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Class Warfare: The Mortal Enemy Of Economic Growth And Jobs

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Our economy is lousy, the labor force participation rate is the lowest in 31 years, we've had 43 consecutive months with unemployment over 8 percent, and a record 47 million people are on food stamps, so one might expect President Obama would welcome as much help as he could get. Surely he would want private sector job creators – investors and entrepreneurs – to have the strongest possible incentives for turning around this Obama "recovery" where household incomes are falling faster than they fell in the Bush recession.

But Obama's priority is class warfare. That's why he relentlessly denounces job creators as "millionaires and billionaires." That's why he demands that they be punished with higher tax rates.

Recently New York Senator Charles Schumer, one of Obama's comrades, vowed that there would be no bipartisan budget deal without higher taxes on the rich.

What is it that drives class warriors? "Fairness," of course, is the familiar battle cry, but according to the IRS the top 1 percent of taxpayers pay about 36 percent of federal income taxes. Before the financial meltdown when the rich were richer, the top 1 percent paid over 40 percent. By any standard, that's a lot – especially considering that as we have heard, 47 percent of taxpayers don't pay any income tax.

We need to understand that class warfare is a mortal enemy of economic growth and jobs. At the very least, class warfare means "progressive" taxation — higher tax rates on investors and entrepreneurs, eventually reaching confiscatory levels. In many places, class warfare has gone much farther with suffocating regulations, exchange controls, asset seizures, arbitrary imprisonment and other measures that suppress private property rights and throttle a market economy.

Confiscatory tax rates cannot be justified as revenue-generators, because they don't raise much money. They discourage work, they drive away investors and entrepreneurs to lower-tax jurisdictions, and there aren't enough rich people to keep the government going very long, even if all their assets were expropriated. If assets were expropriated this year, that would be a one-time event, and next year government would have no choice but to plunder the middle class and the poor.

Whatever tax revenue is realized means less money available for private employers to hire people and less money for consumers to buy things. This offsets any possible benefits from government spending — the theoretical "stimulus" effect is zero.

Actually, the economy suffers when money is taxed away from private individuals and spent by government. In part, this is because regardless how smart politicians and bureaucrats might be, they have only a miniscule fraction of the total knowledge in a society. Politicians and bureaucrats tend to have book learning that's related to academic credentials, whereas specific, practical knowledge needed to make an economy work is dispersed among multitudes of ordinary people. This includes knowledge about the best locations for a particular business, individuals most likely to be good employees, changing consumer preferences, the most suitable business models, technologies and so on.

Private individuals not only have such knowledge, they have stronger incentives than politicians or bureaucrats to use the knowledge effectively. It's well-known that people tend not to be as careful with other people's money as they are with their own money.

It's hard to argue, as class warriors do, that the rich have "too much," meaning compared to average pay or some other arbitrary standard. Pay is a matter of supply and demand. Many people can do good yard work, but it's tough to find individuals capable of turning around a troubled computer company — particularly when large amounts of money and large numbers of jobs are at stake.

In any event, employees aren't really paid by bosses. They're paid by consumers who voluntarily buy a company's goods or services among many possible choices available in the marketplace. Newspapers aren't able to pay as many people or pay as much money like they used to, because more consumers are reading news online for free.

Some people earn large amounts of money by taking risks that other people don't want. Commodities speculators assume the risk that prices of various commodities might go up or down. Insurance companies assume the risk that various adverse events might happen. If confiscatory taxation limits the gains needed to offset losses, fewer people will be willing to help others avoid risks.

Is it fair that some people get rich because they're lucky? No, but government didn't earn the money, either, and it's hard to think of any moral justification for seizing it. If government did seize the money, undoubtedly politicians and bureaucrats with the most clout would make sure it was spent to help enhance their power, and why would that be wonderful? When lawfully-acquired private property is secure, people have incentives to make the most of their luck, by investing some of the money which would make more equity capital available, by saving some of the money which would make more lending possible and/or by spending it which would mean more revenue for private businesses.

Quite apart from incentive effects, progressive taxation has contributed to hideous complexity in the tax code. This is because the higher tax rates go, the stronger the incentives various interest groups have to lobby for special treatment, and since politicians always need more campaign contributions, they're eager to oblige lobbyists. The more complex the tax code, the more arbitrary and capricious enforcement is sure to be. With high top rates, progressive taxation promotes an illusion of "fairness," while causing considerable unfairness.

Lindy L. Paull, who served as chief of staff for the Joint Committee on Taxation, reported: "The Internal Revenue Code consists of nearly 1.4 million words and includes 693 separate sections that impact individual taxpayers. The Treasury Department has issued some 20,000 pages of regulations containing over 8 million words. Individual taxpayers who file an annual Form 1040 must deal with its 79 lines, 144 pages of instructions and 11 schedules totaling 443 lines plus instructions to go with them. There are 19 separate worksheets imbedded in the Form 1040 instructions, and the possibility of filing numerous other forms, depending on the circumstances."

Despite these problems with class warfare, Obama has led America along the class warfare road. He has made it clear he'll try to escalate class warfare if he's elected for a second term.

Argentina's progressive president Christina Kirchner has gone farther and shows what we might expect. Several years ago, she seized private pensions supposedly to help cover government budget deficits. Government spending subsequently soared 40 percent! Frightened Argentines fled the country, carrying suitcases stuffed with cash. The government retaliated by organizing teams of dogs trained to sniff vehicles and luggage for the scent of flight capital.

Class warfare tends to intensify, because people don't like to be pushed around. If government threatens their property or their lives, they're likely to push back. Dedicated class warriors could be counted on to assert their power with more force. Class warfare attracts people who like to use force, which is why class warfare is associated with so many thugs.

During the French Revolution, the Jacobin class warrior Maximilien Robespierre believed in “equality of wealth,” and he enforced confiscatory taxes with the guillotine.

Other much-admired class warriors like Lenin, Stalin and Mao were strong believers in executing class enemies.

During the Bolshevik Revolution, Lenin declared class war against wicked capitalists, seizing privately-owned land, banks, wholesale and retail businesses. He triggered a famine in which an estimated 5 million Russians starved to death. Lenin was famously reported to have remarked that “You can’t make an omelet without breaking eggs.”

Lenin’s successor Stalin pursued class war against “kulaks” – supposedly rich peasants who might have had several cows. Kulaks were demonized as “bloodsuckers, vampires and profiteers.” In 1929, Stalin ordered their property seized, and some 7 million people subsequently starved to death.

Mao denounced “capitalist-roaders,” “counter-revolutionaries” and other class enemies. He promoted the “Great Leap Forward” in which as many as 45 million Chinese people were worked, starved or beaten to death between 1958 and 1962.

Where did all this class warfare come from?

According to tax historian E.R.A. Seligman, progressive taxation goes back to Athens during the sixth century B.C.E., but it disappeared in the Roman republic and empire. In some parts of Italy after about 1000 C.E., town populations embraced the idea of taxing people differently, but they persuaded assessors that poor people should pay higher rates than the rich.

The history of taxation abounds with struggles among interest groups, each of which has tried to push tax burdens on somebody else. For example, the Medici family that controlled Renaissance Florence manipulated progressive tax rates to ruin their rivals. As Seligman explained, “Individuals were frequently reduced to beggary, and forced sales of property to pay taxes were a common occurrence.” Ruthless tax collectors provoked much political turmoil during the 1400s.

In 1795, the revolutionary French government (the Directorate) imposed a 100 percent tax on income above modest exemptions. Not surprisingly, people subject to the tax scrambled to transfer assets out of harm’s way, and the tax yielded only about a fifth of what officials had anticipated. Martin-Michel-Charles Gaudin, the French finance minister at the time, observed that the 100 percent tax caused much resentment, but “no real revenue was to be expected.”

The first U.S. income tax was enacted in 1862, during the Civil War, and there were two brackets (three percent of incomes from $600 to $10,000 and five percent for incomes above that). That tax ended in 1871. The Confederacy had a progressive income tax, too.

Progressive taxation didn't become widespread until after 1900. Self-styled "progressives" promoted higher tax rates for the rich. Ironically, though, peacetime progressive tax rates were very low by our standards. High – progressive – tax rates were mainly a consequence of war, notably World War I and World War II. During World War II, FDR issued an executive order that outlawed annual pay exceeding $25,000 (the equivalent of perhaps $200,000 today). High income tax rates persisted into the 1960s, because of the Cold War. Since then, progressives, who claim to love peace, have worked hard to revive high wartime rates. They opposed the Kennedy, Reagan and Bush across-the-board tax cuts of the 1960s, 1980s and 2000s respectively.

Progressive taxation has survived as a dogma that the rich should pay higher tax rates simply because they have more money. Like Obama, Schumer and so many others, today's defenders of class warfare don't feel they need to provide a moral, philosophical or economic justification for it. The case for class warfare boils down to nothing more than envy and resentment.

The last extended discussion about progressive taxation in the United States– on property, personal incomes, corporate incomes and inheritance — was more than a century ago. Farmers were having a hard time, because the number of farms quadrupled between 1850 and 1900, and total cultivated acreage nearly tripled to more than 840 million acres. Soaring food production generated downward pressure on prices for agricultural commodities, and farmers struggled to cut their costs. Farmers resented having to pay higher prices for imported goods, because of high tariffs that were the principal source of federal revenue. The farmers had a point.

Farmers in the South and West wanted an income tax from which they could be exempt, an income tax that would push the tax burden onto the rich who lived in the East. An income tax bill was introduced in nearly every session of Congress during the 1870s and 1880s. "Most of the agitation was by those active in the 'share-the-wealth' and 'soak-the-rich' campaigns," reported historians Roy G. Blakey and Gladys C. Blakey. Those income tax bills were buried by the Republican-controlled House Ways & Means Committee.

More and more people spoke out for a progressive income tax. Felix Adler, who founded the popular Ethical Culture movement, demanded an income tax with rates up to 100 percent. A publication called *The Progressive Taxpayer* urged higher tax rates on the rich to "maintain among men a certain real equality." Joseph Pulitzer, the New York newspaper publisher, beat the drums for special taxes on high incomes, luxuries and inheritances.

The main political opponents of the income tax were Republicans who defended high tariffs, but there were principled opponents without conflicting interests, too. Economist David A. Wells, who had previously supported an income tax, became a critic. He called graduated rates the beginning of “unmasked confiscation.” Tax historian Randolph Paul pointed out that many Democratic newspapers like the *New York Times*, *Brooklyn Eagle* and *Boston Globe* opposed an income tax because it could authorize inquisitorial power to pry into people’s private lives. The higher the rates and the more aggressively an income tax was enforced, the more it would promote evasion and capital flight. The *Milwaukee Journal* warned about “a tax of tyrants.” Such critics had a point.

Paradoxically, in 1894, an income tax bill was passed as an amendment to the Wilson-Gorman tariff bill. President Grover Cleveland, a low-tax, free trade Democrat, didn’t want an income tax or high tariffs. He refused to sign the final bill, but Congress had enough votes to make it law. The income tax provision was subsequently overturned by the Supreme Court.

As it turned out, most of the arguments offered on behalf of progressive taxation were satisfied by proportional taxation where everybody pays the same rates – in modern lingo, a flat tax. The same rate applied to a higher income yields more tax revenue.

The traditional justification for proportional rates is the idea that people should pay for the most fundamental benefit of government – namely, national defense. The more property people own, the greater their presumed benefit, and the more they should pay. To be sure, governments often start wars and imperil their citizens. Many governments also become tyrannical and seize their citizens’ property or worse. There’s no precise formula in the taxing business.

Ultimately, the progressive income tax became law, in 1913, because about 98 percent of the people were exempted, and perhaps they anticipated sharing some of the loot. It’s not hard to see why that was a formula for legislative success.

But Milton Friedman warned people to “always look a gift horse in the mouth.” The presumed “fairness” of our progressive income tax was illusory, even after President Franklin Delano Roosevelt hiked income tax rates during the Great Depression. FDR’s New Deal programs, intended to help the middle class and the poor, were funded mainly by the middle class and the poor, because the biggest source of federal revenue during the 1930s was the federal excise tax. It applied to beer, cigarettes, soda, chewing gum and other cheap pleasures enjoyed disproportionately by the middle class and the poor. Under FDR, depression era excise taxes more than doubled. Until 1936, the federal excise tax generated more revenue than the federal personal income tax and the federal corporate income tax combined.

During World War II, the federal income tax became a people's tax. Millions of previously-exempt citizens had to pay it. In 1942, for instance, the IRS received some 28 million tax returns – 1,300 percent more than a decade earlier.

While progressive taxation can make the rich poorer, it makes the poor poorer, too. If the aim is to foster economic growth and jobs, then one needs to forget about class warfare.

Economists in the French Enlightenment (like Jacques Turgot) and the Scottish Enlightenment (like Adam Smith) recognized that essential human institutions such as language, culture, legal customs, mutual aid societies and markets develop spontaneously when governments get out of the way. In *The Wealth of Nations*, for instance, Smith, who supported proportional taxation, observed that "Little else is requisite to carry a state to the highest degree of opulence from the lowest barbarism but peace, easy taxes, and a tolerable administration of justice."

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