

## *Original Paper*

# A Framework for Income, Inheritance, and Wealth Tax in America amid Increasing Income Inequality when the Richest are Leaving even the Rich Far Behind

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### ***Abstract***

*Income inequality in America has run a full circle, and has now touched or even exceeded the dizzying heights of income recorded in 1928 before the Great Depression of 1929.*

*On the other hand, the middle class has been undergoing a relentless economic squeeze since 1974. The median family income has literally been stagnant for almost half a century.*

*Stagnant incomes do not fully reflect the decline in the standard of living of most Americans. Facing job insecurity, rising health-care costs, the massive \$1.75 trillion college loan debt, credit has become a palliative of the middle class to address the deeper anxieties of downward mobility.*

*Many are unable to fulfill the “American Dream” because they cannot afford the middle class standard of living: having a good job, being able to retire in security, owning a home, having affordable health care, and a better future for their children.*

*This inequality is now so vast that it is almost twice as high as in Europe.*

*In 2017, an American CEO’s pay went up 361-times the median pay of a worker—by far the widest gap in the world.*

*Because of an incestuous relationship between Washington and Wall Street, we have a tax code that has been hatched to reward wealthy individuals and corporations.*

*Some of the world’s richest men paid just a tiny fraction of their income in federal tax in 2021.*

*For the first time Trump’s tax cuts helped billionaires pay less than the working class.*

*Many large U.S.-based multinational corporations employ accounting tricks to make profits made in America appear as if they were generated in offshore tax havens—with minimal or no taxes. Thus by using such a clever maneuver, multinationals are able to avoid paying an estimated \$90 billion in federal income taxes each year.*

*Encouraged by the Friedman doctrine, the 1970s represented a turning point when America took a sharp*

*turn toward unfettered capitalism—and greed. American CEOs set themselves upon a journey toward maximizing shareholder value. And it is this radical ideology that has guided American business over the last fifty years.*

*This is a mind-set that encourages risk aversion and short-run behavior: an accountant's short-cut to profits, with a focus on cost reduction, rather than long-term concerns about innovation, quality, and customer satisfaction.*

*And it is this journey that has contributed so much to America's industrial decline.*

*A key development that has accelerated this decline is the financialization of America. In recent decades, the share of financial services has been about 7-8% of GDP. However, in sharp contrast, the sector accounts for 25-30% of all corporate profits. Yet, the sector has created only 4% of all jobs.*

*In 1999 and 2000 America went through a massive deregulation of the financial markets, which proved to be disastrous, because it led--in 2008--to the worst stock-market crash in America since the Great Depression of 1929.*

*Finance and its way of thinking have now come to permeate every facet of business, so much so that Wall Street is no longer supporting Main Street businesses that create jobs for the masses.*

*As a result of this "cognitive capture," while the policy decisions taken after 2008 crash resulted in huge gains for the financial industry, but losses for homeowners, small businesses, workers, and consumers. One of most depressing aftermaths of this crisis was that it wiped out \$16 trillion in household wealth.*

*The wealthy have compounded their wealth by stifling true, dynamic capitalism and making America no longer the land of opportunity that it once was. They have made America the most unequal, advanced industrial country while crippling growth, distorting key policy debates, and fomenting a divided society.*

*The objective of this paper is to develop a federal-tax framework. Taxation is as much a political as an economic issue. There are two visions or schools of federal taxation. While one is grounded in lower taxes for the wealthy and the corporations; the other's calling card is community: and shared prosperity.*

*These two schools can be described as: (1) The School for the "Rich and the Privileged," and (2) The School for the "Masses."*

*The former consists of three groups: (a) "Trickle-down" Economics; (b) "Supply-side Economics;" and (c) "Meritocracy" or the "Job Creators."*

*The latter has just one group: "Progressive Taxation."*

*We believe that a good way to judge the merits of the two schools of thought is to see their historic track record. So we looked at the economic history of America over the entire twentieth century.*

*Economist John Kenneth Galbraith has called the "trickle-down" economics as the "horse-and-sparrow" theory. David Bradley argues, that another name for this theory should be "horse shit" economics.*

*The “trickle-down” idea has a long pedigree, and has long been discredited. This is because higher inequality has not only not produced more growth, but, the median family income in America has been stagnant for almost a half century.*

*The idea of “supply-side” economics was proposed under Ronald Reagan. This was based on the notion that emphasized deregulation and tax cuts: with the argument that this would free up the economy that would then lead to increase in the supply of goods and services—as well as incomes of individuals.*

*This policy was in direct contradiction to Keynesian economic theory, according to which, aggregate demand--not supply--is the driving force in an economy.*

*However, the idea did not work for Reagan. Neither did it work for Gorge W. Bush.*

*Supporters of meritocracy try to peddle the myths that we are living in a meritocracy, in which great wealth is both earned and deserved. But what if the rich derive much of their income not from work they perform, but from the assets they own? Moreover, what if great wealth increasingly comes not from enterprise, but from inheritance?*

*Presidential candidate Mitt Romney--and President, Bain Capital, a private equity firm--argued that 47 percent of Americans were paying no income tax. He said they were freeloaders because they were living off of government handouts.*

*Ironically, Romney paid only 14% of his reported income as federal income tax in 2011: which is far less than what people with substantially less income paid. Second, the source of his income was Bain Capital. The private equity firms, like Bain Capital, are associated with offshore bank accounts and big corporate buyouts. In these buyouts, previously healthy firms are loaded up with debt, stripped of their assets, with mass layoffs, and after milking the firm's assets are sold to the highest bidder.*

*So, the reality is that it is people like Romney who are the real freeloaders.*

*An important distinction we need to make is to recognize the difference between “Takers”: those stifling job creation, versus “Makers:” businesses that create real jobs.*

*Finally, our analysis revealed that the “Rich and Priviledged” school consistently offered false promises that failed to materialize, but instead, produced big deficits.*

*The birthplace of freedom—and progressive taxation--happens to be President FDR's America.*

*The years 1947-1973 are considered the golden years of America's middle class. The foundation of this goldilocks economy was the social covenant of shared prosperity, based on President Kennedy's dictum--that “a rising tide lifts all boats.” Its main features were: powerful unions, a high minimum wage, progressive taxation, and corporations providing health and retirement benefits.*

### **Keywords**

*Progressive taxation, “trickle-down” economics, “supply-side” economics, the “job-creators,” meritocracy, “the makers”, “the takers.”*

## 1. Introduction

The objective of this paper is to develop a *framework* for federal income, inheritance, and wealth tax.

Federal taxation can be classified in *two* broad categories: (1) The school for the “*Rich* and the *Privileged*,” and (2) The school for the “*Masses*.” The former consists of three groups: “Trickle-down” Economics; the “Supply-side Economics;” and “Meritocracy” or the “Job Creators.”

The latter has just one group: Progressive Taxation.

We believe that a good way to judge the merits of the two schools of thought is to see their *historic* track record. So we are going to look at the economic *history* of America over the entire *twentieth* century.

We have divided the paper in *ten* major parts:

- Part I: A History of the American Economy—1900-1970s
- Part II: A History of the American Economy—1970s-2018
- Part III. The Financialization of America
- Part IV. Wall Street Culture of Excessive Gambling and Speculation
- Part V. America the Most Unequal, Advanced Industrial Society
- Part VI. Government an Integral Part of a Civilized Society
- Part VII: A Framework of Federal Income, Inheritance, and Wealth Tax
- Part VIII. The School for the “Rich and the Privileged”
- Part IX. The School for the “Masses”
- Part X. How Should America Address Massive Inequality?

We have provided an *outline* of the paper’s topics below:

### **Part I: A History of the American Economy--1900-1970s**

2. Henry Ford and the Birth of the American Middle Class
3. The Stock Market Crash of 1907
4. The Great Depression of 1929
5. Franklin D. Roosevelt and the New Deal: 1933-1945.
6. The Golden Years of American Middle Class: 1947-1973

### **Part II: A History of the American Economy—1970s-2018**

7. America in Economic Decline: 1980-2018
8. Outsourcing: Ceding the Industrial Commons to the Competition
9. General Electric’s (GE) Proud Heritage of Innovation
10. “Neutron” Jack and the Financialization of GE
11. Taxpayers Bailout GE After Stock Market Crash of 2008

### **Part III. The Financialization of America**

12. Finance Becomes a Dominant Force in America
13. Massive Deregulation of Financial Markets Leads to Stock Market Crash of 2008

**Part IV. Wall Street Culture of Excessive Gambling and Speculation**

14. Wall Street Resorts to Gambling by Pushing Virtual CDOs Not Backed by Real Securities
15. Credit Default Swaps Derivatives: Financial Weapons of Mass Destruction
16. Most Banks (Note 1) Used Short-term Borrowing or Put No Money Behind What they Insured
17. Wall Street's Use of Deceptive Practices
18. Excessive Compensation Encourages "Go-for-Broke" with "Other People's Money"

**Part V. America the Most Unequal, Advanced Industrial Society**

19. Increasing Income Inequality in America: The Richest are Leaving even the Rich Far Behind

**Part VI. Government an Integral Part of a Civilized Society**

20. Negative Attitudes toward Government: Glorification of Self Interest and Greed
21. Business Cannot Thrive without Active Governmental Support

**Part VII: A Framework of Federal Income, Inheritance, and Wealth Tax**

22. A Federal Tax System Should be Fair and Reflect a Society's Values
23. Two Major Schools of Federal Income Tax
  - The School for the "Rich and the Privileged"
  - The School for the "*Masses*"

**Part VIII. The School for the "Rich and the Privileged"**

24. The "Trickle-down" Economics
25. The "Supply-side" Economics
26. Trump Tax Cuts: Billionaires Pay less than Working Class for the First Time
27. "The Job Creators"
28. Focus of Big Business: Make Money for Shareholders and CEOs--Not Job-Creation
29. Meritocracy: "The Makers"

**Part IX. The School for the "Masses"**

30. A Short History of Progressive Taxation in America
31. A System of Progressive Income Tax
32. Tax on Capital Gains vs. Wages and Salaries
33. A System of Progressive Inheritance Tax
34. Supreme Court's Citizen United Ruling: A U.S. Corporation is Legally a Person

**Part X. How Should America Address Massive Income Inequality?**

35. A Global Wealth Tax
36. Raise Capital Gains Tax and Close Tax Loopholes
37. Impose a Windfall Profits Tax

## Part I. A History of the American Economy 1900-1970s

### 2. Henry Ford and the Birth of the American Middle Class

In 1908 Henry Ford launched the first *Model T* automobile. However, a change of monumental proportions occurred when he introduced the world's *first moving* assembly line in 1914: a move that cut the Model T's assembly time from 12 hours to *just* 93 minutes (Cwiek, 2014; Datta, 2022a).

However, there was a *downside* to this positive development. The new assembly line required *unskilled* workers who would perform the same *repetitive*, specialized tasks *all* day long, day in and day out. At that time, there was chronic *absenteeism* and *high* worker turnover. Thus, Ford gambled that *higher* wages would attract better, more reliable workers. So, he made an *extraordinary* offer to workers: \$5 a day for eight hours of work, which works out to \$120 in 2014 dollars. That was more than *double* the average factory wage at that time (Cwiek, 2014; Datta, 2022a).

As it turned out, Ford's gamble was a total *success*. It led to a sharp *increase* in productivity at Ford, and the Ford Motor Co. *doubled* its profits in less than two years (*ibid*).

For American workers that was a *defining* moment of the 20<sup>th</sup> century (*ibid*).

One factor Henry Ford considered in his decision to *double* the wages of his factory workers, was that they could then *afford* to buy the cars they made. This decision was a "game changer" because it greatly *expanded* the auto market (*ibid*).

And that is how the American *middle class* was *born* (*ibid*).

### 3. The Stock Market Crash of 2007

During the early part of the 20<sup>th</sup> century in America, people lined up at betting parlors, called "bucket shops," to place *bets* on whether the price of stocks would go up or down *without* actually owning the stock. It was this *unregulated* speculation that led to the stock market crash of 1907. So, states all over the country *outlawed* this gambling activity which became a *felony* after the law became effective (Datta, 2010).

### 4. The Great Depression of 1929

Throughout the 1920s, the U.S. economy expanded rapidly. The New York Stock Exchange was the center of reckless *speculation*, where everyone—from millionaires to cooks and janitors—poured their savings into *stocks* which then led to a *rapid* expansion of the stock market reaching its *peak* in August 1929. The result was the Great Depression of 1929 that was the *worst* economic downturn in the history of the industrialized world, lasting from 1929 to 1939 (Datta, 2022a).

President Herbert Hoover, a Republican, believed that it was *not* the business of the government to directly intervene in the economy, and that it was *not* the responsibility of the government to create jobs or provide economic relief for the public (*ibid*).

## 5. Franklin D. Roosevelt and the New Deal 1933-1945

By the time Democrat Franklin D. Roosevelt (FDR) was inaugurated on March 4, 1933, the banking system had *collapsed*, and the *unemployment* rate was about 25%. In some cities *unemployment* had reached astounding levels. By 1933, Toledo, Ohio's rate climbed up to 80%, and in Lowell, Massachusetts as high as 90% (Datta, 2022a).

At the very outset, FDR reassured the American public with this message of *hope*:

- “Let me assert my firm belief that the only thing we have to fear is *fear* itself” (*ibid*).

Based on *Keynesian* economics, FDR instituted the New Deal which was a series of programs and projects that were implemented during the *Great Depression* (*ibid*).

The following are FDR's major accomplishments (*ibid*):

- He signed the Tennessee Valley Authority (TVA) Act into law that enabled the central government to build *dams* along the Tennessee River that controlled flooding and generated low-cost *hydroelectric* power.
- Under his leadership, Congress passed a law that *paid* commodity farmers (e.g., wheat, corn, etc.) to leave their fields *fallow*, in order to end agricultural *surpluses* and to *raise* commodity prices.
- The *Glass Steagall Act* was passed in 1933, which was designed to *separate* commercial banking from investment banking, to protect bank depositors from the *dangers* of banks indulging in *risky* investments and *speculation*.

*Ironically*, in 1999 President Clinton signed into law the *Financial Services Modernization Act* which *repealed* the *Glass-Steagall Act* (GSA) of 1933.

- In 1935 FDR created the Works Progress Administration (WPA) to provide *jobs* for unemployed people.
- In 1935 FDR signed into law the *National Labor Relations Act*, also known as the Wagner Act, to *monitor* union elections and *prevent* management from treating their workers unfairly.
- Next FDR signed the *Social Security Act* of 1935, which guaranteed *pensions* to millions of Americans.
- He also set up a system of *unemployment insurance*, and stipulated that the government will help dependent *children* and the *disabled*.

One of the most important legislations that FDR signed into law in 1944 was the G.I. Bill aimed at the returning WWII soldiers (*veterans*). It offered the following benefits for them:

- Those who wanted to continue their college or vocational education, could do so tuition-*free* up to \$500, and also be eligible for a *cost-of-living* stipend.
- The GI Bill *opened* the door of higher education to the American working class as *never* before. In 1947, veterans accounted for 49% of the college admissions.
- The bill provided \$20 weekly *unemployment* benefit for veterans up to one year.

- The U.S. government *guaranteed* loans for veterans that enabled them to buy a home, business, or farm.
- *Medical care* for veterans was also an important part of the GI Bill. The government opened *new* hospitals for *veterans* and created the Department of Veteran Administration to manage them.
- By 1956 about *10 million* veterans had received benefits from the GI Bill.

## 6. The Golden Years of America's Middle Class: 1947-1973

The years 1947-1973 are considered the golden years of America's middle class: a golden age the U.S. will perhaps *never* experience again (Gold 2017; Datta: 2022a, 2022b).

There are *three* major factors that made this *goldilocks* scenario possible (*ibid*):

- An *expanding* market for *basic durable* goods: both in the U.S., as well as Europe and Japan, because their economies had been *devastated* during the war.
- A tight *oligopolistic* structure made it possible for the leading American companies to practice *cost-plus* pricing.
- Legislation under FDR provided big labor a “countervailing power” to big business.

By the end of World War II, there was a lot of *pent-up* demand for basic *durable* goods. This was further bolstered by the needs of Europe and Japan (Levy, 1988; Datta, 2022a).

For *eighteen* years from 1929 to 1946, America had gone through a period during which material aspirations had been put on the *shelf*. During the Great Depression there was *no* income. During the war there was income but *no* consumer goods (*ibid*).

If progress can be defined by material goods, then the fifties and sixties were the *golden* decades in American history. Within the space of a *single* generation, 1947 to 1973, the real U.S. Gross Domestic Product (GDP) more than doubled at 130% (Datta, 2022a).

*Median* family income went up a *whopping* 83% during the same period. The foundation of this *goldilocks* economy was the social *covenant* of *shared* prosperity and growth between *big* business and *big* labor which fed the American belief--in the words of President Kennedy--that “a rising tide lifts *all* boats” (*ibid*).

One of the most *remarkable* features of the post WWII period was that even *ordinary* Americans became members of the *middle class* (*ibid*).

As indicated before, the *most* important piece of *labor* legislation in U.S. history was passed in 1935 under FDR: the National Labor Relations Act. During the post-war period, this legislation provided big labor a “countervailing power” to big business, with government acting as a *referee* (Datta: 2011, 2022a). In 1950 United Auto Workers Union (UAW) signed a long-term contract with General Motors (GM)--which Ford and Chrysler also later agreed to. This agreement was called the *Treaty of Detroit* and was negotiated under the leadership of President Truman, a Democrat. It was based on a framework of *shared prosperity* (Datta: 2011, 2022a).

Its main features were: *powerful* unions, a *high* minimum wage, *progressive* taxation, and *corporations*



providing health and retirement benefits (*ibid*).

This contract shaped labor-management relations for *decades* and became a *model* for many industries (*ibid*).

Unfortunately for the middle class, the goldilocks economy came to an *abrupt* end.

## Part II: A History of the American Economy—1970s-2018

### 7. America in Economic Decline: 1980-2018

In an article published in *The New York Times Magazine* in 1970, Nobel laureate Milton Friedman declared that the *social* responsibility of a business is “to increase its *profits*” and “to make as much money as possible” (Datta: 2021, 2022a, 2022b).

He forcefully alleged that “social responsibility” is a “fundamentally *subversive* doctrine. He said, in a *free-enterprise* system, its advocates are “preaching pure and unadulterated *socialism*” (*ibid*).

The 1970s represented a *turning* point when America took a sharp turn toward *unfettered* capitalism—and *greed*.

And it is this *radical* ideology that has guided mainstream economists and business leaders over the last *fifty* years (*ibid*).

Encouraged by the *Friedman* doctrine, American CEOs set themselves on a journey toward *profit* maximization—or its counterpart: maximizing *shareholder* value. This new mind-set encouraged *risk aversion* and *short-run* behavior: an accountant’s *short-cut* to profits: with a focus on *cost reduction*, rather than *long-term* concerns about innovation, quality, and customer satisfaction (Hayes & Abernathy:2007, 1980; Datta: 2021, 2022a, 2022b).

The captains of industry used Friedman’s academic credentials and reputation as a *license* to *ruthlessly* pursue, among other things, *massive* layoffs, *union-busting*, *outsourcing*, and a drastic *decline* in research and development outlays (*ibid*).

And it was this *momentous* philosophical shift—from substance to *shadow*—that has contributed so much to the American industrial *decline* (*ibid*).

*Lower* quality and *lack* of innovation played a key role in the virtual *disappearance* of U.S. companies from the consumer electronics industry, and their *loss* of world dominance in such markets as automobiles, steel and tires (*ibid*).

Downsizing in the *past* was considered to be a symbol of *decline*, and therefore had a *negative* connotation. It used to be a mark of *shame* to fire workers on a mass scale. However, since the early 1990s the balance has swung radically *toward* the shareholders. Today, a CEO would be embarrassed to admit that he sacrificed profits to protect employees or a community. Wall Street loves it because such actions often result in boosting—usually for a *short* period—the price of a company’s stock (Datta, 2022a).

There are two example that deserve *special* mention: IBM and General Electric.

### 7.1 The Case of IBM

Even healthy companies, like IBM and General Electric, began laying off workers. For example, IBM *abandoned* its proud heritage of a promise of permanent employment. Beginning in 1990, it *fired* 41% of its labor force in *five* years (Datta, 2022a).

We will cover GE in Section 10.

Economic *inequality* in America has been going up persistently since 1974, squeezing the middle class. The *median* family income has literally been *stagnant* for almost *half* a century (*ibid*).

America's income inequality has now *widened* so much that it rivals the *highest* level recorded in 1928 that led to the Great Depression of 1929 (Datta: 2010, 2011, 2021, 2022b).

A massive *deregulation* of financial markets—an act that *legalized* activity that was either *illegal* for most of the last century, or was *prohibited*—led to a *meltdown* of the American stock market in 2008: the *worst* financial disaster since the Great Depression of 1929 (*ibid*).

## 8. Outsourcing: Ceding the Industrial Commons to the Competition

Pisano and Shih (2009) argue that America's economic decline of the 1980s and early 1990s *didn't* really disappear. It was just *hidden* during the *bubble* years behind a *mirage* of prosperity, and all the while the country's industrial base continued to *erode* (Datta: 2021, 2022a, 2022b).

Thanks, in a large measure to the Friedman doctrine, for decades, U.S. companies have been *outsourcing* manufacturing to *save* costs on the belief that manufacturing *at home* held *no* competitive advantage. But that has been a *disaster*, because *today's* low-value manufacturing operations contain the *seeds* of *tomorrow's* innovative new products. What those companies have been *ceding* is the country's *industrial commons*--that is, the *collective* operational capabilities that support *new* product and process development in the U.S. industrial sector. Consequently, America has *lost* not only the ability to develop and manufacture *high-tech* products--like televisions, memory chips, and laptops--but also the *expertise* to produce *emerging* hot products like the *Kindle e-reader*, *high-end servers*, *solar panels*, and the *batteries* that will power the next generation of automobiles (*ibid*).

Prof. Shih, a professor at Harvard Business School, and coauthor of the above article, points out that “when you *give up* making products, you *lose* a lot of added value.” In other words, “what you *make* *makes* you, economically anyway” (Foroohar, 2017, pp. 175-176, *italics* added).

## 9. General Electric's (GE) Proud Heritage of Innovation

In 1889, Thomas Edison founded what would become one of the most “*storied* conglomerates” in the United States. The company was called Edison General Electric: a “company that *mirrored* the growth of *industrial* America from the steam age to the age of electricity and beyond” (Owles, 2017, *italics* added).

Over its long life, GE had a *plethora* of innovations to its credit: incandescent electric lamp, 1879; giant electric locomotive, 1893; X-Ray machine, 1896; first voice radio broadcast, 1906; electric home

appliances, 1910; vacuum tubes, 1912; first home test of television, 1927; moldable plastics and silicone compounds, 1930s and '40s; commercial jet engines, 1941; nuclear power, 1957; laser lights, 1962; and medical devices, 1976 (Owles, 2017).

Before 1981, the large portion of GE's revenue came from jet turbines, nuclear power reactors, mining equipment, complex materials, and electronics (Foroohar, 2017, p. 153).

Following Berle and Means' (1968) case for the *stakeholder* theory of the corporation in 1932, Ralph Cordiner, then CEO of General Electric (GE), too, made a call for a *similar* philosophy. He said that the top management of a large publicly-held corporation was a *trustee* of the enterprise whose responsibility was to manage the corporation in the *best-balanced* interest of shareholders, customers, employees, suppliers, and plant community cities (Datta, 2021).

Cordiner's slogan soon became quite *popular*, and many American corporations incorporated it in their "corporate philosophy" statements (*ibid*).

For decades after World War II, big businesses, like GE, *bent over* backward to distribute their profits *widely*. In its 1953 annual report, GE proudly *bragged* about how much it was paying its *workers*, how its *suppliers* were benefiting, and even how much it paid the government in *taxes* (Leonhardt, 2022; Datta, 2022 a; Foroohar, 2017, p. 164).

However, that state of affairs changed *dramatically* when Jack Welch joined GE as CEO in 1981, and ran it for the next *two* decades, as we have shown in the next section (*ibid*).

## 10. "Neutron" Jack and the Financialization of GE

In the years leading up to the financial market crash of 2008, GE had become one of the *largest* financial services companies. It was America's largest *nonbank* financial company: an enterprise that was "Too Big to Fail." Yet, it was *not* subject to the regulation required for real banks like those on the Wall Street (Foroohar, 2017, p. 152).

### 10.1 Jack Welch's Business Philosophy

In his autobiography, Welch wrote that compared to the *industrial* operations he knew so well, *financial* operations—such as lending and credit—seemed an *easy* way to make money. "You *didn't* have to invest heavily in R&D, build factories, and bend metal day after day" (Foroohar, 2017, pp. 163-164).

As mentioned earlier, the publication of the Friedman doctrine in 1970 represented a *turning* point when America took a sharp turn toward *unfettered* capitalism—and *greed*.

One person who enthusiastically *embraced* this doctrine was Jack Welch (Leonhardt, 2022; Datta, 2022a; Foroohar, 2017, p. 164).

Welch bought wholesale into Friedman's Chicago-School thinking about creating *shareholder value*. Soon after he became GE's CEO, he *promised* to deliver an unbelievable 15% earnings growth every year. He fulfilled that promise several ways:

- By *cutting* tens of thousands of jobs, *cutting down* R&D expenses into *half* (as a percentage of sales); *sold off* GE's famous *small appliances* division, that made televisions, toasters,

microwaves, etc.; imposed a single *edict* for top management to be *first* or *second* in your product-market; and raise your profits every *quarter* (Foroohar, 2017, p. 164).

Welch encouraged *relentless* and *brutal* competition *within* GE, with a philosophy that rewarded those who took *big* risks with *big payoffs*. It is this philosophy that built “hidden *debt bombs* that went off so famously during the *subprime-mortgage crisis*” in 2008 (Foroohar, 2017, p. 170, *italics added*).

He was also responsible for *terminating* GE’s tradition of lifetime employment. *Instead*, he created what may be called a “gig economy,” in which every employee became, in reality, a “temp” (*ibid*).

#### 10.2 Jack Welch’s Record at GE

David Gelles (2022), a *New York Times* reporter, has been interviewing CEOs for years. In his book on Jack Welch he says that Welch became a *role* model for many CEOs, who began *imitating* him (Leonhardt, 2022; Datta, 2022a).

Welch was *ferociously* ambitious and competitive, with a *ruthlessness* that corporate America hadn’t seen before. A *Fortune* magazine ran story from 1997 *extolled* the *brutal* environment that Welch had created, especially at GE Capital. “The culture at (GE) Capital isn’t just entrepreneurial, it’s *aggressively* so” (Foroohar, 2017, p. 169, *italics added*).

So, not surprisingly--because of this *toxic* culture--many top engineers *left* GE. It got so bad that one manager had to check himself into a *mental* hospital, after a *brutal* encounter with Jack Welch (Foroohar, 2017, pp. 169-170).

And with this *aggressive* mindset, this is what he did for the next *twenty* years (*ibid*):

- Under Welch, GE unleashed a wave of *mass* layoffs and factory *closures* that other companies *imitated*. Under his rule, *one* out of ten employees were routinely *fired* every year *no* matter what. During the first five years, he fired 112,000 employees to cut costs in order to boost GE’s stock price. And this action earned him the infamous nickname “*Neutron*” Jack after the *bomb* that destroys *people*, but leaves buildings intact (Foroohar, 2017, p. 154; Leonhardt, 2022; Datta, 2022a).
- Profits began flowing *not* back to workers in the form of higher wages, but to *big investors* in the form of stock buybacks (Leonhardt, 2022; Datta, 2022a).
- GE began doing everything it could to pay as *little* in taxes as possible (Leonhardt, 2022; Datta, 2022a).
- Another step he took to *reduce* costs was to *cut back* drastically on research and development, as mentioned above (Andersen 2020, p. 150; Leonhardt, 2022; Datta, 2022a).
- During his tenure, the company bought and sold hundreds of businesses to boost its stock price (Foroohar, 2017, p. 153).
- Moreover, the company traded its *divisions* the same way a *portfolio* manager trades *stock* (*ibid*).
- *Debt* financing, pioneered by former Citibank CEO, Walter Wriston, became the *core* of its operations (*ibid*).

- While the businesses that focused on consumer *credit* and lending *doubled*, manufacturing *stagnated* (*ibid*).
- GE Capital became the *largest* issuer of commercial paper—*short-term* IOUs—in the *world*: a sum so gigantic that in 2008 it needed \$88 Billion to conduct its normal operations (*ibid*).
- GE eventually began to act like a *bank*, borrowing money to conduct *daily* operations (Foroohar, 2017, p. 154).
- To keep his promise of 15% annual earnings growth, Welch resorted to *moving* money—and jobs—offshore (*ibid*, p. 164).
- He used *creative* accounting techniques that allowed him to “pull profits seemingly out of thin air” (*ibid*, p. 165).
- Between 1996 and 2001 GE’s reported *earnings per share* grew by 90%: an extraordinary figure for a large conglomerate. This is because of massive *under-reserving* in its reinsurance unit. That means, it did *not* put aside enough money in the event that many claims may be called at the *same* time. If GE had done that, it would have reported a growth of just 5.6% (*ibid*).
- GE Capital regularly allowed GE to *manipulate* its quarterly statements by engaging in trades right *before* the reporting day that would artificially bump up GE’s earnings (*ibid*).
- Thanks to its *creative* accounting and triple-A rating, GE was able to borrow money more *cheaply* than competitors that included large banks. However, GE was so *leveraged* in the run-up to the 2008 financial crisis, that it could *not* go through a single day without *selling* billions of dollars of commercial paper to pay its many loans (Foroohar, 2017, pp. 165-166).

So, based on the above discussion, it is clear that an important *legacy* of Welch was that he *transformed* GE from a manufacturing to a largely *financial services* company (Foroohar, 2017, p. 153; Andersen, 2020, p. 150; Leonhardt, 2022; Datta, 2022a).

That is why Foroohar argues that GE Capital, a *major* arm of GE, “was focused *not* on ‘making’ *but* ‘taking’”: from equipment leasing, leveraged buyouts, and even *sub-prime* mortgages (*ibid*, *italics* added).

In Welch’s 20 years as CEO, GE’s market value grew from \$12 billion to \$410 billion in 2001, making him one of the most *famous* corporate leaders of his time (Leonhardt, 2022; Datta, 2022a).

In 1999 *Fortune* magazine crowned Jack Welch as “The Manager of the *Century*” (Note 2) (*italics* added, Note 2; Foroohar, 2017, p. 153).

However, these good times did *not* last very long. As of August 2022, GE’s market cap had sharply *declined* to \$83 Billion (Leonhardt, 2022; Datta, 2022a).

## 11. Taxpayers Bailout GE After Stock Market Crash of 2008

The *sub-prime* mortgage market, in which GE Capital was a major player, spectacularly *imploded* during the stock market *crash* of 2008. So, GE had to be *bailed out* by taxpayers for \$139 Billion in

guaranteed *loans* from Federal Deposit Insurance Corporation (Foroohar, 2017, p. 154).

Things got so bad that Jeffrey Immelt, who succeeded Welch as CEO, had to go out to Omaha, Nebraska, hat in hand, and *beg* for a loan of \$3 billion from Warren Buffett, who was happy to oblige because he was able to buy GE's stock on the cheap (*ibid*).

#### 11.1 GE Forced to Go Back to its Industrial Roots After Dodd-Frank Legislation

In 2010 Dodd-Frank Act was passed to address the aftermath of the 2008 stock market crash. And this is the most powerful *reason* why in 2014, GE was forced to *spin off* its finance arm--GE Capital--entirely. In response to a question why GE decided to divest its finance division it had nurtured for so long, Jack Welch answered in two words: "Dodd-Frank" (Foroohar, 2017, p. 172).

Before the 2008 stock-market meltdown, GE was a "Too Big to Fail" *financial* company, but it had *not* been regulated like one. In 2013 GE was designated a "systematically important financial institution." The company was now under *heightened* regulatory examination. Actions that earlier were a part of regular daily routine could now become *illegal*. Thus, big *banks* and companies that acted like *one*, would be required to carry *more* capital on their balance sheet, which would then *lower* their profit margins (Foroohar, 2017, p. 172).

Finally, Jeffrey Immelt, then CEO of GE, declared that being so deeply involved in finance "doesn't really make sense for us" *anymore*. So, the rest of the company went *back* to its industrial roots, *dumping* all financial activities, in order to focus solely on *manufacturing* (*ibid*, p. 153).

The future of GE now looks bright like its *past*, although its growth markets are likely to be *overseas*. Developing countries like, China, India, Turkey and South Africa will need new houses, bridges, roads, airports and consumer goods for a growing middle class in each country (Foroohar, 2017, p. 174).

### Part III. The Finanancialization of America

#### 12. Finance Becomes a Dominant Force in America

Rana Foroohar, *Financial Times* business columnist, and CNN global economic analyst, has written a *masterful*--and timely--account of the *financialization* of America in her book: *Makers and Takers--How Wall Street Destroyed Main Street* (2017). We have drawn heavily from her work in this paper.

The GDP share of the U.S. financial markets—finance and insurance—*more* than *tripled* since 1947 to 8.4% in 2010. By comparison, the industry's before-tax *profit* as a percentage of total domestic business profits averaged *more* than *three* times as much at 27% between 1987 and 2010 (Datta, 2011). In recent decades, the share of financial services has been about 7-8% of GDP. However, in sharp contrast, the sector accounts for 25-30% of all corporate profits (Note 3).

Yet, the sector has created only 4% of all jobs (Foroohar, 2017, p. x).

From the early 1990s through 2006 *skill* levels and pay in the financial sector went *up* dramatically so that bankers were making *1.7 times* more than comparable employees of other businesses. That is why the best-and-the-brightest have *flocked* to the finance companies. Responding to a *shortage* of

engineers, the Society of Manufacturing Engineers ran an ad campaign that told students: “Engineers create wealth by *solving* problems rather than creating ‘paper’ wealth by playing with the markets” (Datta, 2011).

Even now the *best* graduates continue to gravitate towards Wall Street. This is because of a \$200,000 paycheck, *exit* opportunities, and proximity to *power* (Miao and Sun, 2021).

Late John Bogle--the founder of the Vanguard Group--was one of the few leaders in the mutual-fund business who wanted to *reform* the financial sector. In 2014 he said that today’s stock market is *not* unlike a *Ponzi* scheme. He said our *bloated* financial system “might be sucking up some *60 percent* of the returns that ordinary *retirement* savers could otherwise earn on their money” (Foroohar, 2017, pp., 139-139).

Earlier, he provided the following insight into how enormously *profitable* the U.S. financial sector is (Datta, 2011):

- It is the *largest* profit-making sector in America. Our financial services companies make *more* money than our *energy* companies—*no* mean profitable business in this day and age. Plus, our *healthcare* companies. They make almost *twice* as much as our *technology* companies, *twice* as much as our *manufacturing* companies.

Finally, he concluded that we’ve become a *financial* economy which has *overwhelmed* the productive economy to the *detriment* of investors, and the *detriment* ultimately of our society.

Bogle estimated that the financial sector takes away \$560 billion per year out of society (Datta, 2011).

### 13. Massive Deregulation of Financial Markets Leads to Stock Market Crash of 2008

As mentioned earlier, in 1999 President Clinton signed into law the *Financial Services Modernization Act* which *repealed* the *Glass-Steagall Act* (GSA) of 1933. In the aftermath of the Great Depression of 1929, GSA was designed to *separate* commercial banking from investment banking to *protect* bank *depositors* from the dangers of bankers indulging in *risky* investments and *speculation* (Datta: 2011, 2022a, 2022b).

J.P. Morgan introduced the first credit default swap (CDS) *derivative* in 1997. Soon the technique was *copied* throughout the industry, and the CDS market began to rise rapidly (Datta, 2010).

That is why Brooksley Born--the then chairwoman of the Commodity Futures Trading Commission--argued that the *derivative* market was growing rapidly, but was *not* regulated by any government agency (Note 4).

Yet, in spite of *strong* opposition from Brooksley Born, President Clinton signed the *Commodity Futures Modernization Act* (CFMA) of 2000 that was intended to keep financial *derivatives unregulated* (Note 4). The passage of CFMA was a *momentous* event, because it *rolled back* the *gambling* activity that was *illegal* for almost the entire twentieth century, as mentioned earlier. The act now allowed investors to *bet* on securities they did *not* own.

Partnoy, a former Stanley Morgan trader, and now a law professor at University of San Diego, believes

this was one of the greatest *mistakes* in the history of financial markets (Datta: 2010, 2011, 2022a, 2022b).

As we have indicated below--thanks to its *political* clout--the *financial* sector was able to secure a *legal* license from the U.S. government to engage in *gambling* and *speculation*.

As we are going to show later, Brooksley Born turned out to be quite *prescient* because this colossal deregulation of financial markets led, in 2008, to the *worst* stock-market crash since the Great Depression of 1929.

#### **Part IV. Wall Street Culture of Excessive Gambling and Speculation**

##### **14. Wall Street Resorts to Gambling by Pushing Virtual CDOs Not Backed by Real Securities**

The passage of Commodity Futures Modernization Act (CFMA) of 2000 rolled back the gambling activity that was illegal for almost the entire twentieth century, as mentioned above. The act now allowed investors to *bet* on securities they did *not* own.

Soon Wall Street started *running out* of risky assets. The passage of CFMA allowed Wall Street to come up with an ingenious—and *risky*--idea: CDS (credit default swaps) based on synthetic or virtual CDOs (collateralized debt obligations) that mirrored a regular pool of *existing* mortgages. These synthetic CDOs allowed banks to sell layers upon layers of securities based on the same junk bonds (Datta, 2010).

Wall Street banks bought huge amounts of the so-called “super-senior” subprime tranches of synthetic CDOs. According to the computer models, these AAA-rated securities were senior enough to be safe from even Noah’s-era flood (Datta, 2010).

##### **15. Credit Default Swaps Derivatives: Financial Weapons of Mass Destruction**

In 1994 a team of brash, young, idealistic bankers from J.P. Morgan—many with degrees in mathematics and computer science—got together in Boca Raton, Florida to address a problem that has bedeviled banks for ages: the *risk* of loan default. With the heady *arrogance* of youth, they all believed that they held the *secret* to transforming the financial world (Tett, 2009; Datta: 2010, 2022b).

The team introduced a *derivative* called credit default swap (CDS): an *insurance* policy that would enable a bank to *transfer* default risk onto a *third* party, in lieu of payment of a *regular* premium. They argued that this would *revolutionize* banking because it would allow banks to separate *risk* from lending. This *seemingly* savvy maneuver would *free up* the bank’s capital reserve, permit it to make *more* loans and *remove* the credit risk from its *books* (*ibid*).

However, the Morgan team’s *utopian* dream of separating risk from lending was *too good to be true* because it meant that “you could *have* your cake and *eat* it too!” (*ibid*).

First, the CDS derivatives were so *complex* that hardly anyone understood them: *not* even Soros; Rohatyn described them as potential “hydrogen bombs.” Warren Buffet *presciently* predicted that these derivatives were “financial weapons of mass *destruction* (Datta 2010, 2022b).



Later, recalling the event, Mark Brickell, then J.P. Morgan's managing director, made the following memorable comment (Philips, 2008; *ibid*):

- “I have known people who worked on the Manhattan Project. And for those of us on that trip, there was the same kind of feeling of being present at the creation of something *incredibly* important.”

Like Oppenheimer and his team of *nuclear* physicists in the 1940s, little did Brickell and his group realize that they were creating a *monster* (*ibid*).

The enormous *deregulation* of the financial markets led to a collapse of the global financial markets in 2008, that many consider as the *worst* since the Great Depression (Datta: 2010, 2022b).

The *TNT* was the *collapse* of the U.S. *housing* market, and the *failure* of the \$1.2 trillion *subprime* mortgage derivatives—Collateralized Debt Obligations (CDOs)—that major Wall Street banks had *created*, and *aggressively* sold around the world (*ibid*).

But the *rocket fuel* was the *Credit Default Swaps*—CDS—a market 50 times *bigger* than the subprime mortgage market (*ibid*).

#### *15a. Most Critical Factor in Credit Default Swaps (CDS): Systematic risk*

When a recession occurs it can result in *real* losses which have to be borne by *someone* in the system. While an *individual* business may be able to transfer default risk to another, the *entire* financial system *cannot* successfully pass the risks off through ever more ‘sophisticated’ financial modeling (Datta, 2010).

But the most dangerous is *systematic* risk. It is a risk that is based on the possibility that derivative contracts of a company are *not* independent, and *all* may be dragged into a recession *simultaneously* (*ibid*).

Since all Wall Street banks were using Li's model it created a new *correlation* risk. More importantly, the model was *not* equipped to handle the situation where *all* boats might *capsize*, en-masse (Tett, 2009; Datta, 2010).

One of the most depressing aftermaths of the 2008 financial crisis was that it *wiped out* \$16 trillion in *household* wealth (Foroohar, 2017, p. 17).

One of most depressing aftermaths of the 2008 financial crisis was that it *wiped out* \$16 trillion in *household* wealth (Foroohar, 2017, p. 17).

#### *15b. Wall Street Pushes Sub-prime Mortgages*

The *double-digit* rise in prices of existing homes from 2000 through mid-2005 encouraged speculation. With Wall Street's voracious appetite for highly profitable subprime mortgages, many lenders virtually ignored their standards and began lending to unqualified buyers who were “one refrigerator away from default” (Datta, 2010).

#### *15c. Belief that Diversification and Pooling Could Eliminate Default Risk*

Relying on Li's Gaussian copula model, Wall Street banks began to believe that default risk in subprime mortgages could virtually be eliminated simply by a process of diversification: by pooling

individual mortgages into bundles and slicing them into tranches, each with a different risk and return profile (*ibid*).

So, Wall Street introduced new CDOs—collateralized debt obligations—which were backed by “low-rated corporate bonds, emerging-market debt, and subprime mortgage loans” (*ibid*).

The argument was that in the event of a major flood, the top half of a ten-story building would be protected by the bottom five floors. The highest or the senior level was deemed the safest, and the lowest level—called equity tranches—the riskiest (Datta, 2010).

Wall Street and the rating agencies also believed that even the *lowest* quality bonds would not all default at the same time (*ibid*).

Amazingly, Wall Street successfully convinced the rating agencies that the top tranche—e.g., a pool of BBB-rated *subprime* mortgage loans—should be given AAA rating. These subprime senior securities offered significantly higher returns than ordinary AAA bonds (e.g., GE). Therefore, they generated a high demand among many institutional investors who generally bought only AAA-rated bonds. So, the largest investment houses and banks were able to unload billions of dollars of subprime equity tranches--*junk* bonds--onto state pension funds of public employees (Datta, 2010).

#### 15d. Derivatives on Steroids: “CDO squared” and “CDO cubed”

When Wall Street banks could not sell some of the high-risk bottom equity tranches in different CDOs they then combined them into another pool called “CDO squared,” and repeated the process with “CDO cubed.”

A CDO-cubed is essentially a triple derivative, that is a derivative of a derivative of a derivative—which is why it has been called “derivatives on steroids.” So, every time a new pool of the riskiest bottom tranches was created, it would yield a new crop of a senior tranche with AAA rating (Datta, 2010).

### 16. Most Banks Used Short-term Borrowing or Put No Money behind What They Insured (Note 5)

Believing in the above delusion, several companies—e.g., American International Group (AIG), Bear Stearns, and Lehman Brothers—that insured these bets with credit default swaps (CDS), put no money behind their commitments (Datta, 2010).

And, across the board, banks financed these risky assets through short-term financing (*ibid*).

Interestingly, J.P. Morgan was one company that opted out of the subprime mortgage business, because it considered the business too risky (Tett, 2009: 103; Datta, 2010).

When the housing market collapsed, the loss from the subprime mortgage-based CDOs rose from \$300 billion to a trillion dollars (Datta 2010).

In September 2008 AIG was unable to cover its massive CDS losses. The U.S. government, considering it *too big to fail*, invested \$180 billion in AIG (Datta, 2010).

Earlier, in March 2008, the Federal Reserve Bank had agreed to guarantee \$30 Billion in Bear Stearns’ assets as a part of the government-sponsored deal for JP Morgan to acquire Bear Stearns (*ibid*).

In September 2008 Lehman Brothers filed for bankruptcy (*ibid*).

## 17. Wall Street's Use of Deceptive Practices

Some securities packaged by Goldman Sachs and Tricadia were so vulnerable that they failed within months after they were created (Datta, 2010).

Goldman Sachs, Deutsche Bank, and Tricadia used the CDOs—"collateral debt obligations"--to place unusually large negative bets that put them at cross purposes with their own clients (Datta, 2010).

Commenting on this situation, Sylvan Raines, an expert in this field, said that when you buy protection against an event you have had a hand in causing, you are buying fire insurance on someone else's house, and then committing arson (Datta, 2010).

Michael Lewis, a former bond trader at Solomon Brothers, says it is incredible that a bank could advise customers on what to buy and sell, and at the same time bet against the securities they're trying to sell them (Datta, 2010).

## 18. Excessive Compensation Encourages "Go-for-Broke" with "Other People's Money"

In a *prescient* paper, Prof. Raguram Rajan (2005) argued that although the financial sector has enhanced its ability to *spread* risk more widely, it has also *exposed* the sector to large *systematic* shocks. This has therefore made the world a *riskier* place (Datta, 2010).

Michael Lewis reports that there is a sense of *entitlement* among Wall Street bankers. They expect *huge* bonuses—because they believe "they *earned* it"—that are *out* of all proportion to their contribution to the American economy (Kroft, 2010; Datta, 2010).

A bond *derivative* trader can make *more* money in *one* good year, than a doctor, or an airline pilot, will make in an entire *career* (Amerman, 2009; Datta, 2010). This encourages everyone to take *excessive* risks with "Other People's Money." The "go-for-broke" incentive schemes shower rich *rewards* for making money, but impose *little* penalty for losses (Blinder, 2009; Rajan, 2005; Datta, 2010).

For 2009--the leading Wall Street firms paid \$140 billion in compensation and benefits to their derivative *traders*: "the *largest* collective payday on record" (Grocer and Lucchetti, 2010; Datta, 2010).

So, based on this unbelievably huge payoff right after the 2008 market crash, there is only one conclusion one can draw: that Wall Street operates on a unique principle and that is: "Heads I win, tails you lose."

In view of the above, Michael Lewis believes that the business of Wall Street has become *divorced* from productive enterprise, and the Wall Street leaders have completely *lost* any sense of responsibility to society.

## Part V. America the Most Unequal, Advanced Industrial Society

### 19. Increasing Income Inequality in America: The Richest are Leaving even the Rich Far Behind

As mentioned earlier, a direct result of America's economic decline is that the *middle* class has been suffering from a relentless economic *squeeze* since 1974. Income inequality in America has now run a *full circle*, and has now *touched* or even *exceeded* the dizzying heights of income recorded in 1928 (Datta:

2011, 2022a, 2022b).

For 45 years--between 1974 and 2018--the U.S. gross domestic product (GDP) grew by a yearly average of 2.9%. Unbelievably, however—and in sharp *contrast*-- the *median* family income has literally been *stagnant* for almost a *half century* with a yearly average growth rate of a *mere* 0.6% (Datta, 2022a).

Moreover, during the whole 1998-2008-decade, *median* family income *declined* by 3% (Datta, 2022a).

The value of the federal *minimum* wage is at the *lowest* point in 66 years. After the longest period in history without an increase, federal minimum wage today is worth 27% *less* than 13 years ago, and 40% less than in 1968 (Cooper, Hickey, and Zipperer, 2022).

An important part of this inequality has been an *extraordinary* increase in *CEO* compensation . An American CEO's pay went up from 42-times the average pay of a blue-collar worker in 1980, to 343-times the median pay of a worker in 2010. In 2017, an American CEO's pay went up 361-times the median pay of a worker—by far the *widest* gap in the world (Datta, 2022a).

Another factor that has *raised* income inequality are tax *loopholes* that favor big corporations and the rich (*ibid*).

Foroohar reports that today's super managers—CEOs, bankers, accountants, consultants, agents, and lawyers—are getting getting somewhere between 30 and 80 percent of their income *not* in cash, but in stock options and stock shares which are taxed at a much lower rate. While this *lowers* their taxes, but at the same time it *increases* economic inequality (2017, p. 15).

From the above discussion, it is clear that one factor that has *exacerbated* income inequality is that the wealthy have *not* been paying their fair share of federal income tax.

It is no secret that the gap between the rich and everyone else has been getting *wider*. Yet, the extent to which the *richest* are leaving *even* the rich *far* behind, is *not* widely known (Datta: 2011, 2022a).

The *pretax* income-share of the top .01 % shot up *six* times from 0.88%% in 1974, to 5.28% in 2017 (Datta, 2022a).

The average *pretax* income of this group--17,291 families--was \$35 million in 2018 (*ibid*).

The *three* richest Americans--Jeff Bezos, Bill Gates, and Warren Buffet--are worth *more* than the *bottom half* of the entire U.S. population (Stiglitz, 2019, p. 5).

The *top* 1% Americans owned 32.3% of the nation's *wealth* as of the end of 2021 (Note 6).

A *ProPublica* investigation found that some of the world's richest men—Jeff Bezos, Michael Bloomberg, Carl Icahn, Elon Musk, Warren Buffet and George Soros—paid a *tiny* fraction of their income in federal tax (Eisinger, Ernsthausen, and Kiel, 2021; also, Iacurci, *ibid*).

Warren Buffet, and George Soros--a highly successful *hedge fund* manager himself--suggest that the earnings of *hedge fund* managers—which for some can run into *billions* of dollars—should be taxed as *ordinary* income *not* as capital gains (Datta, 2011).

Warren Buffet took a survey of his employees in 2007, and found that whereas he paid an average of 17.7% of his income in federal income tax, the average in his office was 32.9% (Backman, 2020).

So, Stiglitz points out that America has now become “the most *unequal* advanced industrial country”

(2013, back cover, *italics* added).

This inequality is now so vast that it is almost *twice* as high as in Europe (Chancel, 2018).

## Part VI. Government an Integral Part of a Civilized Society

### 20. Negative Attitudes toward Government: Glorification of Self Interest and Greed

This *anti-government* attitude has been fostered by *free-market* enthusiasts. For example, President Ronald Reagan clearly said it in his first inaugural address: “Government is *not* the solution to our problem; government *is* the problem” (Datta: 2021, 2022b).

Kuttner (1999, p. x) points out that the *intellectual* bedrock of this push is a *religious* adherence to the belief that literally all *public-sector* activity—for example, financial support for the poor, protection of rights of labor unions, and *even* macroeconomic policies—does more *harm* than good (Datta, 2022b).

Believers of this ideology view *laissez-faire* economics as a “*revealed wisdom*” (*ibid*).

*Religious* faith in this idealized framework has generated a political *jihad*, intent upon peeling off the community and government *safeguards* against market abuses and imperfections. These guard rails are *central* to the modern American economic system that was built during the Great Depression of 1929, and World War II (*ibid*).

A stark example of this *animus* is lobbyist Grover Norquist who declared that “I don’t want to abolish government. I simply want to reduce it to the size where I can...*drown* it in the bath tub” (*italics* added, Note 7).

Furthermore, an *overtly* and proudly *selfish* ideology, finances and propels the drive to *cut* taxes on the *wealthy*, punch *holes* in the safety net, *unchain* business from the shackles of regulation and litigation (Kuttner, p. x; Datta, 2022b).

The conservative dialectic *criticizes* those who would “reward need” by supporting *public* programs for the poor, and even *reject* Adam Smith’s belief that the *state* must provide the foundation of the *education* and physical *infrastructure* of an industrial society (*ibid*).

The *extreme* manifestation of the current conservative economics appears to imply that there is *no* such thing as a market failure. That in *every* situation the market will produce *better* results than alternatives.

The majority of scholars recognize that it carries an important point to the level of *absurdity* (*ibid*).

Darren Walker, chief executive of the Ford Foundation, says that Friedman’s thinking became *theology*—the *intellectual* scaffolding that allowed its disciples to justify decades of greed is *good* excess (Datta, 2021).

Stephanie Mudge observes that Friedman’s articulation of markets as the *source* and *arbiter* of human freedoms has a *semi-evangelical* tone (*ibid*).

In the words of American journalist William Greider, Friedman was the most *influential* economist of the second half of the twentieth century in the eyes of his admirers. However, he was also the most *destructive* public intellectual of our time (*ibid*).

Joseph Stiglitz says that Friedman had done distinguished analytic and empirical work in economics.

However, *later* he became largely a conservative *ideologue* (Datta, 2021).

Henry Mintzberg (2004, p. 147) points out that in recent years we have been witnessing a *glorification* of self-interest perhaps *unequalled* since the 1920s. *Greed* has been raised to some sort of *high* calling; corporations are urged to *ignore* broader social responsibilities in favor of *narrow* shareholder value; chief executives are regarded *as if* they alone create economic performance (Datta, 2021).

## 21. Business Cannot Thrive Without Active Governmental Support

The *ravages* of unpoliced financial markets are well known—the latest example being the stock market *crash* of 2008. At a *minimum*, modern commerce and economic growth depend upon: clear *rules* of the game, *enforceable* contracts, *independent* courts, community *infrastructure*, and *public* investment, especially in *education*” (Kuttner, 1999, p. xi; Datta, 2022b).

The government *sets* the “basic rules of the game”. It *enforces* the laws. It provides the soft and hard *infrastructure* that makes it possible for society and economy to operate (Stiglitz, 2013, p. 116).

If the government does *not* provide roads, ports, education, or basic research, the ordinary business *cannot* flourish.

Economists call such investments as “public goods” (*ibid*).

In earlier decades, research conducted through *our* state universities and agricultural extension services have contributed tremendously to agricultural *productivity* (*ibid*).

More importantly, government-sponsored research has promoted the *information* technology revolution--*internet* being the most important--as well as advances in *biotechnology* (*ibid*).

## Part VII: A Framework of Federal Income and Inheritance Tax

### 22. A Federal Tax System Should Reflect the Values of a Civilized Society

According to Google, *taxation* provides a means to *redistribute* economic resources towards those with *low* incomes or *special* needs. Taxes provide the revenue needed for critical *public* services such as *social security*, *health care*, *national defense*, and *education*. Taxation is as much of a *political* issue as an *economic* issue (Note 7).

As mentioned earlier, Stiglitz, too, makes a similar point, and that is, that a society needs to take *collective* action by which the *entire* country comes *together* to make these public investments (2013, p. 116).

So, Stiglitz argues that taxation has to be *compulsory* to avoid the free rider problem.

Thomas Piketty underscores the same point. He reminds us that taxation is *not* a technical matter. “It is preeminently a *political* and *philosophical* issue. Without taxes, society has *no* common destiny and collective action is *impossible*” (2014, p. 493, *italics* added).

#### 22.1 Essential Characteristics of an Income Tax System

So, what are the crucial characteristics an income tax system should have?

First of all, such a system should be *fair*.

Second, it should be anchored to the foundation of *values* that should be the hallmark of a *civilized* society: helping the *handicapped*, the *needy*, and the *vulnerable*; provides basic *health care*; provides for *old-age* security and *unemployment* insurance; promotes *growth* through *education* of the masses, and advances in *technology* that can create real jobs that help *society*; and backs the twin goals of equality of *opportunity* and social *mobility*.

Third, an important objective of an income tax system should be to encourage *job creation*. It is important to realize that one of the major objective of the Federal Reserve Board, too, is to promote employment.

### 23. Two Major Schools of Federal Income Tax

We present a system that is quite unconventional. We believe the U.S. federal income system can be divided in two *main* schools:

- The School for the “Rich and the Privileged”
- The School for the “Masses”

The school for the rich and the privileged consists of three groups:

- “Trickle-down” or “Supply-side” economics
- “Job Creators”
- Meritocracy or the “Makers”

The school for the masses has just one category:

- Progressive Taxation

## Part VIII. The School for the “Rich and the Privileged”

### 24. The “Trickle-down” Economics

The proponents of “trickle-down” economics argue that giving *tax breaks* to wealthy investors and large corporations will eventually “trickle down” to *everyone*. More recently, the term has been used to describe “supply-side” economics. Major examples include—all Republicans--Reagan tax cuts, George W. Bush tax cuts, and Trump tax cuts (The Tax Cuts and Jobs Act of 2017) (Note 8).

Major examples in U.K. include the economic policies of economist Frederick Hayek, tax policies of Margaret Thatcher, and Liz Truss’s mini-budget tax cuts of 2022. Truss *resigned* due to a failed budget and stock market turmoil. She was in office for just 44 days, making her the *shortest-serving* prime minister in British history (Note 9).

The “trickle-down” idea has a long *pedigree*, and has long been *discredited*. This is because higher inequality has *not only not* produced more growth, but as we have shown, the *median* family income in America has been *stagnant* for almost a half century (Stiglitz, 2013, p. 8).

Democrat President Lyndon Johnson argued that “Republicans...simply *don’t know* how to manage the economy. Ther’re so busy operating the *trickle-down* theory, giving the *richest* coporations the *biggest* break, that the whole thing goes to hell in a handbasket” (*italics added*, Note 9).

Economist John Kenneth Galbraith reported that “trickle-down economics” had been tried before in America in the 1890s under the name of “horse-and-sparrow” theory which was *partly* to blame for the Panic of 1896 (economic depression).

Then he goes on to say the following eye-opener about David Stockman, Director of the office of Management and Budget under President Reagan (Note 9):

- David Stockman has said that supply-side economics was merely *a cover* for the *trickle-down* approach to economic policy—what an older and less elegant generation called the horse-and-sparrow theory: “If you feed the horse enough oats, some will pass through to the road for the sparrows.”

David Sockman further revealed that the supply-side formula was the *only* way to get a tax policy that was really ‘*trickle down*.’ Supply-side *is* trickle-down theory (Note 9).

In his Presidential campaign against Ronald Reagan in 1980, George W. Bush and independent candidate, Ross Perot, both called “trickle-down” approach as “voodoo economics” (Note 9).

Political scientists, Brainard Peters and Maxjmilian Nagel (2020), describe “trickle-down economy” a “*zombie* idea”: one that “has been the *most* enduring *failed* policy idea in American politics (*italics* added, *ibid*).

In his book, Sowell Thomas (2012) suggests that trickle-down economics has *never* been advocated by *any* economist. He asks why in the world would anyone give something to A, hoping that it would trickle down to B, rather than give it directly to B, and *cut out* the middleman? (Note 9).

In their 2011 research paper, social scientists, Dan Andrews, Chrisopher Jencks, and Andrew Leigh found *no* relationship between *top* income growth and *overall* economic growth (Note 9).

In 2020, economists David Hope and Julian Limberg looked at data from 18 countries spanning 50 years. They found that the tax cuts for the *rich* only resulted in *increasing* income inequality, making the rich *richer*, with *no* positive effect on real per capita GDP or employment (Note 9).

Nobel laureate, Joseph Stiglitz, in a 2015 paper, found that the post-World War II evidence also does *not* support “trickle-down” economics, but rather “*tricke-up*” economics where putting more money in the pockets of the poor or the *middle class* benefits *everyone*: even the rich (Note 9).

Bruce Bartlett (2009), a domestic adviser to Ronald Reagan, was one of the *originators* of Reaganomics, the “supply-side” economic theory. However, he *no* longer supports it because he believes it was a *failure*. Now he has not only embraced *Keynsian* economics, but also “makes a compelling case for *tax increases*, once utter *anathema* to him and his economic allies” (back of front cover).

In their research, economists Thomas Piketty, Emanuel Saez, and Stephanie Stantcheva (2014) have shown that *lowering* top tax rates has in reality been accompanied by *no* change or *lower* growth around the *world* (Stiglitz, 2019, p. 25).

Robert Reich blames *conservative* think tanks, such as, the Heritage Foundation, Cato Institute, and Club for Growth for promoting what he, too, regards as a *discredited* idea (Note 9).



John Kenneth Galbraith, who was born on a *farm*, has compared “trickle-down economics” to “horse-and-sparrow theory” (*ibid*).

In a *provocative* blog, David Bradley (2017) has tried to explain the *essence* of this theory. He says horses are fed *oats*, but some of what they eat is *not* digested, and then passes through their system. Thus the *oats* become available to the sparrows in the *horse dung*.

Then Bradley argues, that another name for this theory should be *horse shit* economics. Then he goes on to add the following (*ibid*):

- “It is way past time for us to be taking this *crap* idea as a serious idea. It is a *swindle* perpetrated by the *wealthy* on the poor and middle class. There is *no* reason to class it up in discussions as “supply side” or “trickle down” economics. Best to call it what it is—it is *horse shit* economics.” (*italics added*).

## 25. The “Supply-side” Economics

As mentioned earlier, the 1970s represented a *turning* point when America took a sharp turn toward *unfettered* capitalism—and *greed*. Encouraged by the Friedman doctrine, American CEOs set themselves on a journey toward maximizing *shareholder* value. And it is the pursuit of this ideology that has contributed so much to America’s industrial *decline*.

A direct result of the Friedman doctrine was the birth of a global movement toward the Right or *conservatism* with the election of Ronald Reagan in America in 1980, and of Margaret Thatcher in U.K. in 1979 (Stiglitz, 2019, pp. xiv- xv).

At that time the two countries were following *Keynesian* economics, which stressed how government could maintain *full employment* by managing *demand* through *monetary* and *fiscal* policy. However, Reagan *replaced* that theory by a so-called “supply-side” economics. This was based on the idea that emphasized *deregulation* and *tax cuts*: with the argument that this would *free* up the economy that would then lead to *increase* in the supply of goods and services—as well as *incomes* of individuals (*ibid*).

This policy was in direct *contradiction* to Keynesian economic theory, according to which, aggregate *demand--not supply--is the driving* force in an economy (Note 10).

The question is how successful was Reagan’s radical idea? Stiglitz argues that supply-side economics did *not* work for Reagan (2019, p. xv). Earlier, Nobel laureate Paul Krugman, too, had made the same point (Note 11).

Also, as we have indicated below, it did not work for Gorge W. Bush either.

According to Google, the tax cuts—especially for high-income earners—under President George W. Bush did *not* improve economic growth *or* pay for themselves. Instead, they *ballooned* deficits and debt and *increased* income inequality. Furthermore the economic expansion that lasted from 2001 to 2007 was weaker than average (Note 12).

## 26. Trump Tax Cuts: Billionaires Pay Less than Working Class for the First Time

Now let us see the impact of Trump's massive tax *cuts* in 2017. Dominic Rushe, writing in *The Guardian* (2019) starts with this *dramatic* headline: "Trump's tax *cuts* helped billionaires pay *less* than the working class for the *first time*" (*italics added*).

Quoting Emmanuel Saez and Gabriel Zucman from their book, *The Triumph of Injustice* (2019), Rushe reports that in 2018 the richest 400 families in America paid an average effective tax rate of 23%: *lower* than the 24.2% paid by the *bottom* half of American households (*ibid*).

The Trump tax package granted the top 0.1%--the *super-rich*—of U.S. households a 2.5% tax cut that pushed their rate *below* that of the *lower* 50% of households!

In campaigning for his massive tax cuts in 2017 this is what Trump promised:

- "This is a revolutionary change and the biggest winners will be the *everyday* American workers as jobs start pouring into our country, as companies start competing for American labor, and as wages start going *up* at levels that *you haven't seen in many years*" (Note 13).

However, the tax cuts have not led to a significant rise in economic growth, employment has *slowed*, and wage growth has been *lackluster* (*ibid*).

Emphasizing the *same* theme, Paul Krugman says: "it was a big *fizzle*" (*italics added*; Note 14).

Finally, according to Ari Melber of MSNBC, at the end of Trump's reign in 2020, the U.S. *debt* went up by far more than \$7 trillion, raising the national debt to \$31 trillion: which was 25% of *all* national debt (Note 15).

## 27. "The Job Creators"

In a presidential campaign in 2011, Republican candidate, Mitt Romney argued that 47 percent of Americans were paying *no* income tax. He said they were living off of government *handouts*. He made that statement at a \$50,000-a-plate fund-raiser in a *lavish* setting in Boca Raton, Florida (Stiglitz, 2013, p. xviii).

Now we need to look at *two* things. First, what *percentage* of his income Romney was paying as federal income tax? Second, what was the *source* of his income?

According to Romney, he paid 14% of his reported income as federal income tax in 2011: which is *far less* than what people with substantially *less* income paid (*ibid*).

The source of his income was Bain Capital, a *private equity* firm of which he was the President (Foroohar, 2017, p. 212).

According to Foroohar, most people *rightly* associate private equity firms, like Bain Capital, with *offshore* bank accounts and big corporate *buyouts*. In these buyouts, previously *healthy* firms are loaded up with *debt*, and *stripped* of their assets, there are mass *layoffs*, and total *lack* of transparency in their financial affairs (*ibid*; also Stiglitz, 2013, p. xvi; Dealbook, 2007).

ABC News confirmed Foroohar's statement and reported that Romney had *parked* millions of dollars of his personal wealth in investment funds set up in the *Cayman Islands*, a notorious tax haven (Mosk,

Ross, and Churchman, 2012).

So based on the above discussion, Stiglitz rightly points out that the *irony* is that it is people like Romney who are the real *freeloaders* (2013, p. xviii).

## 28. Focus of Big Business: Make Money for Shareholders and CEOs--Not Job-Creation

Apple, whose market value in 2012 was *higher* than that of General Motors at its *peak*, had only 47,000 employees in the United States (Stiglitz, 2013, p. xvi). Steve Jobs, the founder of Apple, focused relentlessly on *creating* “irresistible, life-changing products,” with the belief that profits would follow. By *contrast*, however, Cook, the current CEO of Apple, is paying close attention to *money--financial* engineering or making money *from* money--rather than the old-fashioned way of creating *jobs*, and producing *new* products that customers *love* (Foroohar, 20017, p. 2).

Yet, Foroohar points out that Apple’s behavior is *not* an aberration. Stock *buybacks* and *dividend* payments, of the kind Apple has been engaged in—are activities that *primarily* enrich a company’s top management and its biggest shareholders. But now they have become quite *common* (2017, p. 3).

However, such an activity can *suppress* a firm’s capacity for innovation, *depress* job creation, and *compromise* its competitive position in the *long-run* (*ibid*).

Foroohar raises the effect that *two* factors had on economic *growth*: *globalization* and *technology-driven* job *destruction*.

Thanks to globalization—and the Friedman doctrine--U.S. companies have been *outsourcing* manufacturing for decades to *save* costs because of *cheaper* foreign labor, as we have mentioned earlier.

Even if a business investment is made in America, much of it is spent on *machines* that are meant to *replace* labor, to *destroy* jobs (Stiglitz, 2013, p.xvi).

So, Stiglitz makes a *salient* point. He says, in an age of *globalization*, creating *stockholder* value has entirely been *divorced* from creating *jobs* (*ibid*).

## 29. Meritocracy: “The Makers”

French economist, Thomas Piketty is the author of *Capital in the Twety-First Century* (2013). In the words of Paul Krugman, it is a *magnum opus* (2020). In that book Piketty says that we in America are now living in a *second gilded* age: and back to the “Great Gatsby” levels (Krugman: 2014b).

As we have reported before, income inequality in America has now run a *full circle*, and has now *touched* or even *exceeded* the dizzying heights of income recorded in 1928.

On the other hand, as mentioned before, the *middle* class has been undergoing a relentless economic *squeeze* since 1974. The *median* family income has literally been *stagnant* for almost *half* a century.

Paul Krugman suggests that what is really *new* about “Capital” is the manner in which it *demolishes* the most treasured of conservative *myths*: the assertion that we are living in a *meritocracy* in which great wealth is *both* earned and deserved (2014a).

But Krugman asks how do you defend that position, if the rich derive much of their income *not* from work they perform, but from the *assets* they own? Moreover, what if great wealth increasingly comes *not* from enterprise, but from *inheritance*? (2014a).

The conservatives argue that *investment* should be taxed *less* heavily than work, because it encourages investment and promotes economic growth. However, Michael Sandal, a political philosopher, points out that lurking *beneath* the surface, is a *moral* assumption about *merit*. And that is that investors are “job creators” and thus should be rewarded with *lower* taxes (2020, p. 220).

Paul Ryan, a former Speaker of the U.S. House of Representatives, and a candidate for Vice President—offered the most *stark* version of this argument. He made a distinction between “makers,” who contribute most to the economy, and “takers,” those receive *more* in government benefits than they pay in taxes (*ibid*).

Ryan worried that as the welfare state grew, the “takers” would *outnumber* makers” (*ibid*).

Ryan was a *devotee* of libertarian novelist, Ayn Rand, a *critic* of the welfare state, and who believed that *collective* power was an *evil* force *against* the *self-interest* of individuals (*ibid*; Datta, 2022a).

Foroohar argues, that the *traditional* role of finance to *grow* an economy, has been to take the savings of households and turn them into investment. However, that critical link has now been *broken*. Today finance practices mostly *alchemy*: issuing massive amounts of *debt*, and channeling money to different parts of the financial system *itself*, rather than investing in Main Street (2017, p. 6).

Citing Adair Turner, former British banking regulator, Warren Buffet, and others Foroohar argues that the *primary* “takers” in today’s economy are those in the *financial* industry, who enagage in *speculation* and reap *huge* windfalls with *little* contribution to the *real* economy (Sandel, 2020, p. 220).

Again, Foroohar has cited Adair Turner, who has articulated a devastating *indictment* of the financial sector. He says that *instead* of funding *new* ideas and projects that create *jobs* and raise *wages*, the financial establishment has *shifted* its attention to *securitizing* *existing* assets (like homes, stocks, bonds, commodities, etc.), turning them into *tradeable* products that can be spliced, diced, and sold *again and again*: until things *blow up* as in the stock market crash of 2008 (2017, p. 7).

As mentioned in Section 19, an important part of income *inequality* has been the *gargantuan* compensation that America’s super managers have been getting. In 2017, an American CEO’s pay went up 361-times the median pay of a worker—by far the *widest* gap in the world. Also, instead of salaries, the super managers are being paid with *stock awards* and *options* that are subject to *capital gains* tax that are taxed at a much *lower* rate than wages or salaries.

Derek Bok, former president of Harvard University, says that American companies prefer linking CEO pay to performance. However, a major practical problem is *measuring* performance reliably. Second, the record of performance-based pay has been rather *disappointing*. Third, there is *no* credible empirical evidence showing that performance pay motivates managers toward *better* work (Bok, 1993: Ch. 5; Datta, 2011).

Edgar Willard, Jr., the former CEO of DuPont, has *debunked* the three main *myths* of executive

pay: (1) The CEO pay is driven by *competition*, (2) The compensation committees are *independent*, and (3) CEOs deserve a *hefty* compensation because they create *wealth* for shareholders (Morgenson, 2005; Datta, 2011).

*Teamwork* is critical to success in business. So, Japanese corporations have made a conscious effort to *narrow* the gap between the pay of workers and executives. This policy is based on the belief that this practice will *increase* loyalty, cohesion, and productivity. The Japanese also think that *huge* executive paychecks will *undermine* teamwork and *demolish* morale (Bok, 1993, Ch. 5; Datta, 2011).

## Part IX. The School for the “Masses”

### 30. A Short History of Progressive Taxation in America

According to Piketty, the birthplace of *freedom*—and *progressive* taxation—happens to be *America* (Note 17).

Piketty argues that under President FDR, America adopted policies intended to *reduce* the influence of private capital, such as rent control, as in Europe. His goal was more to *reduce* inequality than to eradicate private property (2014, p. 153, *italics* added).

However, Picketty and Saez (2007) report that, starting with the Reagan administration, there has been a dramatic *decline* in *top marginal* individual income tax rates. In the early 1960’s, the statutory individual income tax rate for the *marginal* dollar of the highest incomes was 91 percent. This rate *declined* to 28% by 1988 under Reagan; 39.6% in 2000 under Clinton; 35% under G.W. Bush in 2008; 39.6% under Obama; 37% under Trump in 2020; and 37% under Biden (Note 18).

Corporate income tax rates were: Reagan, 35%; Clinton, 35%; G.W. Bush, 21%; Obama, 35%; Trump, 21%; and Biden 25%, with a minimum of 15% for large corporations.

Picketty and Saez (2007) point out, that corporate *income taxes* as a fraction of GDP have *fallen* by *half*: from around 3.5-4.0% of GDP in the early 1960s, to *less* than 2% of GDP in the early 2000s (*ibid*).

In *contrast*, corporate *profits* as a percentage of GDP in the early 2000s have *not* declined (*ibid*).

On the other hand, *payroll tax* contributions—from both employees and employers—that finance *Social Security* have substantially gone *up* from 6% in early 1960’s to over 15% in the 1990s and 2000s (*ibid*). However, the Social Security payroll tax applies only up to a *cap*, which, adjusted for inflation, is \$160,200 in 2023 (Note 18).

From the above data it is clear that the major *drivers* of a *decline* in the progressivity of the American federal income tax system have consistently been the *Republican* administrations starting with Reagan.

### 31. A System of Progressive Income Tax

One of the strongest proponent of *progressive* income and inheritance tax was Republican President Teddy Roosevelt. In an inspired speech in Kansas in 1910, he reasoned that *too much* concentration of *wealth* didn’t merely pose a threat to the incomes of the *middle class*: it *threatened* the very political system itself (Klein, 2011).

Then he went on to say:

- “The really *big* fortune, the *swollen* fortune, by the mere fact of its *size*, acquires qualities which *differentiate* it in *kind* as well as in *degree* from what is possessed by men of relatively small means. Therefore, I believe in a *graduated income tax* on *big* fortunes, and (also)...a *graduated inheritance tax* on *big* fortunes, properly safeguarded against *evasion*, and *increasing* rapidly in amount with the *size* of the estate (Note 19).

### 31a. Principles of Progressive Taxation

Here are the major principles:

- David Cay Johnston makes the same argument that Teddy Roosevelt made about hundred years ago. That the notion of progressive taxation is central to *democracy*. It is grounded in the principle of *ability to pay*. The more one’s income the greater is one’s obligation to pay taxes to support society (2007, Ch. 26).
- Derek Bok, too, suggests that progressive taxation is a necessary step to *curb* excessive earnings (1993, Ch 13).
- In a similar vein, Diamond and Saez (2011) recommend that persons with *high* income should be subject to *high* and *rising* marginal tax rates on their earnings (also, Datta, 2011).
- So, Prof. Michael Baker reminds us that according to economic theory, the *additional* satisfaction gained from the acquisition of another, *marginal*, unit of input or consumption *declines* (Baker, 2015; Datta, 2022b).

## 32. Income Tax on Capital Gains vs. Wages and Salaries

Diamond and Saez (2011) argue that it is usually difficult to make a distinction between capital and labor incomes. For example, people who manage their investment portfolio are spending their *labor* time for expected capital income. However, the U.S. tax law treats the compensation of *private equity* and *hedge fund* managers as realized *capital gains*; yet conceptually it is income from *labor*.

Proponents of a low capital gains tax say that it promotes long-term investment that leads to growth and job creation. A study sponsored by the *Harvard Business Review* (HBR) found that the U. S. financial system primarily advances the interest of shareholders in *short-term* appreciation of their stock at the cost of long-term performance, as we have also mentioned in this paper earlier (Porter, 1992; also Datta 2010).

Shareholders now hold their stock only for a *short* period (Bok, 1993: 111); the average holding period of stocks on the New York Stock Exchange has *declined* from over *seven* years in 1960 to *less than a year* in 2009 (Datta, 2011).

The HBR study, therefore recommended a *minimum* holding period of *five* years for stocks to qualify for the low capital gains tax rate (Porter, 1992).

Yet, the capital gains tax law requires a minimum holding period of just *one* year (Datta, 2010).

Prof. Len Burman says that empirical evidence in support of the belief in a low capital gains tax rate “is

*murky* at best,” and in the words of some hedge fund and private equity managers, “rests more on *faith* than science” (Stewart, 2011).

Warren Buffet (2011) says “I have worked with investors for 60 years and I have yet to see anyone—not even when capital gains rates were 39.9 percent in 1976-77—shy away from a sensible investment because of the tax rate on the potential gain. People invest to make money, and potential taxes have *never* scared them off” (Datta, 2011).

When there is a differential between tax rates for capital and labor, it generates a strong *pressure* to extend the *most* favorable tax treatment to a *broad*er set of incomes (Diamond and Saez, 2011).

Prof. Burman (1999:146) argues that a preference for capital gains “almost surely *reduces* tax revenues.”

But, according to Prof. Burman (1999:147) the *most* crucial argument *against* treating ordinary income and capital gains the *same* is a simple notion: the idea of equity and *fairness*:

- A lower tax for capital gains provides an *unfair* advantage to people who can earn a large share of their income in that form. That is, it favors the *wealthy* over others, and those with a great deal of *flexibility* about *how* to receive their income over those who have *little* choice but to take their income in a *more heavily* taxed form, such as wages and interest (*italics added*).

The name of Andrew Mellon—a Republican banker and U. S. Secretary of the Treasury from 1921-32—is often invoked by supporters of lower taxes on the rich. But even he did *not* like the idea that the people whose only capital is their *mental* and *physical* energy should pay a higher tax rate than “the people whose income is derived from investments” (Johnston, 2007: 288-89; Datta, 2011).

In his blog Pat Garafalo described an *important* principle. And that is, that tax loopholes should *not* allow a *millionaire* to pay a *lower* rate than a *truck driver*. Garofalo then said that the Republican party did *not* want the public to learn as to *who* made that statement. This is because, surprisingly, it was *no* other than President Ronald Reagan himself, who made it the *cornerstone* of his successful 1986 tax reform campaign: a simplified tax code that treated ordinary income and capital gains *alike* (Stewart, 2011; Note 20; Datta, 2011).

### 33. A System of Progressive Inheritance Tax

In an inspired speech in Kansas, Teddy Roosevelt, a *self-made* man, reasoned that *too much* concentration of wealth didn’t merely pose a threat to the incomes of the middle class. It threatened the very *political* system itself (Klein, 2011, *italics added*; Datta, 2011).

He then added:

- “The really *big* fortune, the swollen fortune, by the mere fact of its *size*, acquires qualities which *differentiate* it in *kind* as well in *degree* from what is possessed by men of relatively *small* means. Therefore, I believe in a *graduated income tax* on big fortunes, and...a

*graduated inheritance tax* on big fortunes, properly safeguarded against *evasion*, and *increasing* rapidly in amount with the *size* of the estate (*italics added*) (Note 21).

Let us now make an important point, in support of Teddy Roosevelt, and that is about what the industrialist and philanthropist Andrew Carnegie said: “The Man Who Dies Rich Dies Disgraced.” (Datta, 2011).

The rich have been *successful* in persuading a large portion of Americans that the nation would be better off *without* an inheritance tax, even though that would lead to an *inherited* plutocracy. However, most Americans will *not* be touched by the inheritance and estate tax, because married couples are *exempt* from this tax *upto* \$11 million (Stiglitz, 2019, p. 20).

### 34. Supreme Court’s Citizen United Ruling: A U.S. corporation is Legally a Person

Talking about the role of big money in politics, Teddy Roosevelt added (Klein, 2011, *italics added*; Datta, 2011):

- Every special interest is entitled to justice, but *not* one is entitled to a vote in Congress, to a voice on the bench, or to representation in any public office.
- The Constitution guarantees protection to property....But it does *not* give the right of suffrage to any corporation.

In 2008 the U.S. Supreme Court ruled in the *Citizens United* case that a U.S. corporation is legally a *person*.

The major implication of this momentous decision is that it allows the U.S. corporations to spend an *unlimited* amount of money in U.S. elections *without* disclosure.

Clearly, this Supreme Court decision is a direct *contradiction* of Teddy Roosevelt’s views cited above.

During the 2012 presidential campaign, Mitt Romney, declared that corporations are *people*, too: a position, that is a Gilded-Age legacy (White, 2011).

So, the number one demand of the *Occupy Wall Street* movement was the *repeal* of this ruling because it *equated* “dollars with *free* speech” (Hayat & Darcy, 2011).

### Part X. How Should America Address the Challenge of Massive Income Inequality?

We are presenting three different proposals:

- A global wealth tax
- Raise capital gains tax and close tax loopholes
- Impose windfall profits tax

### 35. A Global Wealth Tax

Pikkety points out that wealth *disparity* in America is *more* extreme than it has ever been, where the bottom 50% of the population owns just 2% of national wealth, while the next 40% owns 22%. He argues that the wealthy will *commandeer* our democratic institutions and buy too much influence over



them (Note 17).

As we have reported earlier, this inequality is now so *vast* that it is almost *twice* as high as in Europe. Piketty says any real reform of the U.S. tax code must consider American's wealth as a *whole*, and measure not only salaries, but also *holdings* such as real property and intangible assets (Foroohar, 2014).

So, Piketty's solution: a global *wealth* tax (*ibid*). This is in addition to his advocacy of a *progressive* income tax.

Stiglitz, too, agrees with Piketty. He says that wealth tax can *capture* income that can be avoided or evaded through capital income tax (Clifford, 2020).

### 36. Raise Capital Gains Tax and Close Tax Loopholes

Steve Rattner is a former U.S. Treasury auto-industry advisor under the Obama administration. He notes, that at present long-term capital gains and dividends carry an income tax rate of 23.8%, which is far *less* than the top marginal rate of 37% on the so-called ordinary income. He suggests that by raising the former closer to the latter will make the system *fairer*. Also, the government should *abolish* the provision that forgives capital gains taxes on assets at *death* (2019).

He says the U.S. should *close* other loopholes, too, to make the system even more *fair* (*ibid*).

### 37. Impose a Windfall Profits Tax

Citing a news report, Stiglitz (2023) says that thousands of Brazil's former president Jair Bolsonaro's supporters *stormed* the country's government buildings on January 8, in *protest* against the newly sworn-in President Lula. These riots occurred *two years* after the assault on the U.S. Capitol by supporters of the outgoing President Trump.

An important reason behind this is an almost universal sense of *grievance*. This is because so many people around the world suffer from economic *hardship*. On the other hand, a very *small* number of the super-rich--and the corporations they control--have become extremely *prosperous* (*ibid*).

The *pharmaceutical* giants have made billions of dollars in *profits* from Covid-19 vaccines that they would *not* have been able to develop without *research* from universities--and government *subsidies*. Russia's war of aggression in Ukraine has enabled *energy and food* companies to increase their profit margins by 256% in 2022, compared to the 2018-2021 average (*ibid*).

These huge profits are *not* the fruits of either hard work or creativity. Rather, they are undeserved *windfall* profits that should be taxed at a rate *higher* than what corporations normally pay (*ibid*).

### 38. Conclusion

The objective of this paper was to develop a framework for income, inheritance, and wealth tax in America.

Income inequality in America has run a full circle, and has now touched or even exceeded the dizzying

heights of income recorded in 1928 before the Great Depression of 1929.

On the other hand, the middle class has been undergoing a relentless economic squeeze since 1974. The median family income has literally been *stagnant* for almost half a century.

Stagnant incomes do not fully reflect the decline in the standard of living of most Americans. Facing job insecurity, rising health-care costs, the massive \$1.75 trillion college loan debt, credit has become a *palliative* of the middle class to address the deeper *anxieties* of downward mobility.

Many are unable to fulfill the “American Dream” because they *cannot* afford the middle class standard of living: having a good job, being able to retire in security, owning a home, having affordable health care, and a better future for their children.

This inequality is now so vast that it is almost *twice* as high as in Europe.

In 2017, an American CEO’s pay went up 361-times the median pay of a worker—by far the widest gap in the world.

Because of an incestuous relationship between Washington and Wall Street, we have a tax code that has been hatched to reward wealthy individuals and corporations. Some of the world’s richest men paid a *tiny* fraction of their income in federal tax in 2021.

For the first time Trump’s tax cuts helped billionaires pay *less* than the working class.

Many large U.S.-based multinational corporations employ accounting tricks to make profits made in America appear as if they were generated in offshore tax havens—with minimal or no taxes. Thus by using such a clever maneuver, multinationals are able to *avoid* paying an estimated \$90 billion in federal income taxes each year,

Encouraged by the Friedman doctrine, the 1970s represented a turning point when America took a sharp turn toward unfettered capitalism—and greed. American CEOs set themselves upon a journey toward maximizing *shareholder value*. And it is this radical ideology that has guided American business over the last *fifty* years.

This is a mind-set that encourages risk aversion and *short-run* behavior: an accountant’s short-cut to profits, with a focus on cost reduction, rather than long-term concerns about innovation, quality, and customer satisfaction.

And it is this journey that has contributed so much to America’s industrial decline.

A key development that has accelerated this decline is the financialization of America. In recent decades, the share of financial services has been about 7-8% of GDP. However, in sharp contrast, the sector accounts for 25-30% of all corporate profits. Yet, the sector has created only 4% of all jobs.

In 1999 and 2000 America went through a massive deregulation of the financial markets, which proved to be disastrous, because it led—in 2008—to the *worst* stock-market crash in America since the Great Depression of 1929.

Finance and its way of thinking have now come to *permeate* every facet of business, so much so that Wall Street is *no* longer supporting Main Street businesses that create jobs for the masses.

As a result of this “cognitive capture,” while the policy decisions taken after 2008 crash resulted in

huge *gains* for the financial industry, but losses for homeowners, small businesses, workers, and consumers.

One of most depressing aftermaths of this crisis was that it wiped out *\$16 trillion* in household wealth. The wealthy have compounded their wealth by stifling true, dynamic capitalism and making America no longer the land of opportunity that it once was. They have made America the *most* unequal, advanced industrial country while crippling growth, distorting key policy debates, and fomenting a divided society.

Taxation is as much a political as an economic matter. There are *two* visions or schools of federal taxation. While one is grounded in *lower* taxes for the wealthy and the corporations; the other's calling card is *community*: and *shared* prosperity. These two schools can be described as: (1) The School for the "Rich and the Privileged," and (2) The School for the "Masses."

The former consists of *three* groups: (a) The "Trickle-down" Economics; (b) "Supply-side Economics;" and (c) "Meritocracy" or the "Job Creators."

The latter has just one group: "Progressive Taxation."

We believe that a good way to judge the merits of the two schools is to see their historic track record. So we looked at the economic history of America over the entire twentieth century.

Economist John Kenneth Galbraith has called the "trickle-down" economics as the "horse-and-sparrow" theory. David Bradley argues, that another name for this theory should be "horse shit" economics.

The "trickle-down" idea has a long pedigree, and has long been discredited. This is because higher inequality has *not only not* produced more growth, but, the *median* family income in America has been *stagnant* for almost a half century.

The idea of "supply-side" economics was proposed under Ronald Reagan. This was based on the notion that emphasized *deregulation* and *tax cuts*: with the argument that this would free up the economy that would then lead to increase in the supply of goods and services—as well as incomes of individuals.

This policy was in direct *contradiction* to Keynesian economic theory, according to which, aggregate *demand*--not supply--is the driving force in an economy.

However, the idea did *not* work for Reagan. *Neither* did it work for Gorge W. Bush.

Supporters of meritocracy try to peddle the *myths* that we are living in a *meritocracy*, in which great wealth is both earned and deserved. But what if the rich derive much of their income *not* from work they perform, but from the *assets* they *own*? Moreover, what if great wealth increasingly comes *not* from enterprise, but from *inheritance*?

Presidential candidate Mitt Romney--and President, Bain Capital, a private equity firm--argued that 47 percent of Americans were paying *no* income tax. He said they were *freeloaders* because they were living off of government handouts.

Ironically, Romney paid only 14% of his reported income as federal income tax in 2011: which is far less than what people with substantially less income paid. Second, the source of his income was Bain

Capital. The *private equity* firm is associated with *offshore* bank accounts and big corporate *buyouts*. In these buyouts, previously healthy firms are loaded up with *debt*, *stripped* of their assets, with mass layoffs, and after *milking* the firm's assets are sold to the highest bidder.

So, the reality is that it is people like *Romney* who are the real freeloaders.

An important distinction we need to make is to recognize the difference between “Takers”: those *stifling* job creation, versus “Makers:” businesses that *create* real jobs.

Our analysis revealed that the “Rich and the Privileged” school consistently offered *false* promises that *failed* to materialize, but instead, produced big *deficits*.

The birthplace of *Progressive* taxation--and *freedom*—happens to be President FDR's America.

The years 1947-1973 are considered the *golden* years of America's middle class. The foundation of this goldilocks economy was the social covenant of *shared* prosperity, based on President Kennedy's dictum--that “*a rising tide lifts all boats*.” Its main features were: powerful unions, a high minimum wage, *progressive* taxation, and corporations providing health and retirement benefits.

*Financialization* of America has become so *pervasive* that today many American firms make *more* money by *moving* money around, getting about *five* times the revenue from *financial* activities--trading, hedging, tax optimizing, and selling financial services--compared to what they did after World War II (Foroohar, 2017, p. 5).

Stiglitz says that there are two sources of wealth. One is increase in capital that results from growth in the economy. The other is from increase in the value of assets that are scarce, such as urban land and other natural resources (Paramore, 2015).

Stiglitz argues that monetary authorities have been permitting banks to do more lending. However, this lending has not gone for capital goods for new businesses. Rather, most of it has gone to increase the value of existing land and buildings.

Thus, this is another factor that is exacerbating income inequality (*ibid*).

The super-rich, too, following the scarcity principle, buy timber land, oil rigs, and office towers (Datta, 2011).

Following the same scarcity principle, *private equity* investors have become the *single* largest group of buyers of *residential* housing market, purchasing \$20 billion worth of deeply discounted homes between 2012 and 2014. Following the financial crisis of 2008, *fewer* Americans can now afford to own a home. So, an increasing number will be forced *rent* a home from a Wall Street investor like Blackstone (Foroohar, 2017, p. 212).

Finally, following the 2008 financial crisis, Goldman Sachs, and other Wall St. banks, have used, once again, the most *dangerous* weapon in the arsenal of the financial sector—*derivatives*—to *manipulate* the *commodities* market—such as *food* and *energy*--and control the *natural* resources that corporations and consumers *need*: and the *prices* the average *consumer* has to pay for them every day (Foroohar, 2017, p. 27).

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  - *People, Power, and Profits*

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## Notes

Note 1. That includes insurance companies line AIG.

Note 2.

[https://www.google.com/search?q=when+did+fortune+declare+welch+manager+of+the+century&source=hp&ei=Dd7BY92iB6yawt0PmquJ0A0&iflsig=AK50M\\_UAAAAAY8HsHU\\_zoIF0cgywdtP5MVblTWC14byf&ved=0ahUKEwid3e7zszX8AhUsjbAFH2pVAtoQ4dUDCAo&uact=5&oq=when+did+fort](https://www.google.com/search?q=when+did+fortune+declare+welch+manager+of+the+century&source=hp&ei=Dd7BY92iB6yawt0PmquJ0A0&iflsig=AK50M_UAAAAAY8HsHU_zoIF0cgywdtP5MVblTWC14byf&ved=0ahUKEwid3e7zszX8AhUsjbAFH2pVAtoQ4dUDCAo&uact=5&oq=when+did+fort)



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 i5YHYK6pB2gIcAB4AIABqAKIAbtUkgEHMzkuNjIuMZgBAKABAbABCg&scient=gws-wiz

Note 3. <https://conversableeconomist.com/2022/09/13/financial-services-share-of-profits/>

Note 4. <https://www.npr.org/templates/story/story.php?storyId=102185942>

Note 5. That includes insurance companies like AIG.

Note 6. <https://www.cnbc.com/2022/04/01/richest-one-percent-gained-trillions-in-wealth-2021.html>

Note 7. Why is it important our society has a tax system? - Google Search.  
<https://www.google.com/search?q=Why+is+it+important+our+society+has+a+tax+system%3F&sa=X&ved=2ahUK>

Note 8. [https://en.wikipedia.org/wiki/Trickle-down\\_economics](https://en.wikipedia.org/wiki/Trickle-down_economics)

Note 9.

<https://www.cnbc.com/2022/10/20/uk-prime-minister-liz-truss-resigns-after-failed-budget-and-market-turmoil.html>

Note 10.

[https://www.google.com/search?q=as+per+keynesian+economics+demand+not+supply+drives+an+economy&source=hp&ei=Pv7wY8XIKeeJwbkPmo2wyA0&iflsig=AK50M\\_UAAAAAY\\_EMTkG3Cyi9kCm4LtDn4\\_Z8jEuBpfGV&ved=0ahUKEwjF\\_N-bwJ\\_9AhXnRDABHZoGDNkQ4dUDCAs&uact=5&oq=as+per+keynesian+economics+demand+not+supply+drives+an+economy&gs\\_lcp=Cgndnd3Mtd2l6EAM6EQguEIAEELEDEIMBEMcbENEDogsIABCABBCxAxCDAToFCC4QgAQ6CAguELEDEIMBOgsILhCABBDHARDRAzoICC4QgWEQsQM6CwguEIAEELEDEIMBOggIABCxAxCDAToFCAAQgAQ6CAguEIAEELEDOggIABCABBCxAzoFCAAQsQM6DQguEIAEEMcbENEDEAo6CggAEIAEELEDEAo6BwgAEIAEEAo6DQguEIAEELEDEIMBEAo6BggAEa0QAzoFCAAQhgM6CQgAEBYQHhDxBDoGCAAQFhAeOgUIABCiBD0HCAAQHhCiBD0KCAAQ8QQQHhCiBD0FCCEQoAE6BQghEKsCOggIIRAWEB4QHToHCCEQoAEQCjoHCCEQqwIQCIAAWKWEBGDpkgRoA3AAeACAAdsCiAGnTJIBCTI0LjMyLjkuNjgBAKABAQ&scient=gws-wiz#cobssid=s](https://www.google.com/search?q=as+per+keynesian+economics+demand+not+supply+drives+an+economy&source=hp&ei=Pv7wY8XIKeeJwbkPmo2wyA0&iflsig=AK50M_UAAAAAY_EMTkG3Cyi9kCm4LtDn4_Z8jEuBpfGV&ved=0ahUKEwjF_N-bwJ_9AhXnRDABHZoGDNkQ4dUDCAs&uact=5&oq=as+per+keynesian+economics+demand+not+supply+drives+an+economy&gs_lcp=Cgndnd3Mtd2l6EAM6EQguEIAEELEDEIMBEMcbENEDogsIABCABBCxAxCDAToFCC4QgAQ6CAguELEDEIMBOgsILhCABBDHARDRAzoICC4QgWEQsQM6CwguEIAEELEDEIMBOggIABCxAxCDAToFCAAQgAQ6CAguEIAEELEDOggIABCABBCxAzoFCAAQsQM6DQguEIAEEMcbENEDEAo6CggAEIAEELEDEAo6BwgAEIAEEAo6DQguEIAEELEDEIMBEAo6BggAEa0QAzoFCAAQhgM6CQgAEBYQHhDxBDoGCAAQFhAeOgUIABCiBD0HCAAQHhCiBD0KCAAQ8QQQHhCiBD0FCCEQoAE6BQghEKsCOggIIRAWEB4QHToHCCEQoAEQCjoHCCEQqwIQCIAAWKWEBGDpkgRoA3AAeACAAdsCiAGnTJIBCTI0LjMyLjkuNjgBAKABAQ&scient=gws-wiz#cobssid=s)

Note 11.

<https://slate.com/business/1996/08/supply-side-virus-strikes-again.html>  
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Note 12.

[https://www.google.com/search?q=Did+Bush+tax+cuts+help+economy&sa=X&ved=2ahUKEwj\\_t4z7tZ\\_9AhU0RTABHSSCDkQ1QJ6BAg3EAE&biw=1423&bih=620&dpr=1.13](https://www.google.com/search?q=Did+Bush+tax+cuts+help+economy&sa=X&ved=2ahUKEwj_t4z7tZ_9AhU0RTABHSSCDkQ1QJ6BAg3EAE&biw=1423&bih=620&dpr=1.13)

Note 13.

<https://www.theguardian.com/business/2019/oct/09/trump-tax-cuts-helped-billionaires-pay-less>

Note 14. <https://www.nytimes.com/2018/11/15/opinion/tax-cut-fail-trump.html?searchResultPosition=1>

Note 15. MSNBC on Twitter: "Ari Melber: "Fact check: True. In those four years that Trump was in office, the nation's debt rose by far over \$7 trillion...[the] national debt hitting \$31 trillion, which is 25% of all U.S. debt." <https://t.co/IGiptWZmk2>" / Twitter

Note 16. <https://www.pbs.org/newshour/nation/piketty-u-s-birthplace-freedom-progressive-taxation>

Note 17. Historical Highest Marginal Income Tax Rates | Tax Policy Center

Note 18. what is the social security wage cap for 2023 - Search (bing.com)

Note 19. <https://www.wbur.org/onpoint/2010/12/15/teddy-estate>

Note 20.

<https://www.americanprogressaction.org/article/the-reagan-speech-todays-gop-doesnt-want-you-to-see/>  
(Pat Garafalo)

Note 21. <https://www.wbur.org/onpoint/2010/12/15/teddy-estate>