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For an increasing number, soaking the rich is just the right thing to do

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One motivating factor in my moving to the US was to avoid the consequences of a class-war fuelled, economically damaging, Jeremy Corbyn tax agenda. Well, politics is surprising sometimes. The state of debate in the US this week has left me wondering whether, on that front, I'd have been better sticking around.

Alexandria Ocasio-Cortez, the freshly elected Democrat congresswoman from New York, kicked off the political week by proposing a new income tax rate as high as "60pc to 70pc". Few of us have any prospect of surpassing the $10m (£7.8m) threshold she proposes for when it would kick in. But the response to such a punitive rate, in this supposed land of radical free enterprise, was muted indifference.

Several top economic commentators, including New York Times columnist Paul Krugman, emphasised that such high tax rates were common in the Fifties, when the US grew robustly. He reminded us too that a group of top economists, including Nobel Prize winner Peter Diamond, actively recommend 70pc-plus marginal tax rates on high earners.

Conservative responses, meanwhile, were defensive. Their main retort centred on how high rates wouldn't effectively raise revenue. Few objected in principle to the government taking so much from anyone's additional income. Even fewer worried about how reducing the payoff to entrepreneurship could adversely affect growth prospects. The respectful tone of disagreement made the vitriolic debate we saw here over the 50p tax rate all seem rather alien.

In truth, the argument from Krugman that reintroducing 70pc tax rates in America is not radical entails a major bait-and-switch. Yes, the US did have very high tax rates on top earners in the Fifties and early Sixties… in theory. As Phil Magness at the American Institute for Economic Research has shown, in 1963 official marginal rates exceeded 50pc for those earning $130,000 in today's money, rising to 92pc on top earners. But the effective rates actually paid were substantially lower. A complex system of deductions, loopholes and workarounds (such as use of employment-related benefits) lowered people's actual liabilities.

Yet the result from economists such as Diamond that 70pc-plus marginal rates today are optimal presumes that governments can fully negate such avoidance. Without this assumption, the "optimal" rate is much lower, and far lower than the Fifties. These models are also based on a whole host of questionable economic and philosophical assumptions, including the idea that governments shouldn't care about the welfare of the rich and that the rich will not really respond in their work and savings decisions. Breach one, or both, of these assumptions and the supposed "optimal" tax rate falls substantially further.

The key insight of this literature is actually that, absent eliminating the ability to “tax plan”, progressives could only justify modestly increasing top tax rates to raise revenue. There simply isn’t as much space to jack up rates while squeezing the rich as some imagine. Once you combine state and local taxes, high-earning individuals in states like New York and California already face marginal tax rates of up to 60pc. Go much further, and the rich will find all sorts of means to avoid paying. The real practical policy lesson is that if Left-leaning Americans want a bigger state with more generous social programs, they must suck up broader-based taxes, such as the VAT we see in Europe.

But the American Left’s willingness to ignore this and instead repeat contradictory arguments favouring higher top tax rates suggests motivated reasoning. For an increasing number, soaking the rich is just the right thing to do, economics be damned. Such class war seeps into the mainstream Democrat platform through new young radicals such as Ocasio-Cortez. Republicans, of course, are traditionally a check on such world views. If they are elected to do anything, so it is said, it’s to cut taxes. And some of that tradition came to play this week. But there are signs that for an increasingly populist, Trumpified Republican party, resisting high marginal tax rates on top earners is no longer a front-line priority.

For all the talk of the 2017 Republican tax cuts being a “giveaway to the rich”, the top marginal tax rate for income only fell from 39.6pc to 37pc. True, there were new large allowances for owners of non-corporate businesses. But Republican politicians have been slowly losing interest in cutting top rates on those who obtain income from their labour.

As the Tax Foundation’s Kyle Pomerleau has shown, this change can be seen through legislative proposals. In 2014, Republican lawmaker Dave Camp proposed a top federal income tax marginal rate of just 25pc. By the time the then Republican speaker of the House of Representatives, Paul Ryan, outlined his proposals in 2016 it had jumped to 33pc. And when the tax bill was eventually passed it settled at 37pc.

This marks a clear direction of travel. Some on the more populist Right go further, openly embracing the idea of jacking up rates too, and sticking it to the supposed wealthy elites who disdain president Trump.

Hardcore conservative commentator Ann Coulter, author of In Trump We Trust, tweeted last week, “Ocasio-Cortez wants a 70pc-80pc income tax on the rich. I agree! Start with the Koch Bros – and also make it WEALTH tax.” Former top Trump adviser Steve Bannon has never gone that far. But he did propose raising the top federal tax rate to 44pc for those with incomes above $5m back in 2017.

Whether it’s due to the legacy of the crash, the inequality narrative, or the desire to bash opponents financially, US politics is becoming increasingly conducive to punitive top tax rates. On both sides.

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