalized, by the fact that private equity investors, fund managers, and other financial types pay a tax rate of 15 percent — the capital-gains tax — instead of the much higher personal-income tax rate. But it is not as though billionaires get some special break on investment income: Everybody pays the same 15 percent rate on long-term capital gains: you, me, the teacher with a bunch of good stocks in her retirement account, everybody. If you want to argue that we should tax investment income at the same rate as salaries, fine, you can make that case. But you can't make the case, in any honest way, that we ought to tax investment income one way for a politically favored class of people and another way for a politically disfavored class of people.

So what would happen if we taxed, say, carried-interest income at the personal-income rate? What you would very likely see is even higher salaries for finance professionals. Why? Because they can count money, and their after-tax income is more relevant to them than their pre-tax income.

Let's say I'm Joe Wall Street, and I'm a man of simple tastes. I can get by on $850,000 a year. I get my income in the form of carried interest, so I pay the 15 percent capital-gains rate. That means I need $1 million a year to get my $850,000. What happens if you tax my income like it is a salary instead of a capital gain? If I work on Wall Street and live in New York City, then my take-home pay goes down to about $520,000, as Intuit figures it. But even though I am a man of simple tastes, I can't live on $520,000. I'm not moving to Long Island and drinking wine out of a box. I want my $850,000 — and, since I have skills that are in high demand, I can command that price in the marketplace. If you're taxing my income like it is salary, then Evil Fund X has to pay me about $1.7 million a year to produce that $850,000 in income. So my notional salary is up 70 percent to get me back where I was.

And you know what? If you're going to treat that income like salary, I am probably going to want it paid to me *as salary*. Whereas before I had a personal stake in the performance of my company, now I'm just a paycheck-collector — fund's up, fund's down, I get my $1.7 million before taxes. All you have accomplished is to encourage me to demand a 70 percent raise, diminish my incentives, and transfer $700,000 from the private economy — where investments create profit, jobs, etc. — to the government, which will use it for whatever whimsical purposes it dreams up this year. You can get a lot of monkeys high on cocaine for that extra $700k: ten times the coked-up stimulus monkeys. Congratulations.

The middle class is not suffering because there are rich people working in finance. The middle class (and, lest we forget them, the poor) is suffering because there has been long-term stagnation in their real household incomes, in some cases a decline. Higher taxes on financiers will not bring higher salaries to Joe in accounts receivable or Bob in H.R. or Sam on unemployment. To maintain otherwise is flat-Earth thinking.

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