Rethinking Wealth Taxation

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This talk: two points

Wealth is becoming increasingly important relative to income in the main rich countries, in particular in Europe.

$\rightarrow$ See: T. Piketty and G. Zucman (2014) "Capital is Back: Wealth-Income Ratios in Rich Countries, 1700-2010", QJE

There are a number of reasons why taxing capital income, wealth, and inheritances is desirable:

$\rightarrow$ See: T. Piketty, E. Saez and G. Zucman (2014) "Rethinking Capital and Wealth Taxation", working paper

I– Capital is back

How do wealth-income and capital-output ratios evolve in the long-run and why?

Impossible to address this question until recently: national accounts mostly about flows, not stocks

With Thomas Piketty, we have compiled a new database of national balance sheets to address this question

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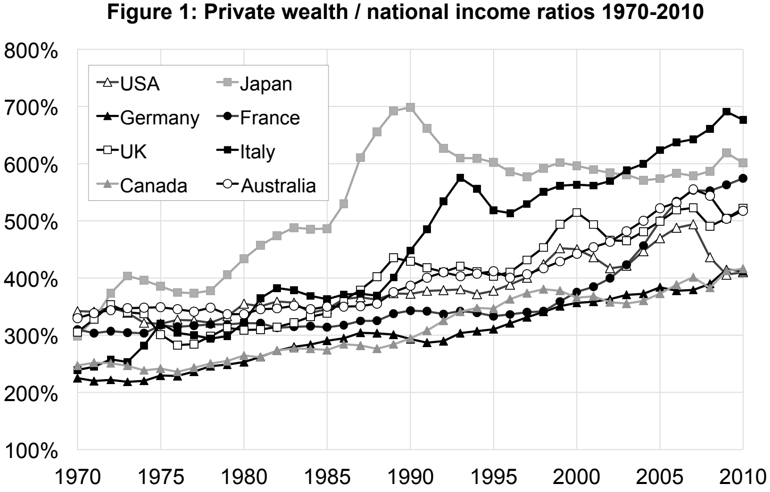
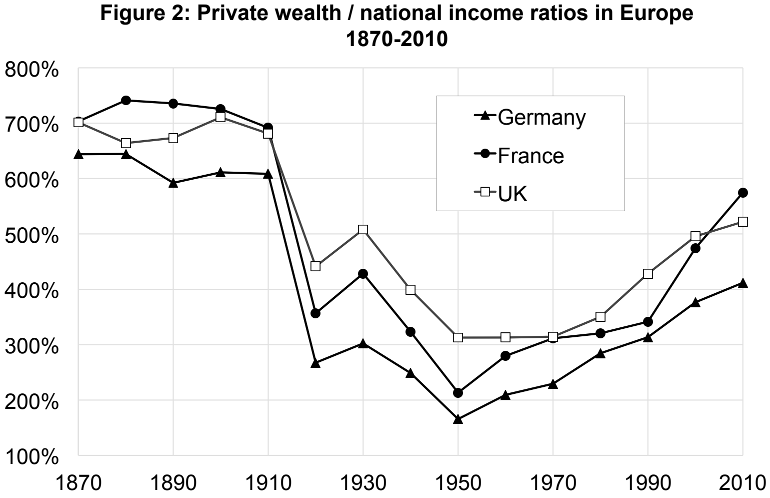
This database is in the process of being expanded into a **World Wealth and Income Database (W2ID)**

Private wealth-national income ratios have been gradually rising since 1970



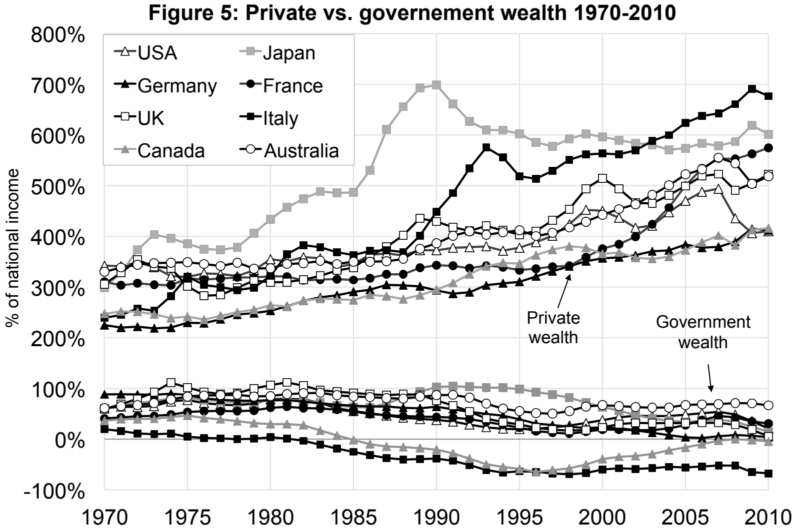
Authors' computations using country national accounts. Private wealth = non-financial assets + financial assets - financial liabilities (household & non-profit sectors)

European ratios appear to be returning to their high 18c-19c values

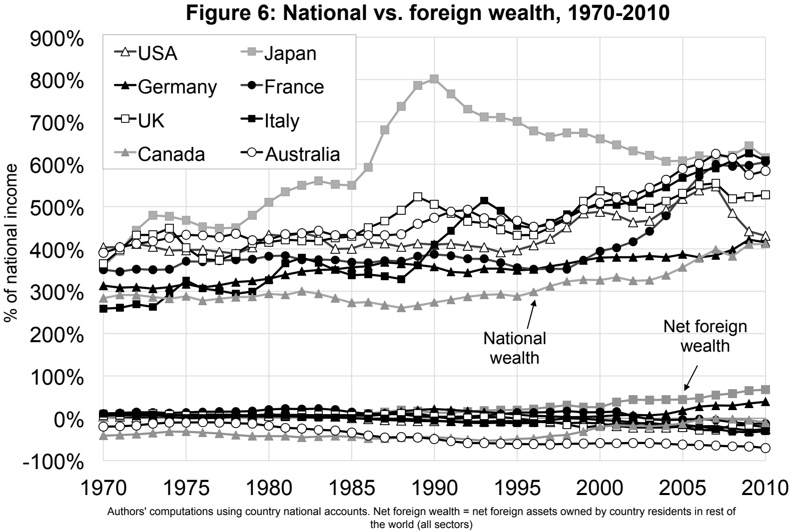


Authors' computations using country national accounts. Private wealth = non-financial assets + financial assets - financial liabilities (household & non-profit sectors). Data are decennial averages (1910-1913 averages for 1910)

Rise of private wealth has been larger than decline of government wealth...



...So that national wealth has also increased



How can we explain the 1970-2010 rise of the wealth-income ratio β?

Two key factors:

A **rise in relative asset prices**, itself driven by changes in capital policies since world wars

Slowdown of productivity and pop. growth, in line with Harrod-Domar-Solow formula $\beta = s/g$:

In the long-run, wealth-income ratio $\beta = s/g$

If $s = 10\%$ and $g = 3\%$ then $\beta \approx 300\%$

But if $s = 10\%$ and $g = 1.5\%$ then $\beta \approx 600\%$

$$\Downarrow$$

Countries with low g are bound to have high β

II– Rethinking wealth taxation

Three key rationales for wealth taxation:

The frontier between capital and labor income flows can be fuzzy
$\rightarrow$ a broad-based, comprehensive income tax is desirable

The very notions of income and consumption flows are difficult to define at the top
$\rightarrow$ the proper way to tax billionaire is a progressive wealth tax

There are meritocratic reasons why inherited wealth should be taxed more than self-made wealth
$\rightarrow$ need inheritance taxes in top of K income and wealth taxes

Argument 1: the frontier between capital and labor income flows can be fuzzy

Main situations where the K/L frontier is fuzzy:

- Business owners can decide how much they get paid in wages vs. dividends
- Corporate executives
- Can be hard to decompose income flows into pure L and K components (ex: bargaining power influenced by equity wealth)

The higher the shifting elasticity, the more it makes sense to tax capital and labor incomes at same rates

$$\Downarrow$$

Fuzziness argument is the most compelling rationale for a comprehensive income tax

Argument 2: a wealth tax may be the correct way to tax billionaires

Income is difficult to observe and define for top wealth holders:

- Capital income retained in holding companies, trusts, etc., can create large gap between economic and taxable income
- In principle, y_{ti} could be estimated as $\Delta k_{ti} + c_{ti}$
- But c_{ti} often hard to define at the top: private jet purchase?
- On the contrary k_{ti} is well defined

The lower the elasticity of the rate of return $\tilde{R}(e_{ti})$ with respect to the tax rate, the higher the optimal wealth tax rate on billionaires

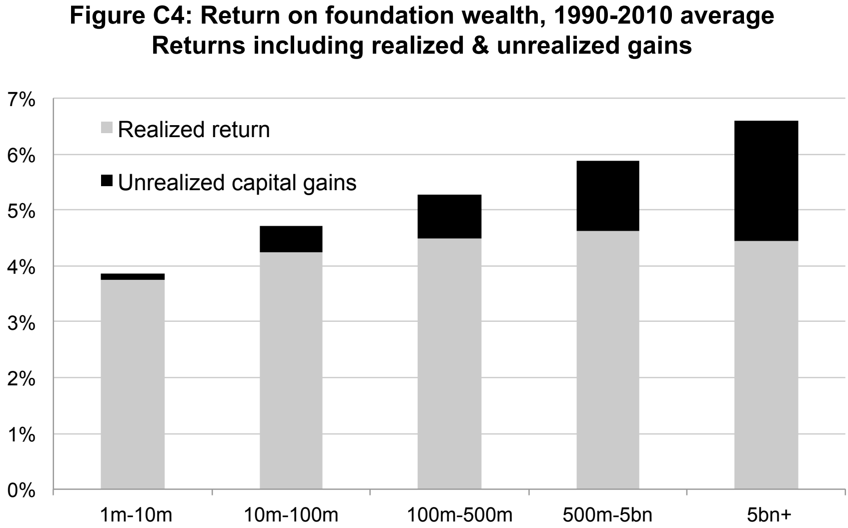
$$\Downarrow$$

Some evidence (Forbes) suggests $\tilde{R}(e_{ti})$ may largely be determined by initial wealth, but many uncertainties

Above a certain threshold, high fortunes tend to grow fast, whatever their source

The growth rate of top global wealth, 1987-2013	
Average real growth rate per year *(after deduction of inflation)*	1987-2013
The top 1/(100 million) highest wealth holders (about 30 adults out of 3 billions in 1980s, and 45 adults out of 4,5 billions in 2010s)	6.8%
The top 1/(20 million) highest wealth holders (about 150 adults out of 3 billions in 1980s, and 225 adults out of 4,5 billions in 2010s)	6.4%
Average world wealth per adult	2.1%
Average world income per adult	1.4%
World adult population	1.9%
World GDP	3.3%

For US foundations, rates of returns rise with wealth, suggesting scale effects



Argument 3: Bequest tax can be desirable on top of K income and wealth taxes

Most normative theories of distributive justice put a strong emphasis on individual merit $\rightarrow$ tax bequests

But individuals value the possibility of leaving a bequest to their children $\rightarrow$ don't tax bequests

For zero-bequest receivers it is harder to leave bequests when labor taxes τ_L are high $\rightarrow$ tax bequests (rather than labor)

Taking all these effects into account, Piketty and Saez (Econometrica, 2013) ask: what is the optimal linear bequest tax rate τ_B from the viewpoint of zero-bequest receivers? (about half of the population)

The "Meritocratic Rawlsian" optimum bequest tax rate

$$\tau_B = \frac{1 - \nu \cdot \frac{G}{R} \cdot \frac{\bar{b}^{left}}{\bar{y}_L}}{1 + e_B}$$

e_B: long-run elasticity of the aggregate bequest flow with respect to the net-of-tax rate $1 - \tau_B$. Don't tax what's elastic.

ν: fraction of wealth acc. driven by bequest motive ($\nu = 0.5$?). Don't tax bequest if people accumulate mainly to leave bequests

$\frac{\bar{b}^{left}}{\bar{y}_L}$: relative position of zero-bequest receivers in the distributions of bequests left and in the distribution of labor income.

$R = e^{rH}$ is the generational rate of return (r: annual return; H: generational length) and G is the generational growth rate.

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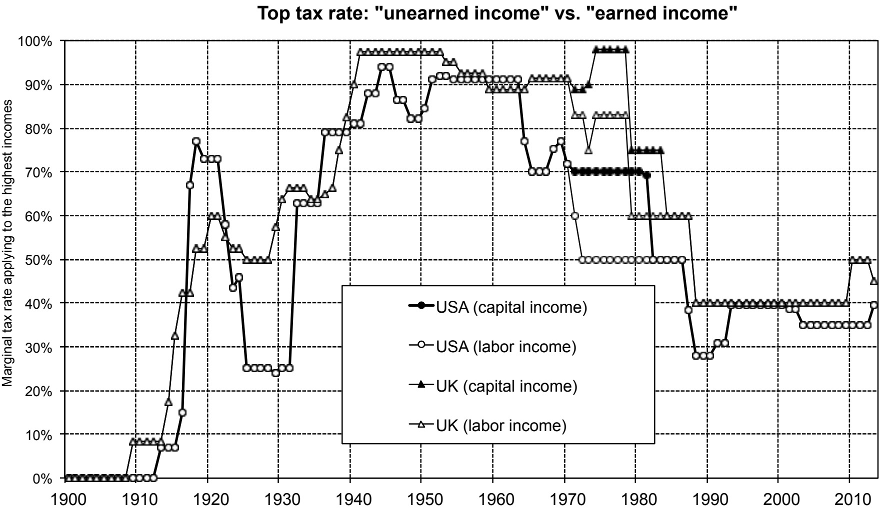
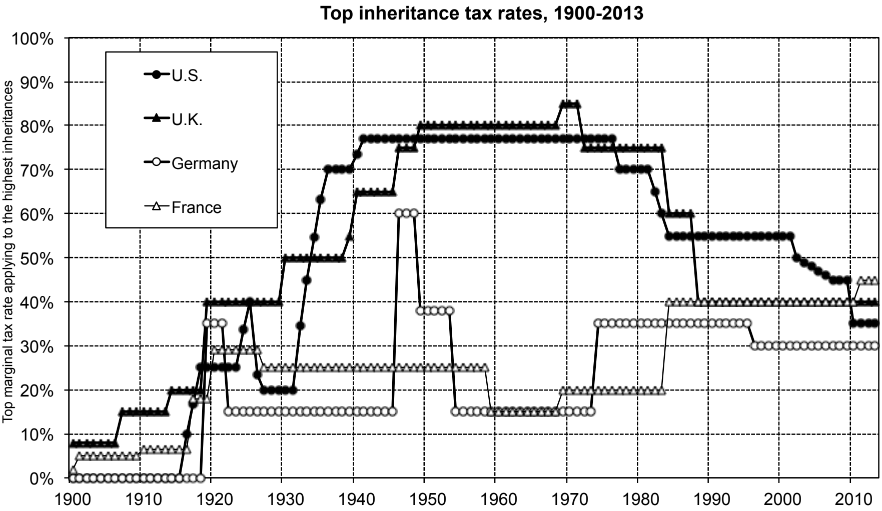
Under some assumptions, optimal τ_B could be 50-60%

Modern democracies have taxed K income, sometimes more than L income



In the 1970s-18980s, the top marginal tax rate on capital income (applying to the highest incomes) in the U.S. and the UK was higher than the top tax rate on labor income. Sources and series: see piketty.pse.ens.fr/capital21c.

Modern democracies have had progressive inheritance taxes



The top marginal tax rate of the inheritance tax (applying to the highest inheritances) in the U.S. dropped from 70% in 1980 to 35% in 2013. Sources and series: see piketty.pse.ens.fr/capital21c.

The past and the future of the wealth tax

Wealth taxes have been much more prevalent in Europe than in the US (Germany, Switzerland, Sweden; then France, Spain...)

But they had too small bases, often not based on market values, lack of international cooperation

With pre-filled declarations, an automatic exchange of bank information, and a financial registry, these problems could be addressed in the near future

See this afternoon: "Challenges of taxing financial wealth"