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Don't Tax the Rich, Tax Inequality

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Don’t Tax the Rich. Tax Inequality Itself.

By IAN AYRES and AARON S. EDLIN

THE progressive reformer and eminent jurist Louis D. Brandeis once said, “We may have democracy, or we may have wealth concentrated in the hands of a few, but we cannot have both.” Brandeis lived at a time when enormous disparities between the rich and the poor led to violent labor unrest and ultimately to a reform movement.

Over the last three decades, income inequality has again soared to the sort of levels that alarmed Brandeis. In 1980, the wealthiest 1 percent of Americans made 9.1 percent of our nation’s pre-tax income; by 2006 that share had risen to 18.8 percent — slightly higher than when Brandeis joined the Supreme Court in 1916.

Congress might have countered this increased concentration but, instead, tax changes have exacerbated the trend: in after-tax dollars, our wealthiest 1 percent over this same period went from receiving 7.7 percent to 16.3 percent of our nation’s income.

What we call the Brandeis Ratio — the ratio of the average income of the nation’s richest 1 percent to the median household income — has skyrocketed since Ronald Reagan took office. In 1980 the average 1-percenter made 12.5 times the median income, but in 2006 (the latest year for which data is available) the average income of our richest 1 percent was a whopping 36 times greater than that of the median household.

Brandeis understood that at some point the concentration of economic power could undermine the democratic requisite of dispersed political power. This concern looms large in today’s America, where billionaires are allowed to spend unlimited amounts of money on their own campaigns or expressly advocating the election of others.

We believe that we have reached the Brandeis tipping point. It would be bad for our democracy if 1-percenters started making 40 or 50 times as much as the median American.

Enough is enough. Congress should reform our tax law to put the brakes on further inequality. Specifically, we propose an automatic extra tax on the income of the top 1 percent of earners — a tax that would limit the after-tax incomes of this club to 36 times the median household income.

Importantly, our Brandeis tax does not target excessive income per se; it only caps inequality. Billionaires could double their current income without the tax kicking in — as long as the median income also doubles. The sky is the limit for the rich as long as the "rising tide lifts all boats." Indeed, the tax gives job creators an extra reason to make sure that corporate wealth does in fact trickle down.

Here's how the tax would work. Once a year, the Internal Revenue Service would calculate the Brandeis ratio of the previous year. If the average 1-percenter made more than 36 times the income of the median American household, then the I.R.S. would create a new tax bracket for the highest 1 percent of income and calculate a marginal income tax rate for that bracket sufficient to reduce the after-tax Brandeis ratio to 36.

This new tax, if triggered, would apply only to income in excess of the poorest 1-percenter — currently about $330,000 per year. Our Brandeis tax is conservative in that it doesn't attempt to reverse the gains of the wealthy in the last 30 years. It is not a "claw back" tax. It merely assures that things don't get worse.

A key aspect of our proposal is the tax's automatic nature. Congress need only act once to protect our future. Just as our tax brackets automatically adjust with the inflation rate, Congress could specify nondiscretionary conditions under which the Brandeis tax would automatically go into effect.

Part of our goal is to change the way politicians speak about income equality. Framing the income of the wealthy in relation to the median income will help us all keep in mind the relative success of the middle class. Our grandparents would be shocked to learn that the average income of the 1-percent club has skyrocketed to more than 30 times the median income — just as we will be shocked if 20 years from now 1-percenters make 80 times the median, which is where we will be if inequality continues to grow at the current rate unabated.

The Occupy Wall Street movement is right to decry the increasing power of the 1 percent as a threat to democracy. President Obama is right to characterize the present as a "make-or-break moment" for the middle class. As 1-percenters ourselves, we call on Congress, for the sake of democracy, to end the continued erosion of economic equality in our nation.

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