Can a Wealth Tax Work?

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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
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

Average tax rates by income group in 2018 (% of pre-tax income)

Average tax rate: 28%

- Working class (average annual pre-tax income: $18,500)
- Middle-class ($75,000)
- Upper middle-class ($220,000)
- The rich ($1,500,000)
The US flat tax: Composition by type of tax

Average tax rates by income group in 2018 (% of pre-tax income)
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 (~ Ancien Regime tax farming)

- Mandatory payments to insurers (private oligopoly) ≈ Medicare tax paid to gov (public monopoly)

- Except insurance premiums are much more regressive
The US tax system: flat… or massively regressive?

Tax rates by income group in 2018 (% of pre-tax income)
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: \( \text{taxes at the top, / health costs for the rest} \)

- 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

Share of pre-tax national income

- Bottom 50%
- Top 1%


Percentage: 10%, 12%, 14%, 16%, 18%, 20%
Snowballing wealth accumulates at the top. Wealth stagnation at the bottom.

Wealth owned by top 1% vs. bottom 50% (trillions of $2018)

- In 1982: $5 trillion (≈ 0.7 year of US national income)
- In 2018: $33 trillion (≈ 2 years of US national income)

Top 1% wealth

Bottom 50% wealth

In 1982: $0.4 trillion ($5,000 per person)

In 2018: $0.5 trillion ($5,000 per person)
Long-Run Changes in Tax Progressivity in America
The shrinking progressivity of the US tax system

Average tax rates by income group (% of pre-tax income)

- Working class
- Middle-class
- Upper middle-class
- The rich

- 1950
- 1960
- 1970
- 1980
- 1990
- 2000
- 2010
- 2018
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

   - But nothing inherent in globalization prevents K taxation: other choices are possible
The key role of the corporate tax for the wealthy

Average tax rate of the top 0.1% (% of pre-tax income)
The slow agony of the corporate tax

Federal tax revenue (% of national income)

Individual income tax

Corporate income tax

Letting tax evasion fester: The case of the corporate tax

Profits booked by US firms in tax havens
(% of foreign profits of US firms)

- Puerto Rico
- Netherlands & Luxembourg
- Singapore
- Caribbean
- Ireland
- Switz.
Paper profits are moving to tax havens; real activity less so

Capital, profits & wages of US firms in tax havens
(% foreign capital, profits, and wages of US firms)

Profits booked in tax havens
Capital in tax havens
Wages paid to employees in tax havens
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

Average tax rates (% pre-tax income)

Effective tax rate in 2018 (incl. health insurance poll tax)

Our reform
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

\[ t > \geq 70\% \text{ estate tax rate } 1936–1980 \]

\[ t > \geq 90\% \text{ top income tax rates (with higher rates on K)} \]

\[ t > \text{Huey Long 1934 “Share the wealth” society: cap wealth at } $50m (\approx $3-4 \text{ billion today}) \]

Legal maximum income/wealth: a US invention

\[ t > \text{Concerns about oligarchic drift & capture span time & political spectrum, from Madison to FDR} \]

\[ t > \text{Europe long seen as oligarchic anti-model} \]
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
  - $\approx \text{"abolish billionaires gradually"}$
- 90% top rate above $10,000 \times$ average wealth ($\approx$ $3-4$ billion) (Piketty, 2019)
  - $\approx \text{"abolish billionaires now"}$
If a wealth tax above $1 billion had been in place since 1982...

Wealth of the Forbes 400 (% of US wealth)

Share of wealth owned by the Forbes 400

- 3% wealth tax
- 10% wealth tax
- 90% wealth tax

[Graph showing the share of wealth owned by the Forbes 400 from 1980 to 2020 with different wealth tax rates.]
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

US macroeconomic capital tax rate vs saving rates

- Capital tax rate
- Private saving rate
- National saving rate

-1915 - 2018
## Summary of our reform: Taxing the rich

<table>
<thead>
<tr>
<th>Type of tax</th>
<th>Revenue (% of national income)</th>
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</thead>
<tbody>
<tr>
<td><strong>Wealth tax</strong></td>
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<tr>
<td>2% rate above $50 million</td>
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<tr>
<td>3.5% rate above $1 billion</td>
<td>1.2%</td>
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<tr>
<td>60% top marginal income tax rate</td>
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<tr>
<td><strong>Income tax</strong></td>
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<tr>
<td>Full taxation of dividends &amp; K gains</td>
<td>1.7%</td>
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<tr>
<td>Integration with corporate tax</td>
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<tr>
<td><strong>Corporate tax</strong></td>
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<tr>
<td>30% effective US corporate tax rate</td>
<td>1.2%</td>
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<tr>
<td>25% country-by-country minimum tax</td>
<td></td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>4.1%</strong></td>
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## Summary of our reform: A fairer social state

<table>
<thead>
<tr>
<th>Type of tax / spending</th>
<th>Revenue (% of national income)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Abolish health care poll tax</td>
<td>–6.0%</td>
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<td>$8,000 for currently-covered workers</td>
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<tr>
<td>$8,000 for the currently uninsured</td>
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<tr>
<td>Public child care and early education</td>
<td>–1.0%</td>
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<tr>
<td>Free tuition for public universities</td>
<td>–0.5%</td>
</tr>
<tr>
<td>Abolish sales taxes Eliminate sales taxes and Trump tariffs</td>
<td>–2.3%</td>
</tr>
<tr>
<td>National income tax Flat 6% rate</td>
<td>5.6%</td>
</tr>
<tr>
<td>Total</td>
<td>–4.1%</td>
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</tbody>
</table>
Our proposed US tax revolution: Who would pay what

Average tax rates (% pre-tax income)

Effective tax rate in 2018 (incl. health insurance poll tax)

Our reform
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

For the first time in over a century, billionaires now pay lower tax rates than their secretaries.

TAX JUSTICE NOW
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?
What’s the effect of minimum taxes for multinational companies?

Make Your Own Tax Plan

**STEP 1**
Adjust the sliders below to make your own tax plan. Or, you can start with a preset tax plan from the dropdown below.

Select a Tax Plan
Elizabeth Warren’s Tax Plan

**STEP 2**
Select the tax you want to change from the navigation bar.

**STEP 3**
Download the results by clicking the button below, or reset the sliders to start over.

Download results
Reset all

Download results of your simulation, send your ideal tax system to your Representative.

Net Surplus: $1493.8B
8.3% of GDP in 2018

Corporate Tax
Reduce tax avoidance

Better Taxation of Multinationals
Starting from the history of tax progressivity in the US...
What if we increased top tax rates to maximize tax collection from the wealthy?

Average tax rates (% pre-tax income)

Top 0.1% tax rate, observed

Top 0.1% tax rate revenue-maximizing reform

Bottom 90% tax rate
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)

Annual pre-tax income growth, 1946-1980

Average income growth: 2.0%
After 1980: people’s growth (average of each person’s growth) << macro growth

Annual pre-tax income growth, 1980-2018

- Top 0.001%
- P99.99
- P99.9
- P99

Macro growth: 1.4%

People's growth: 0.65%
The 2 engines of injustice: falling taxes at the top, rising health poll tax for the rest

Average tax rate (% of pre-tax income)

Top 0.1%

Bottom 90%, incl. health

Bottom 90%
How we simulate the effect of tax changes on pre-tax inequality (for wonks)

Key features of the model:

\( \triangleright \) Model works at percentile group level \( \rho = P0-10, \ldots \)

\( \triangleright \) Actual outcomes for group \( \rho \) in year \( t \): pre-tax income \( z_{pt} \) and average tax rate \( \tau_{pt} \)

\( \triangleright \) Counterfactual outcomes: \( \hat{z}_{pt}, \hat{\tau}_{pt} \) with an alternative tax system in place since year \( t_0 \)

\( \triangleright \) \( z_{pt} \) 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?

Top marginal income tax rate
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: $e^R_{pt}$

$e^O_{pt}, e^R_{pt}$: not immutable parameters: $e^O_{pt}$ could be 0 (as, eg, during World War 2).

Benchmark: $e^O_{pt} = 0.25$ and $e^R_{pt} = 0.75$ at top; can be modified by user.
The working-class does not benefit on net from cash redistribution.

Real average income of bottom 50%: pre-tax vs. post-tax

- **Pre-tax income**
- **Income after taxes and after cash (and quasi-cash) transfers**

Average income in constant 2018 $
The tax system of France appears no more progressive than that of the US.

**Figure 5d. Taxes paid by factor income percentile, France 2018**

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