Democrats bow to Wall Street, saving tax break for billionaires

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10 October 2007

The Democratic Party leadership in the US Senate has effectively killed proposals put forward earlier this year to close a tax loophole that allows billionaire managers of hedge and private equity funds to enjoy tax rates on their income that are far lower than those imposed on average American workers.

The proposed tax hike on the top echelon of Wall Street's financial barons had been touted by leading Democrats as a blow for equity. It was floated last spring after two of the larger funds, the Blackstone Group and Fortress Investment, went public and were compelled to reveal the income and assets of their managers. In the case of Blackstone's CEO Stephen Schwarzman, for example, it was revealed that he was paid $398.3 million last year alone and has an estimated $11 billion equity stake in the firm.

Contributing to the massive fortunes of these managers is a tax system that allows them to count the bulk of their income, paid out as a share (normally 20 percent) of the profits from deals made by the funds, as "carried interest," which is taxed at the capital gains rate of 15 percent, instead of the 35 percent rate that applies to the highest income tax bracket.

This top bracket, it should be noted, is itself at a near-historic low. As recently as 1980, income over $215,000 was taxed at 70 percent, and throughout most of the 1950s and early 1960s, income over $200,000 was taxed at 91 percent.

The Wall Street executives have claimed that they are entitled to the 15 percent rate because of the risks they take on investments. In fact, the vast bulk of the money at risk is that of their investors, for whom they provide a service as money managers, and are compensated for it, just as others who pay ordinary income taxes.

The main legislative proposal put forward in the House of Representatives would have compelled the super-rich fund managers to report their earnings as regular income and pay the 35 percent rate. It has been estimated that the measure would have created at least $6 billion in additional federal revenues.

According to the *Washington Post,* however, the Senate's Democratic leadership has already assured the billionaire and multi-millionaire financiers that would be affected by the measure that they have nothing to worry about.

Citing executives and Capitol Hill lobbyists, the paper reported Tuesday that Senate Majority Leader Harry Reid has met privately in recent weeks with the financial firms and told them that no such legislation will be passed by the Senate this year.

The paper added that "lawmakers and lobbyists agree that if the tax is not raised this year, its chances are not strong in 2008, either; Congress tends to be leery of tax increases in election year."

The *Post* attributes the transformation of the Democrats' feigned outrage over the profiteering on Wall Street into the leadership's deliberate stonewalling of legislation to an aggressive and lavishly funded lobbying campaign mounted by the funds, with the backing of a number of big business organizations.

According to Bloomberg News, private equity firms have paid out over $5.5 million in lobbying fees so far this year, four times what they spent in all of 2006. The Blackstone Group alone has spent $3.74 million this year on one lobbying firm—Ogilvy Government Relations—the largest amount ever paid out to such a firm in a six-month period.

At the same time, the firms' managers and executives have substantially increased their campaign donations, with the lion's share going to Democratic elected legislators. The Center for Responsive Politics reported that employees of funds belonging to the Private Equity

Council, a Wall Street trade group, gave 69 percent of their $3.4 million in campaign donations last year to Democratic candidates. This was up from 51 percent of $2.7 million in 2000. A similar shift was registered for large hedge funds.

According to the *Post* more than 20 lobbying firms have been pressed into service to stop the tax hike—a measure that would affect the income of a relative handful of the country's wealthiest financiers. Two former US senators—Louisiana Democrat John Breaux and Oklahoma Republican Don Nickles—have been hired to spearhead the effort.

The US Chamber of Commerce, the Real Estate Roundtable and other business groups have also joined in the effort to kill the legislation.

The thrust of this campaign has been the claim that taxing Wall Street's billionaires like everyone else would threaten economic growth and ultimately hurt those who could least afford it.

This far-fetched argument is predicated on the assumption that the fund managers would merely pass their increased tax bills on to their customers. As their clients include pension funds, the suggestion was that ending the lucrative tax loophole for the fund managers would really only threaten the benefits of hard-pressed retirees.

Also raised was the supposed threat the change in this arcane tax code would hold for low income communities and minority businesses, as the increased burden upon the fund managers would lead them to cut back on investments in these areas.

None of these arguments hold water, of course. A relatively small percentage of pension money—less than 10 percent, according to some recent studies—is invested through these private funds, and the impact would be slight—even if the Wall Street executives got away with making their customers pick up their tax bill. As for low-income neighborhoods and minority businesses, the amount of money that these funds put into these areas is infinitesimal.

Moreover, the annual windfall of $6 billion or more that the tax system provides the Wall Street managers far exceeds the entire federal budget for low-income housing credits.

Nonetheless, the spurious claims made by the private funds and their lobbyists found a ready audience among the Democrats on Capitol Hill, many of whom began making statements over the summer expressing their concern over the "unintended effects" of closing the tax loophole.

Last July, the *Wall Street Journal* published an article headlined, "Democrats Lose Zeal for Raising Hedge-Fund Tax," which noted that "Many Democratic lawmakers are also major beneficiaries of campaign donations from private-equity and hedge-fund executives, and may be wary of shutting off the spigot."

The *Journal* quoted Washington Democratic Representative Brian Baird as saying, "When you first hear about it, it seems like, 'Yes, this looks like an appealing way to generate a lot of revenue,' but when you study it more it seems like there are some serious unintended consequences."

Other Democrats—Washington Sen. Maria Cantwell, for example—were quoted as expressing their concern for public employee pension funds, while Rep. Joe Crowley and other New York area legislators voiced fears that the new tax rate could drive the hedge funds off-shore.

Behind all of this orchestrated hand-wringing, the Democrats' climb-down on closing the tax loophole for the country's wealthiest is merely one more confirmation that this party—no less than the Republicans—represents and defends the interests not of working people, but those of the ruling elite. Just as the Democrats in Congress have proven unwilling to carry out any action to end the war in Iraq, so too they will do nothing to ameliorate the unprecedented inequality that pervades every facet of American society.