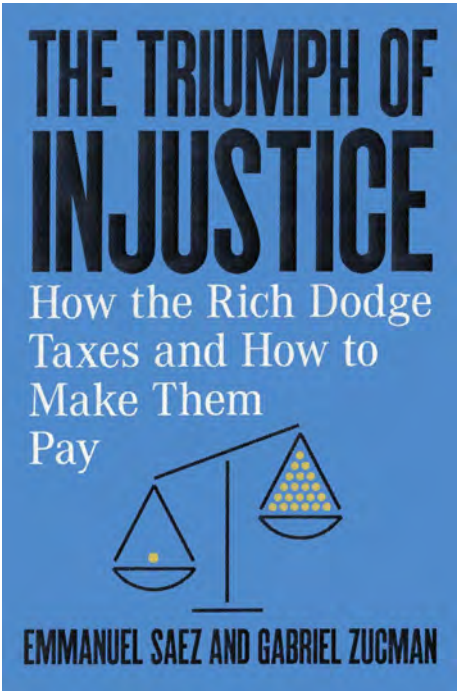
Can a Wealth Tax Work?

Gabriel Zucman

- Demand for progressive wealth taxation
- Can it work?
- Lessons from international experience



Chapters 6–7:

- Tax avoidance, tax evasion, tax competition are not laws of nature
- Policy choices
- With good plumbing a wealth tax can work

The European experience with wealth taxation

This experience was a failure, for three main reasons:

- Tax competition
- Tax evasion
- Low exemption threshold → lobbying → base erosion

Difference between US and European context

The US is in a much better position today

- Taxes expatriates
- Receives information from foreign banks
- High exemption thresholds in Warren and Sanders plan

Making a US wealth tax work

- Taxing all assets at their market values
- When market values are missing, create a market
- Regulation of tax-avoidance industry

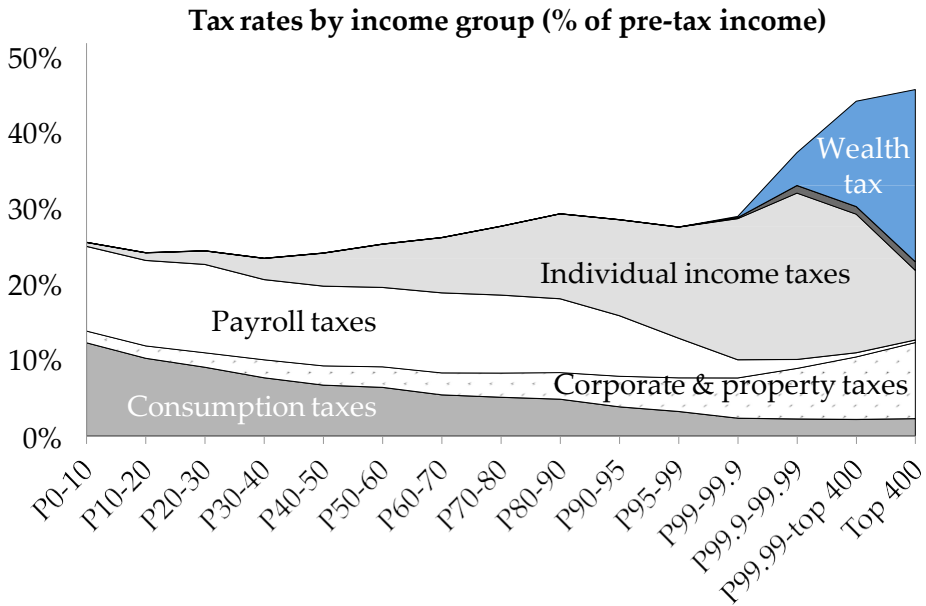
→ Elasticities are not immutable parameters (Slemrod and Kopczuk 2001)

Is it worth the trouble?

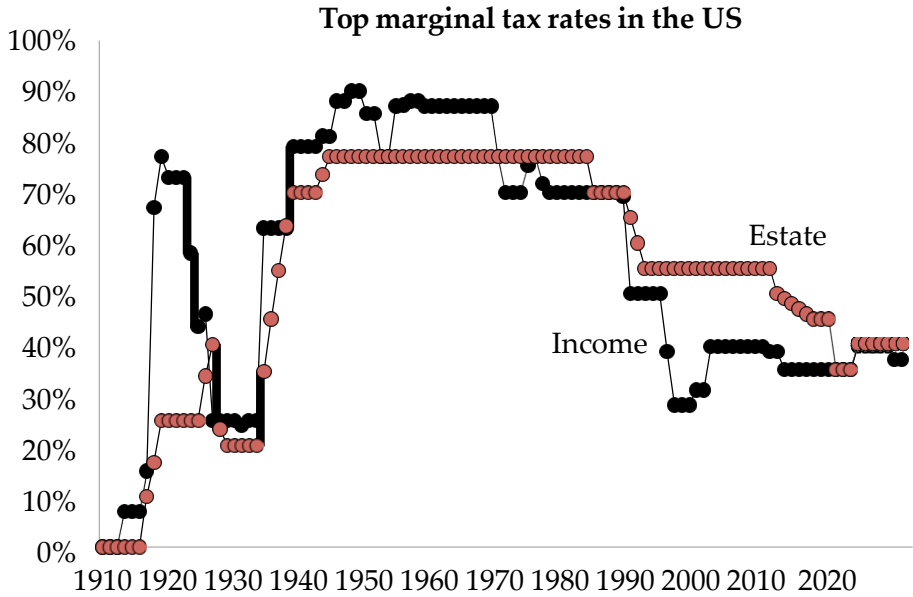
Wealth tax: most direct way to tax the very rich

- Income tax not enough (Buffett)
- Corporate tax too limited (flat rate)

The Warren wealth tax would have a big impact on tax progressivity at the top



The history of taxation is full of U-turns



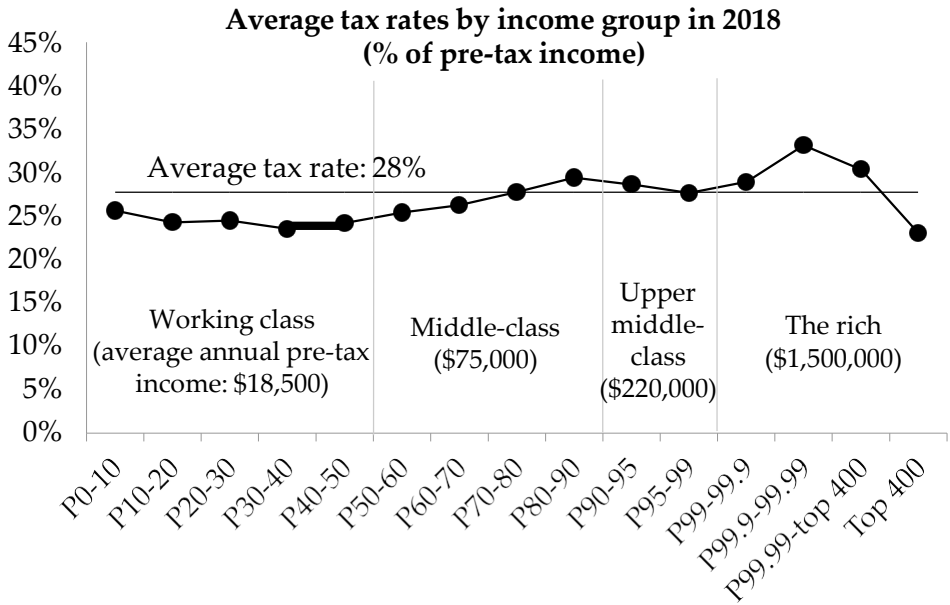
Supplementary Slides

A comprehensive view of the US tax system post-Trump tax reform

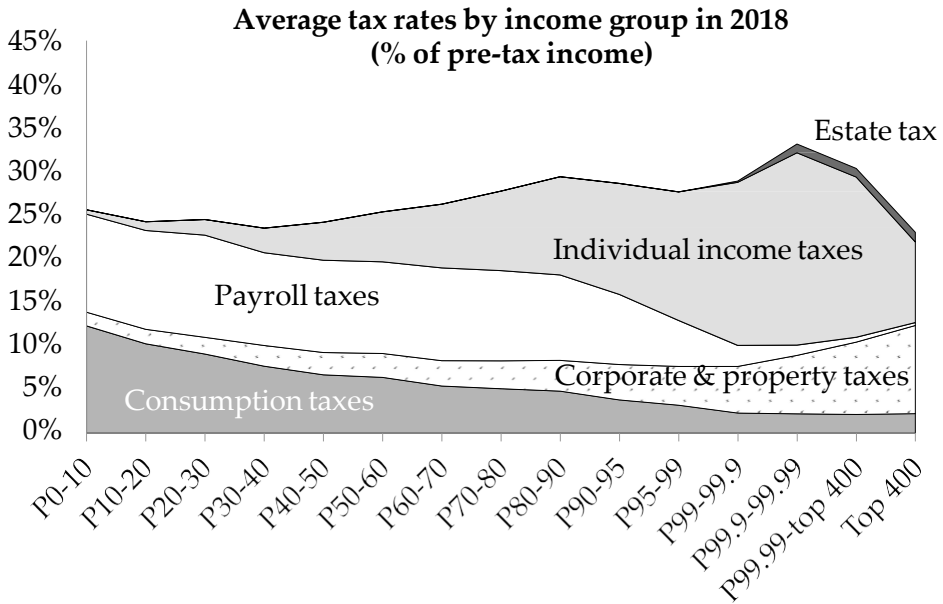
Considering **all taxes paid at all levels of governments in 2018**, we find that:

- Contrary to widely held view, US tax system is not progressive
- For the first time, **billionaires pay lower tax rates than the working-class**
- Top 400 effective tax rate = 23% (incl. corporate taxes, etc.) vs. 25-30% for working & middle classes
- Regressive taxation: a new engine of inequality

The US tax system: A giant flat tax regressive at the top



The US flat tax: Composition by type of tax



Explaining the US flat tax

Why the poor pay a lot:

- Very regressive sales taxes: US has **a poor man's VAT: only on goods, not services**
- ↑ payroll taxes despite ↓ minimum wage (/ = Europe: ↑ min wage, ↓ payroll taxes for low earners)

Why the rich pay little:

- Capital income not/little taxed (corp retained earnings / reduced rates on dividends and capital gains)
- Collapse of corporate taxation (**fed. corporate tax revenue almost halved in 2018** vs. 2017)

Adding health insurance premiums (privatized poll tax) to the picture

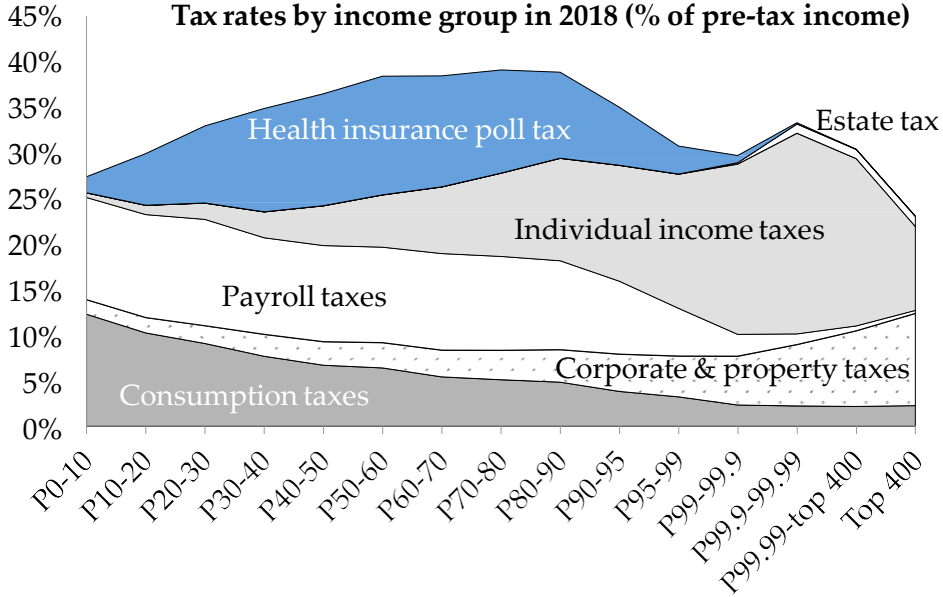
Since 2010, it is mandatory to have health insurance. Mostly done through employers.

- Cost $13,000 per covered worker, irrespect. of income

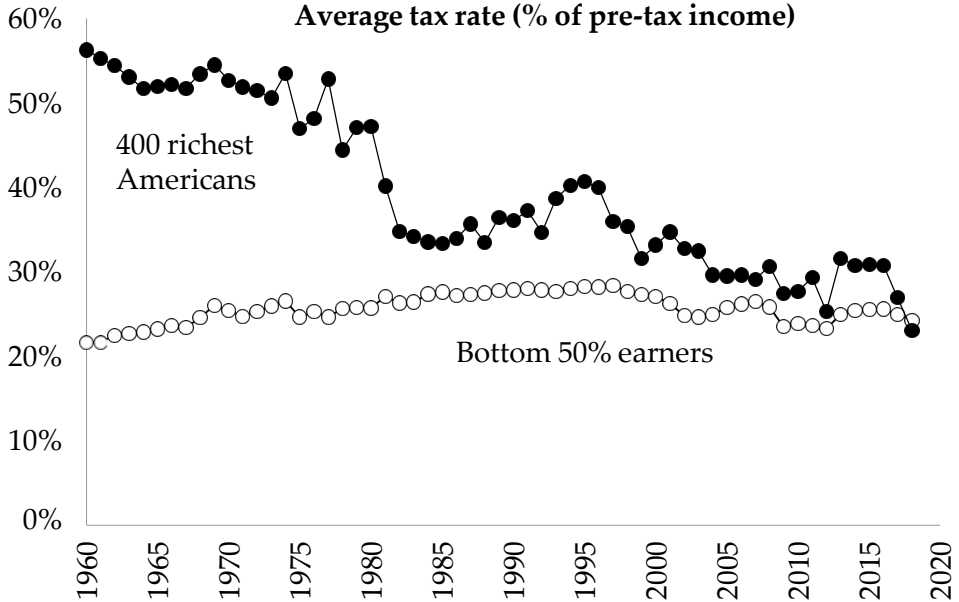
Health insurance premiums = huge poll tax administered by employers on behalf of gov ($\sim$ Ancien Regime tax farming)

- Mandatory payments to insurers (private oligopoly) $\approx$ Medicare tax paid to gov (public monopoly)
- Except insurance premiums are much more regressive

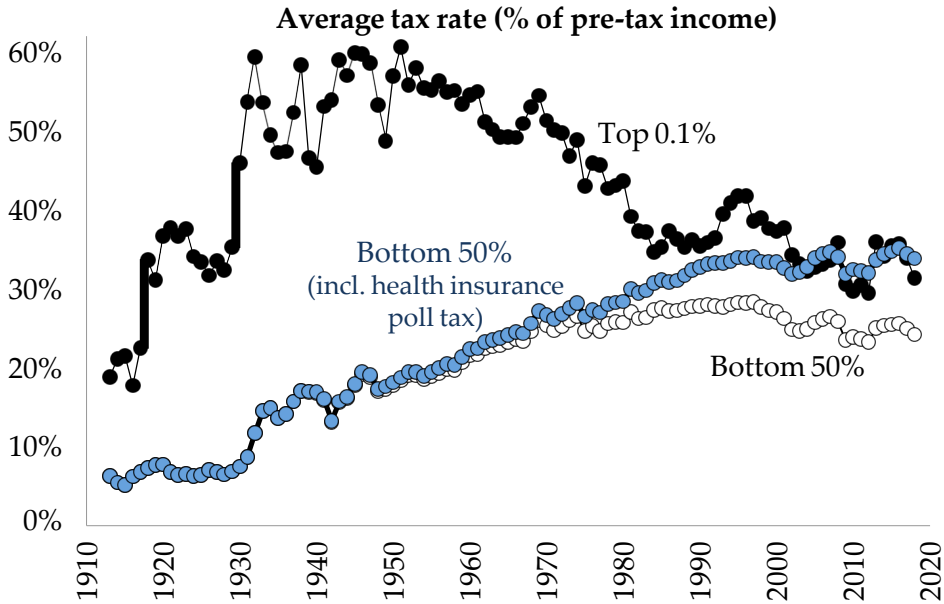
The US tax system: flat... or massively regressive?



For the first time in 2018, billionaires paid lower tax rates than the working class



Including health poll tax, working-class pays more than the top 0.1%



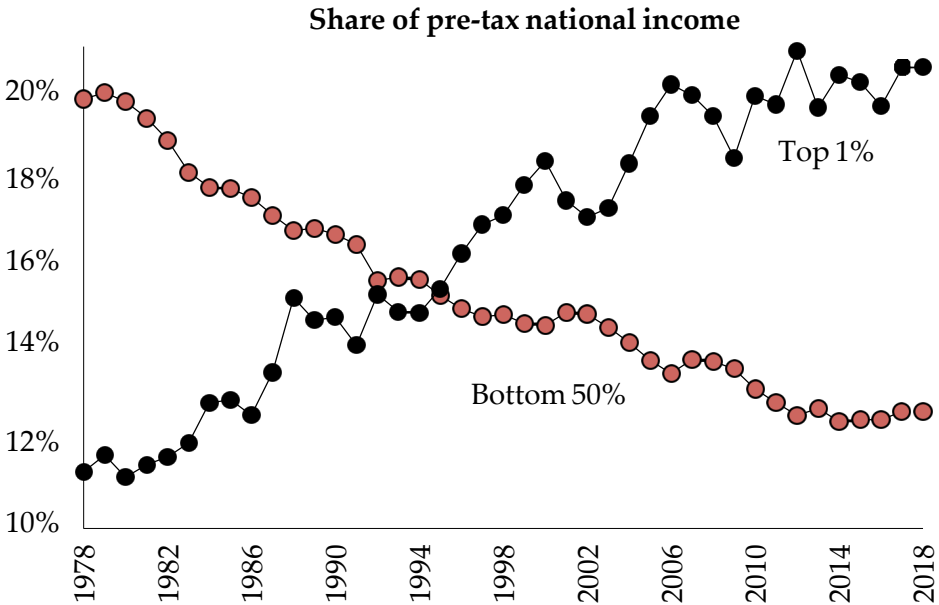
Two engines of inequality: taxes at the top, health costs for the rest

- **Bottom 50% average pre-tax income has stagnated since 1980, at $18,500 per adult**
- Out of this stagnating income, rising share goes to taxes & health → impedes wealth accumulation
- At the top, opposite process: booming income and falling taxes → snowballing wealth accumulation

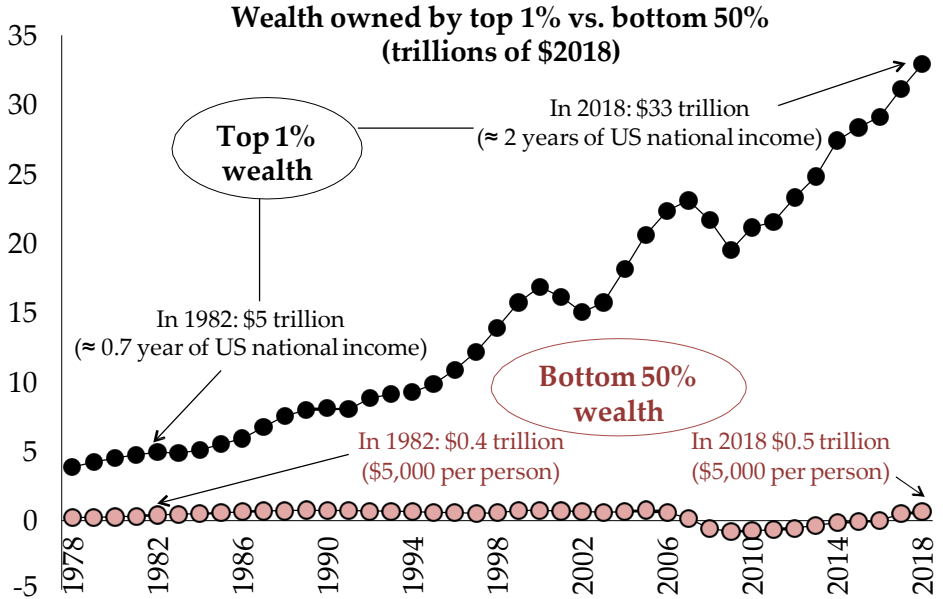
There's no fixing inequality without fixing taxes:

- Progressive taxation is the safeguard that kept top wealth accumul. under control in 20th c., now gone
- **The health care question is a tax question:** what should replace the private poll tax?

The rise of income inequality in the United States

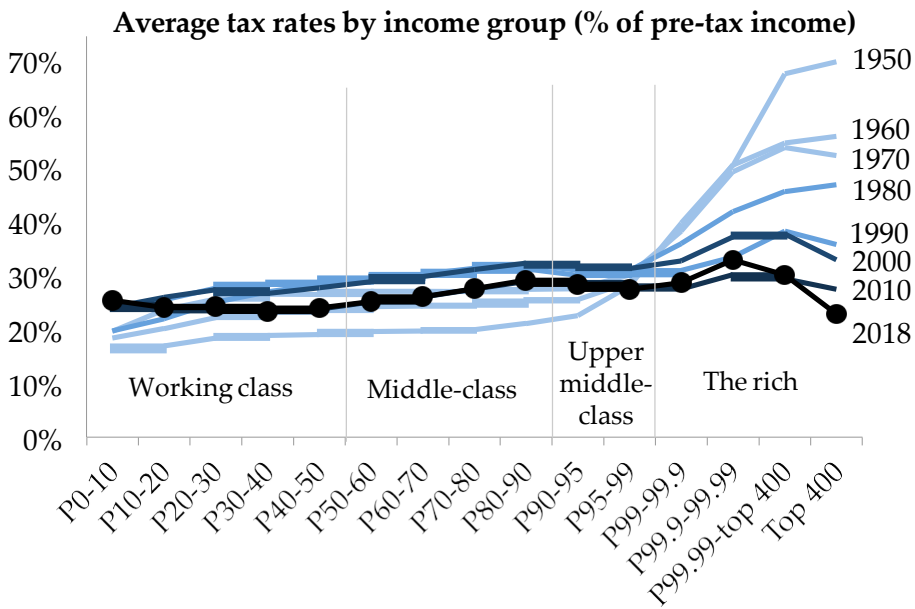


Snowballing wealth accumul at the top. Wealth stagnation at the bottom.



Long-Run Changes in Tax Progressivity in America

The shrinking progressivity of the US tax system

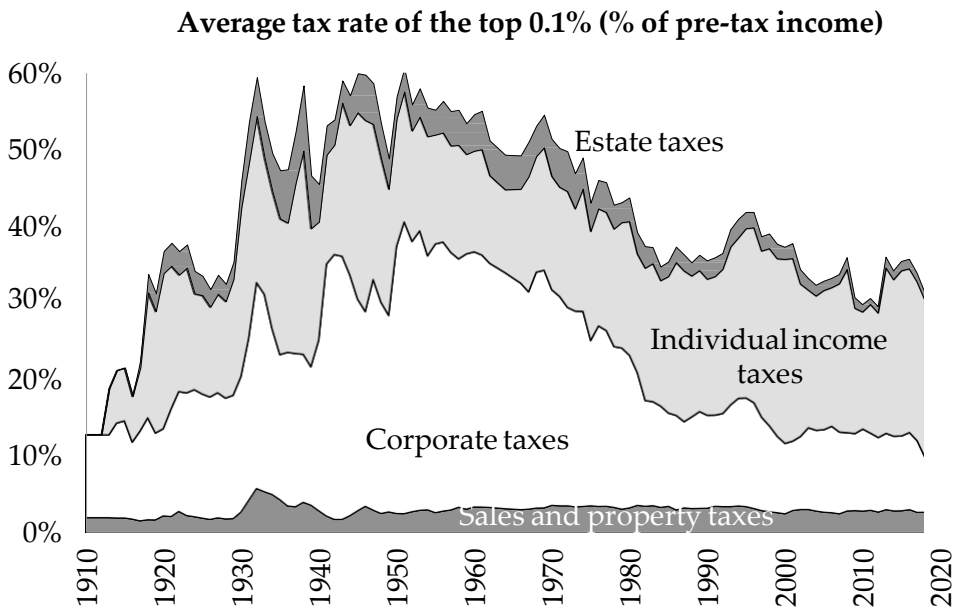


Why has tax progressivity collapsed?

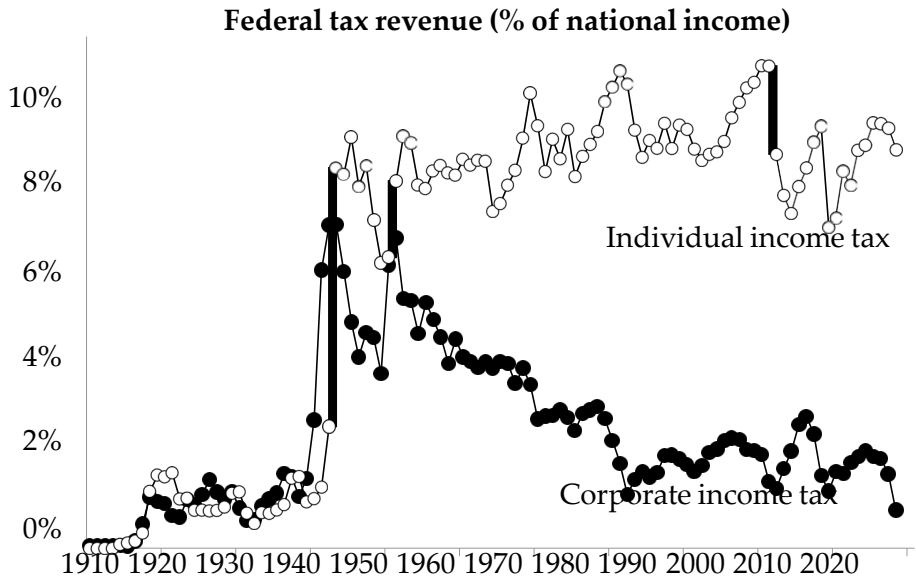
Three main drivers of declining progressivity:

1. Collapse in capital taxation, itself reflecting changes in politics and ideology
2. Choice to tolerate certain forms of evasion. **Let avoidance fester → slash rates → repeat**
   - ▷ 1980s: individual income tax → Reagan 1986
   - ▷ 2000s-2010s: corporate tax → Trump 2017
3. Globalization in its current form: tax havens; tax competition.
   - ▷ But nothing inherent in globalization prevents K taxation: **other choices are possible**

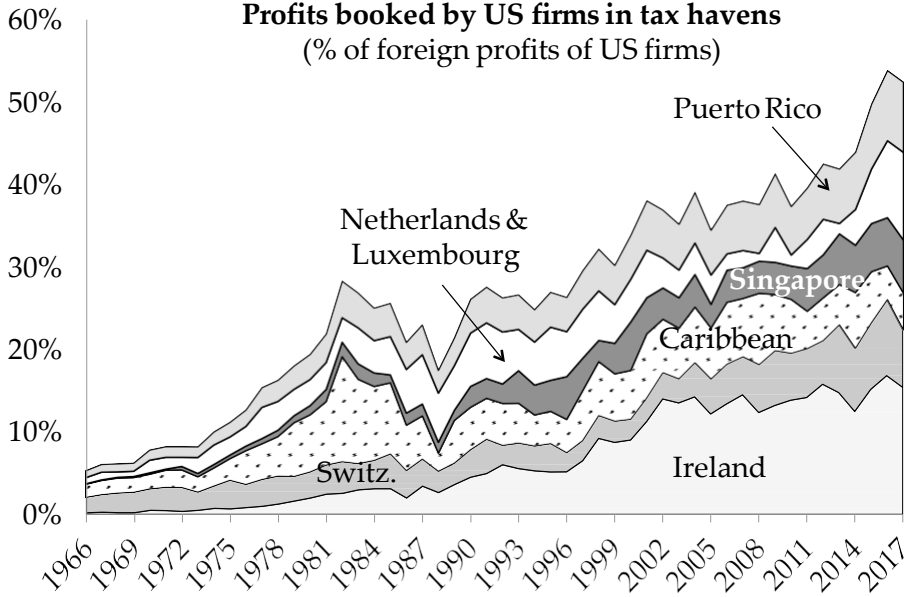
The key role of the corporate tax for the wealthy



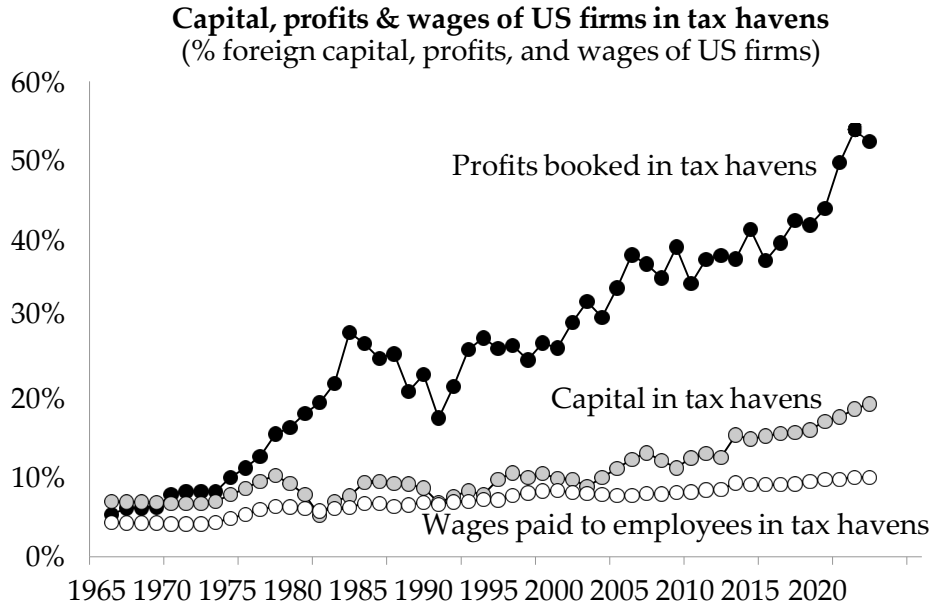
The slow agony of the corporate tax



Letting tax evasion fester: The case of the corporate tax



Paper profits are moving to tax havens; real activity less so



Towards the death of the progressive income tax?

Collapse in global corporate tax rate (halved since 1980s)

Key problem: **no progressive income taxation possible without high enough corporate tax rate**

- If low corporate tax rate, the rich incorporate and retain earnings within their firm → save tax free
- Individual income tax becomes mere consumption tax
- As tax competition rages, gap between corp. vs. top indiv. tax rate rises → rich more likely to incorporate

Any progressive plan must start with a strategy to end inter'l tax competition. **Good news is: this is doable.**

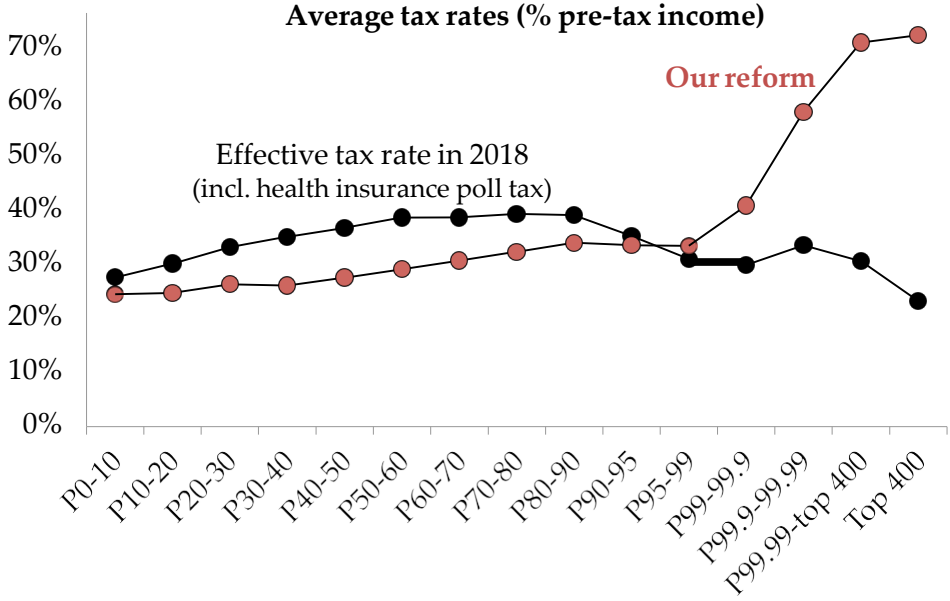
Elements for a 21st Century Tax System

Our approach: three key principles

1. **Reconcile globalization with tax justice**
   - ▷ A plan to stop corporate tax evasion and tax competition
2. **Protect democracy by taxing extreme wealth**
   - ▷ With a 10% wealth tax above $1 billion, can stabilize wealth inequality to 1980 level
3. Fund health care and education (pre-K, university) for all by **reinventing the income tax**
   - ▷ New national income tax in lieu of current poll tax

One among many possible sets of solutions. Simulate yours! TaxJusticeNow.org

Our proposed US tax revolution: Who would pay what



Reconcile globalization with tax justice

A lot can be done unilaterally to tax corp. more

How the US could tax US firms:

- 25% minimum tax on country-by-country profits
- Ex: If Apple pays 2% on the profits it books in Ireland, US would collect the missing 23% = 25% – 2%

How the US could tax foreign firms:

- Sales apportionment of global tax deficit
- Ex: if Nestlé pays 2% globally and makes 30% of its sales in the US, US would collect 30% × (25% – 2%)

Hard to avoid, can be done by any big country unilaterally

Rewrite the treaties of globalization

The treaties of globalization are not set in stone.
They can be rewritten:

- International agreement on 25% corporate minimum tax as pre-condition for further trade liberalization
- **Putting taxes at the heart of future trade deals**
- Defensive measures: sanctions for non-cooperative havens (approach followed successfully to force Swiss banks to cooperate)

→ **Nothing inherent in globalization prevents high K taxation.** Corporate tax could rise back to 50%.

Reconnect with America's wealth tax tradition

US pioneered wealth taxation:

- Wealth taxes as far back as 17th c. in Northern states
- Not only on real estate but also financial assets and other personal property

Fight over wealth taxation: key in US fiscal history

- Massachusetts: wealth taxation until 1915 (attacked by Harvard profs who wanted to tax housing only [regressive], citing European example...)
- Virginia: slave-holding oligarchy existential fight against wealth taxes → archaic poll & sales taxes

Reconnect with America's tradition of progressive taxation

US pioneered steeply progressive taxation

- ≥70% estate tax rate 1936–1980
- ≥90% top income tax rates (with higher rates on K)
- Huey Long 1934 "Share the wealth" society: cap wealth at $50m (≈ $3-4 billion today)

Legal maximum income/wealth: a US invention

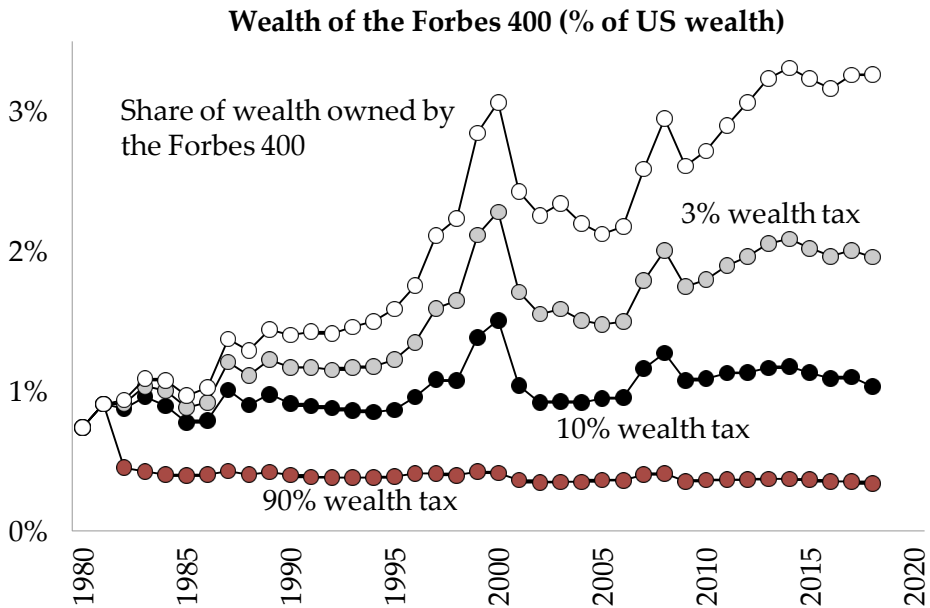
- Concerns about oligarchic drift & capture span time & political spectrum, from Madison to FDR
- Europe long seen as oligarchic anti-model

Reinventing wealth taxation for the 21st century

Two goals: generate revenue to complete the US social state, curb extreme wealth

- Warren wealth tax: 2% above \$50m, **3% above \$1bn**: generate revenue sustainably ($\approx$ 1% GDP)
- **10% top rate above \$1b:** maximizes revenue over 1 generation but eventually grinds down top wealth
  - $\sim$ **"abolish billionaires gradually"**
- **90% top rate** above 10,000 $\times$ average wealth ($\approx$ \$3-4 billion) (Piketty, 2019)
  - $\sim$ **"abolish billionaires now"**

If a wealth tax above $1 billion had been in place since 1982...



Funding health care for all: the national income tax

Other countries use VAT and payroll taxes to fund health. But **these taxes are regressive & have narrow base**

- VAT: exempts saving and big sectors (finance, health, education): VAT base $\approx$ 40% of national income only
- Payroll tax: exempts capital income (growing fast)

Our solution: a tax on all of national income

- Base: all labor costs + interest + business profits + foreign dividends ($\approx$ 94% of national income)
- 6% rate enough to fund health care for all & abolish private poll tax $\rightarrow$ **big tax cut for bottom 90%**

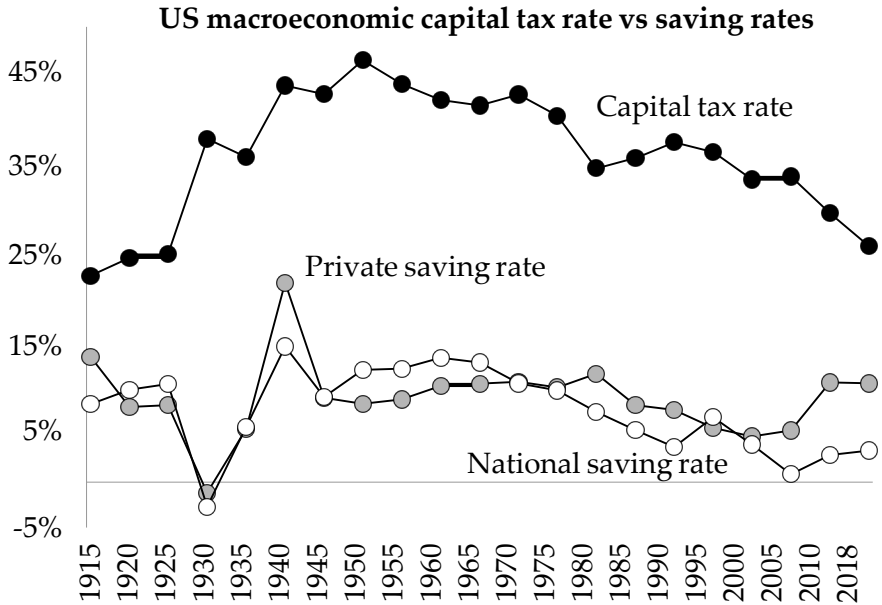
Abolish sales taxes and Trump tariffs

Economists' love for consumption taxes is misplaced

- Theorized during post-WW2 decades of low capital stock / low wealth inequality; opposite context today
- What boosts saving: regulations (eg, automatic enrollment in pensions), not tax incentives
- Consumption taxes have no role in optimal tax system and are particularly archaic in US (sales taxes < VAT)

→ Our proposal abolishes all sales taxes and Trump tariffs (but keeps externality-correcting taxes on gasoline etc.)

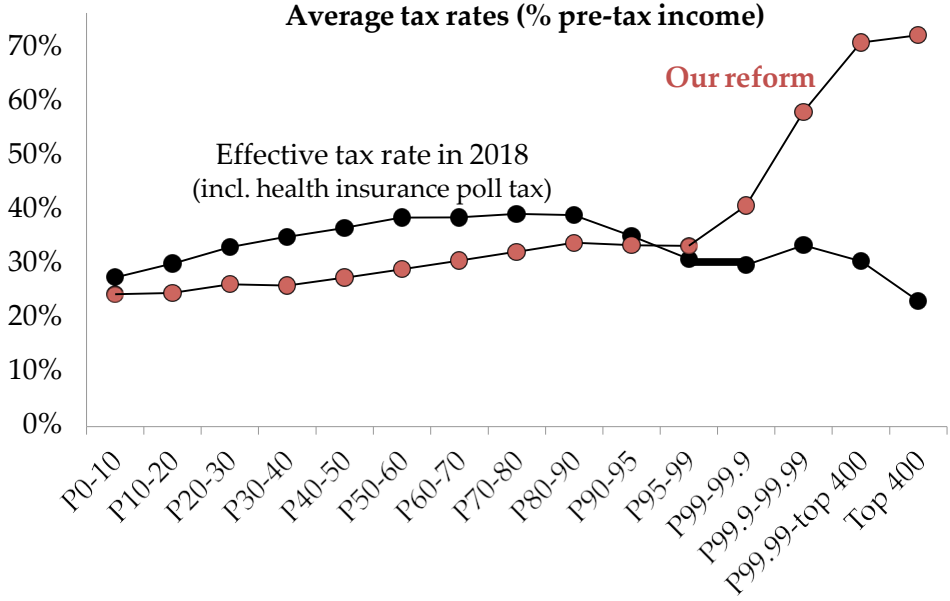
What boosts saving: regulations, not tax incentives



Summary of our reform: Taxing the rich		
	Type of tax	Revenue (% of national income)
Wealth tax	2% rate above $50 million 3.5% rate above $1 billion	1.2%
Income tax	60% top marginal income tax rate Full taxation of dividends & K gains Integration with corporate tax	1.7%
Corporate tax	30% effective US corporate tax rate 25% country-by-country minimum tax	1.2%
Total		**4.1%**

Summary of our reform: A fairer social state		
	Type of tax / spending	Revenue (% of national income)
Abolish health care poll tax	$8,000 for currently-covered workers $8,000 for the currently uninsured	–6.0%
Education for all	Public child care and early education	–1.0%
	Free tuition for public universities	–0.5%
Abolish sales taxes	Eliminate sales taxes and Trump tariffs	–2.3%
National income tax	Flat 6% rate	5.6%
Total		**–4.1%**

Our proposed US tax revolution: Who would pay what



TaxJusticeNow.org

How we simulate tax reforms

Two key questions to analyze a tax reform:

1. Effect on each group's effective tax rate?
2. Effect on the dynamics of pre-tax income inequality?

Existing models (CBO, JCT, Treasury, Tax Policy Center) do 1. but for federal taxes only, and not 2.

TaxJusticeNow.org does 1. (for all taxes at all levels of gov.) and 2. through an interactive user-friendly website

TaxJusticeNow.org, live on October 15

Reinventing fiscal democracy

What the user can do:

- Change existing taxes: income, corporate, estate, payroll, etc. Can change tax rates and enforcement.
- Create new taxes (wealth tax, national income tax, …)

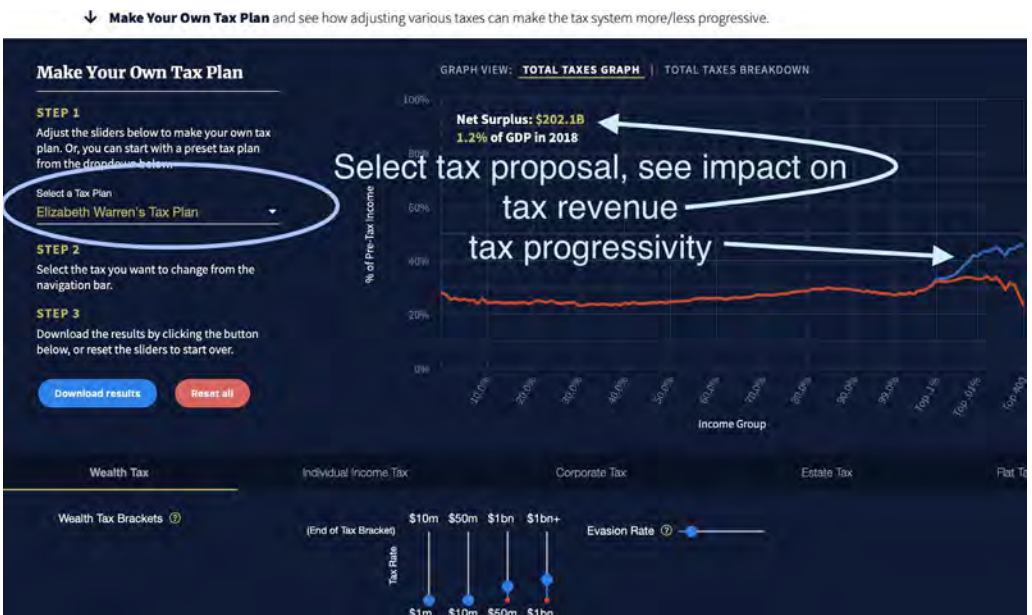
What the website does:

- Show immediate impact on tax progressivity
- Show long-run effect on pre-tax income distribution (inequality)
- User-friendly: move levers or tick boxes, and graphs adjust in real time

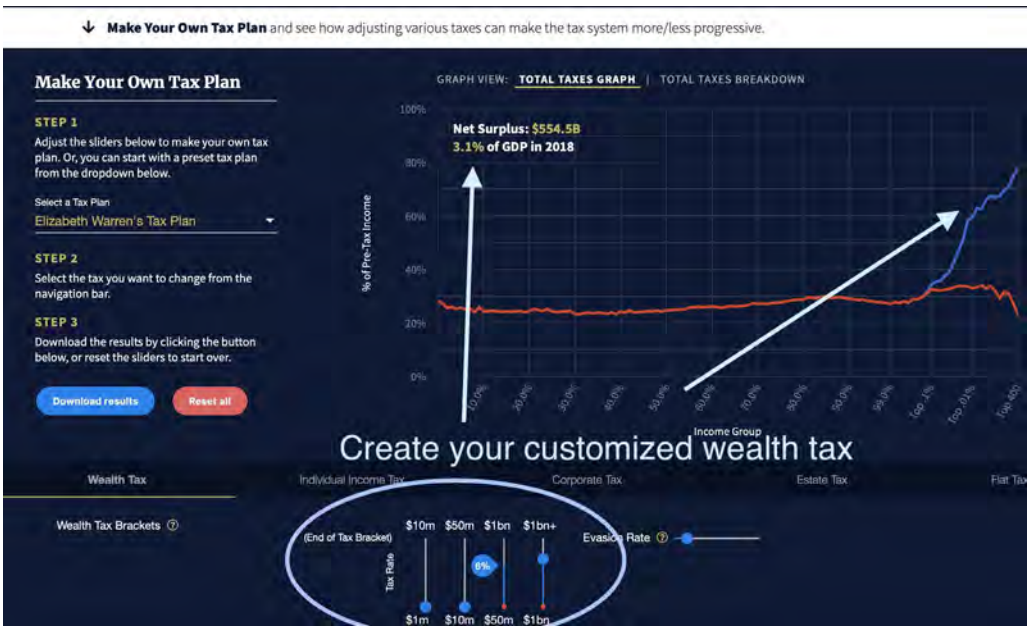
→ Make tax debate available to broad audience

Starting from who pays what today...

What's the effect of Warren's wealth tax?



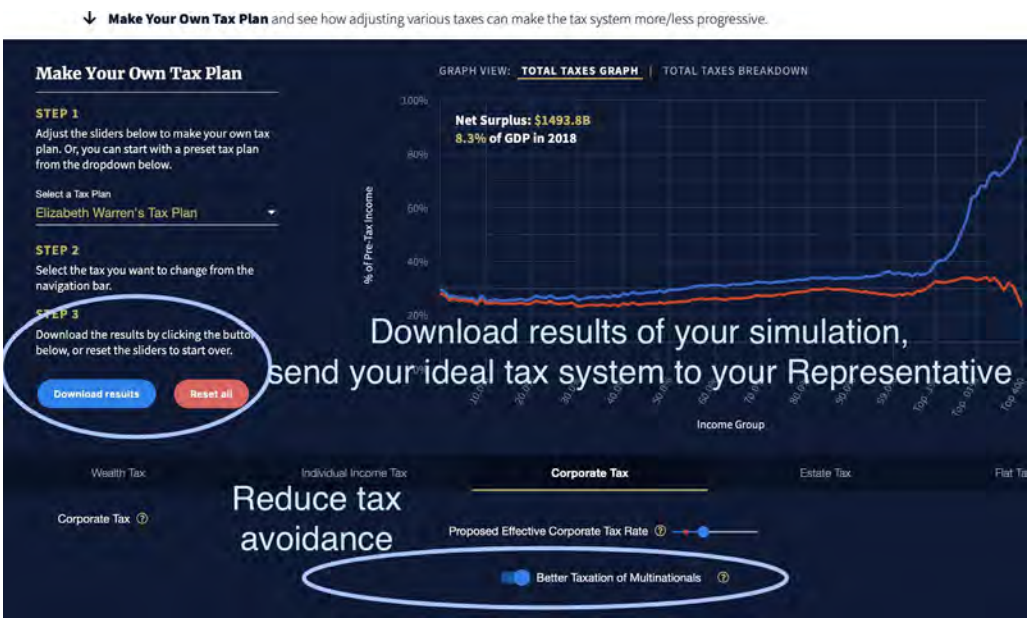
What's the effect of higher wealth tax rates?



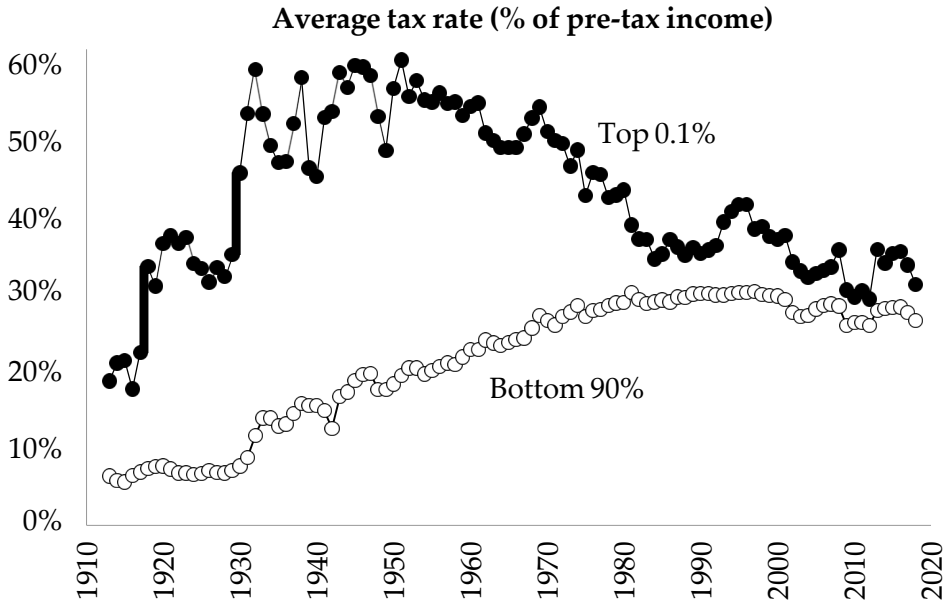
What's the effect of higher top marginal income tax rates?

↓ **Make Your Own Tax Plan** and see how adjusting various taxes can make the tax system more/less progressive.

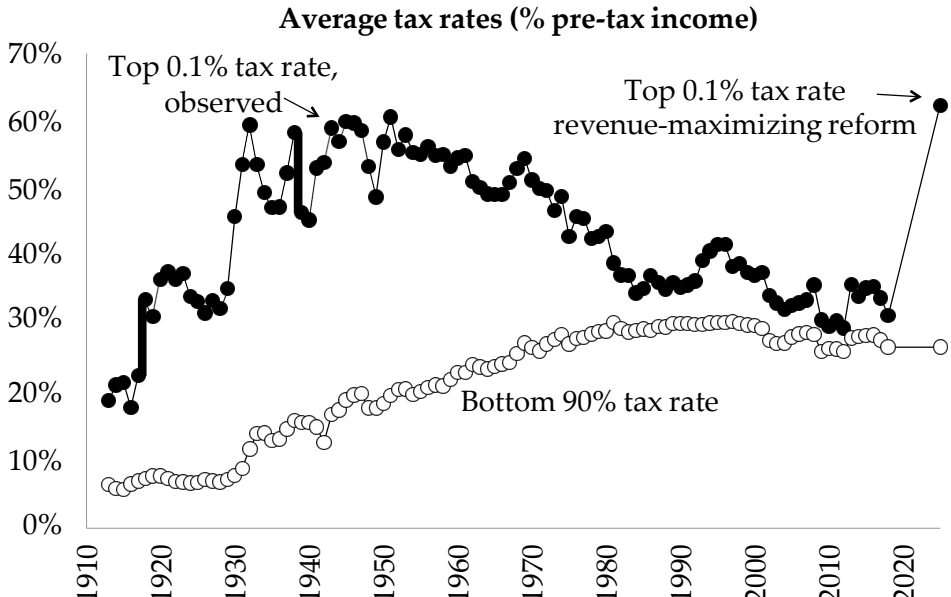
What's the effect of minimum taxes for multinational companies?



Starting from the history of tax progressivity in the US...



What if we increased top tax rates to maximize tax collection from the wealthy?



Conclusion

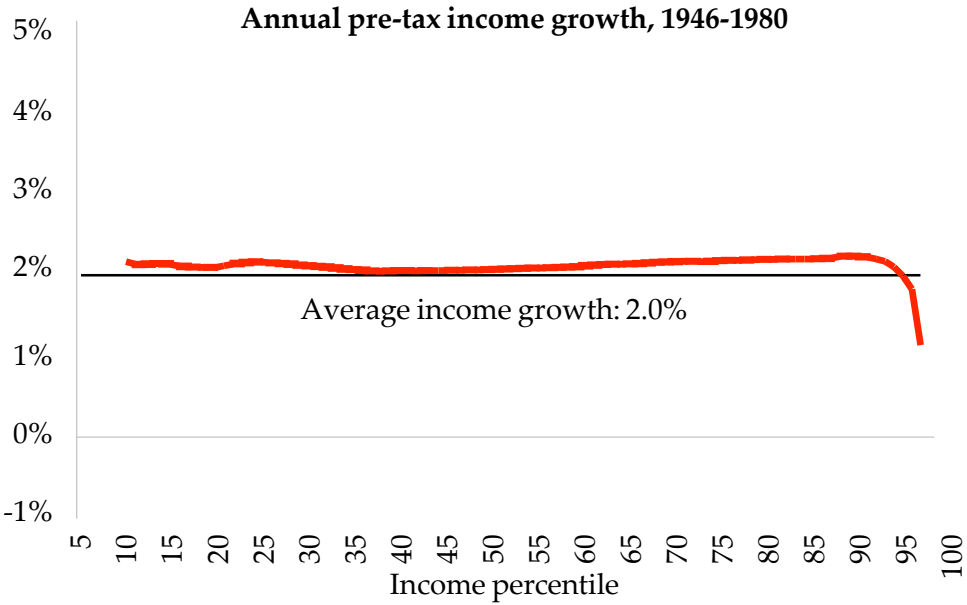
Main findings

Widely held view that external or technical constraints make tax justice impossible is wrong

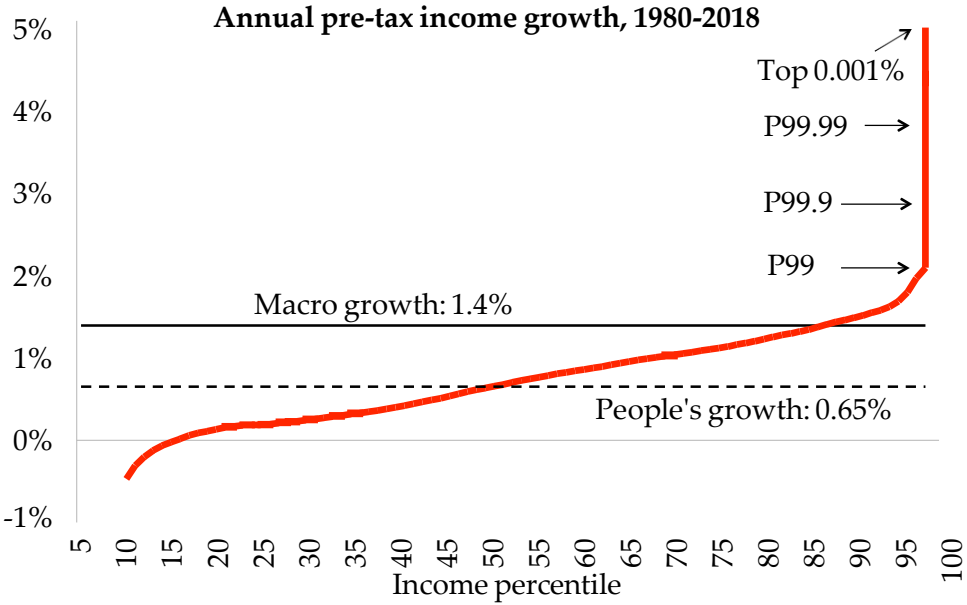
- Technically nothing in globalization prevents progressive taxation
- Tolerating tax evasion is a choice (regulation of tax avoidance industry)
- There is an infinity of possible future policy paths

Economists can be helpful in helping make more concrete the multiplicity of possible futures: TaxJusticeNow.org

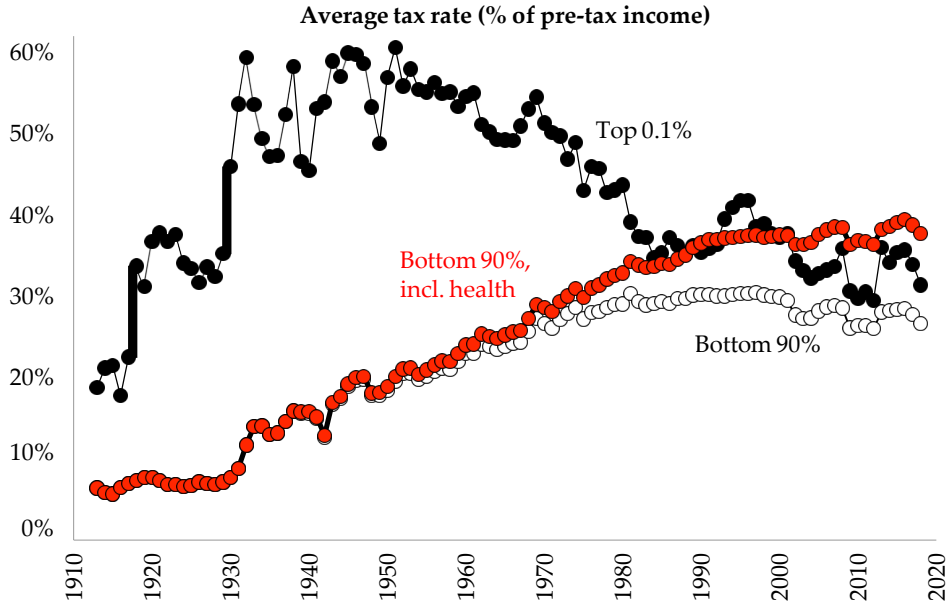
1946–1980: growth equitably shared (triumph of representative agent model)



After 1980: people's growth (average of each person's growth) << macro growth



The 2 engines of injustice: falling taxes at the top, rising health poll tax for the rest

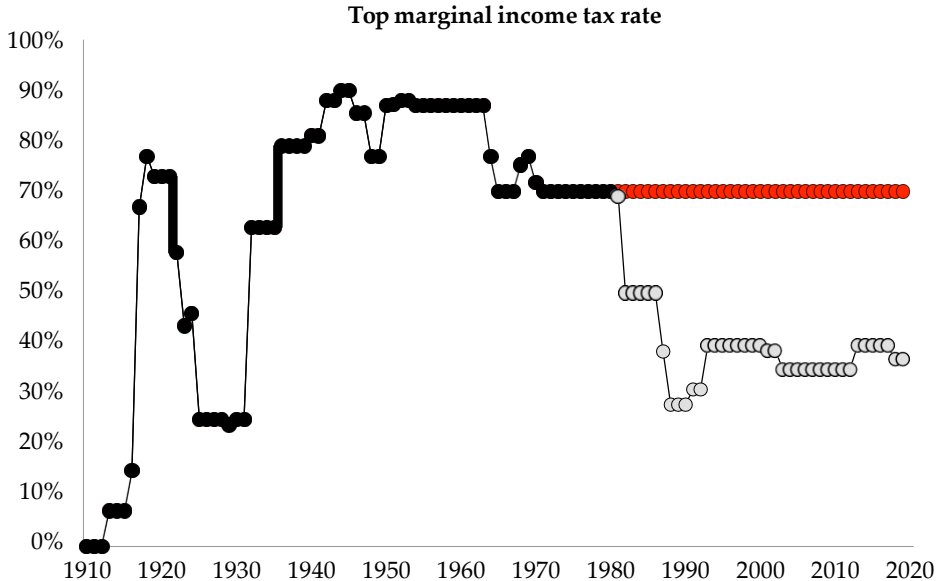


How we simulate the effect of tax changes on pre-tax inequality (for wonks)

Key features of the model:

- Model works at percentile group level p =P0-10, ...
- Actual outcomes for group p in year t: pre-tax income z_{pt} and average tax rate τ_{pt}
- Counterfactual outcomes: $\hat{z}_{pt}$, $\hat{\tau}_{pt}$ with an alternative tax system in place since year t_0
- z_{pt} respond to taxes through behavioral elasticity e_p that depends on overall marginal tax rate mtr_{pt} : $z_{pt} = z^0_{pt} \cdot (1 - mtr_{pt})^{e_p}$

What if the US had kept a 70% top rate since the 1970s?



Two types of real behavioral responses to taxes (for wonks)

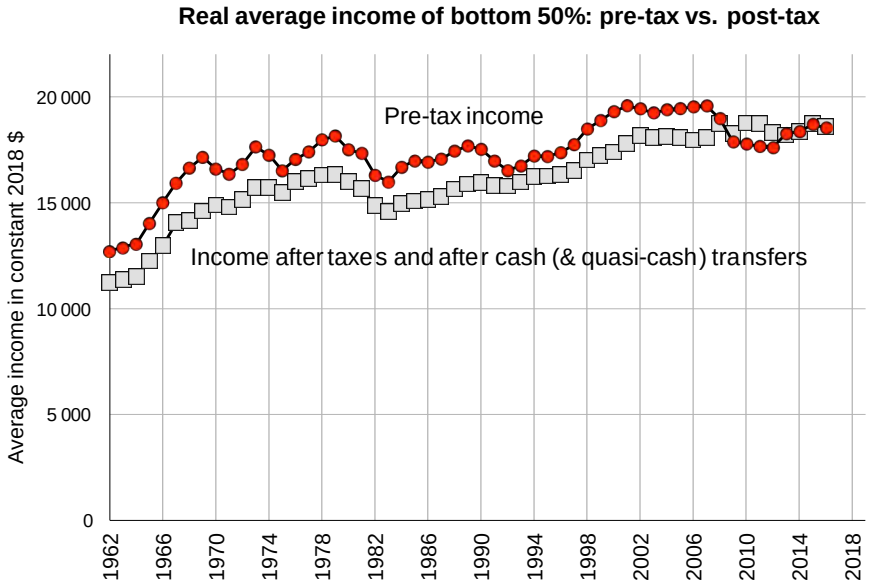
Key distinction: output vs. rent-sharing responses

- Output responses affect **level of output** through labor supply and capital accumulation: elasticity e^{O}_{pt}
- Rent-sharing responses affect pre-tax **distribution of output**: workers bargain for higher wages, private equity owner squeeze workers or customers: e^{R}_{pt}

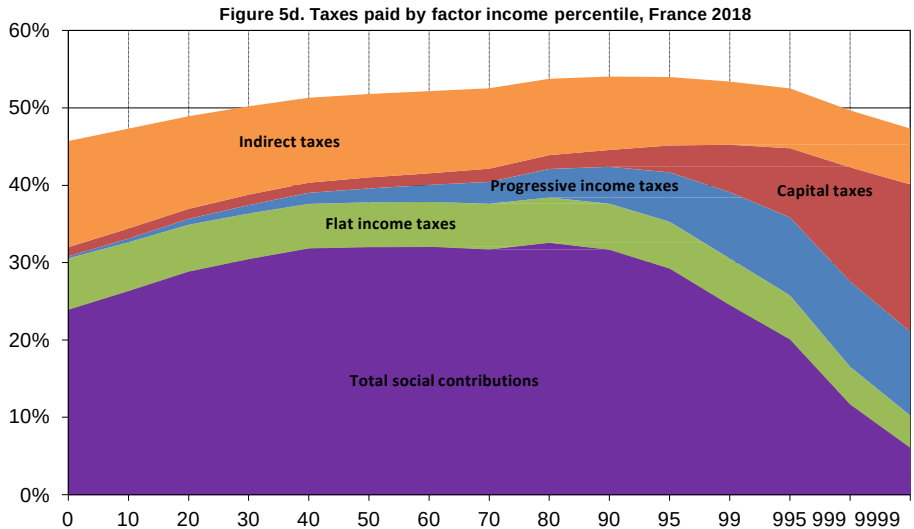
e^{O}_{p}, e^{R}_{pt}: not immutable parameters: e^{O}_{p} could be 0 (as, eg, during World War 2).

Benchmark: $e^{O}_{p} = 0.25$ and $e^{R}_{p} = 0.75$ at top; can be modified by user.

The working-class does not benefit on net from cash redistribution



The tax system of France appears no more progressive than that of the US



Distribution of factor national income among working population, i.e. adults aged 25-60 y.o working at least part-time.