Fighting inequality in society through tax policy
Income and Capital Tax Options

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This talk: two points

- **1. The rise of European wealth-income ratios**

 - Top income shares ↑ much more in US than in Europe
 - But wealth-income ratios ↑ much more in Europe

(EU GDP: 12tr €; net private wealth: 60tr € = 500% GDP)
 (memo: China's reserves < 3tr €: 20 times smaller)

→ In Europe, main fiscal reserve = wealth taxation
 (while in US, main reserve = top income taxation)

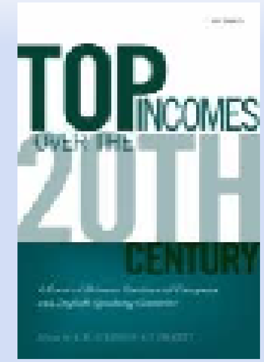
- **2. A proposal for a European wealth tax**

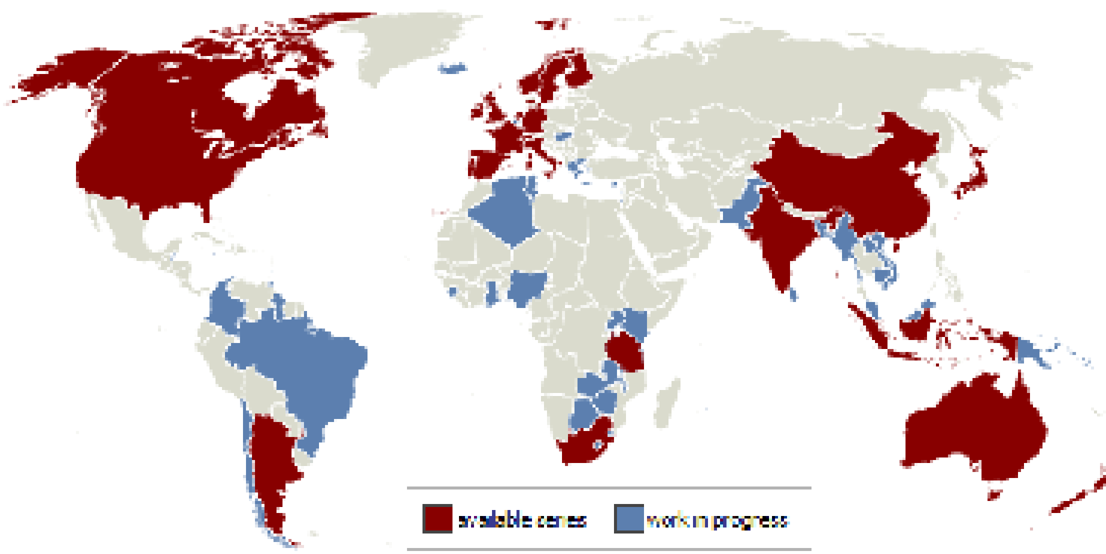
 - A comprehensive wealth tax with rate 1% above 1m€ and 2% above 5m€ would raise ≈ 2% of EU GDP
 - Other options (top income tax, corporate tax, FTT) are also useful, but raise less revenue

1. The Rise of European wealth-income ratios

- **Top income shares ↑ much more in US than in Europe**
- **World Top Incomes Database**: 25 countries, annual series over most of 20^{C}, largest existing historical data set on income inequality
- In US, top 10% income share rose from 35% to 50% of national income (top 1% share rose from <10% to >20%) and absorbed 70% of macro growth over 1980-2010
- In Continental Europe, there was also a rise in top income shares, but it started later (mid 1990s rather than early 1980s) and was quantitatively much smaller
- F Hollande’s 75% top rate above 1m€ would be much more useful in US than in France

The World Top Incomes Database





Institute for New Economic Thinking

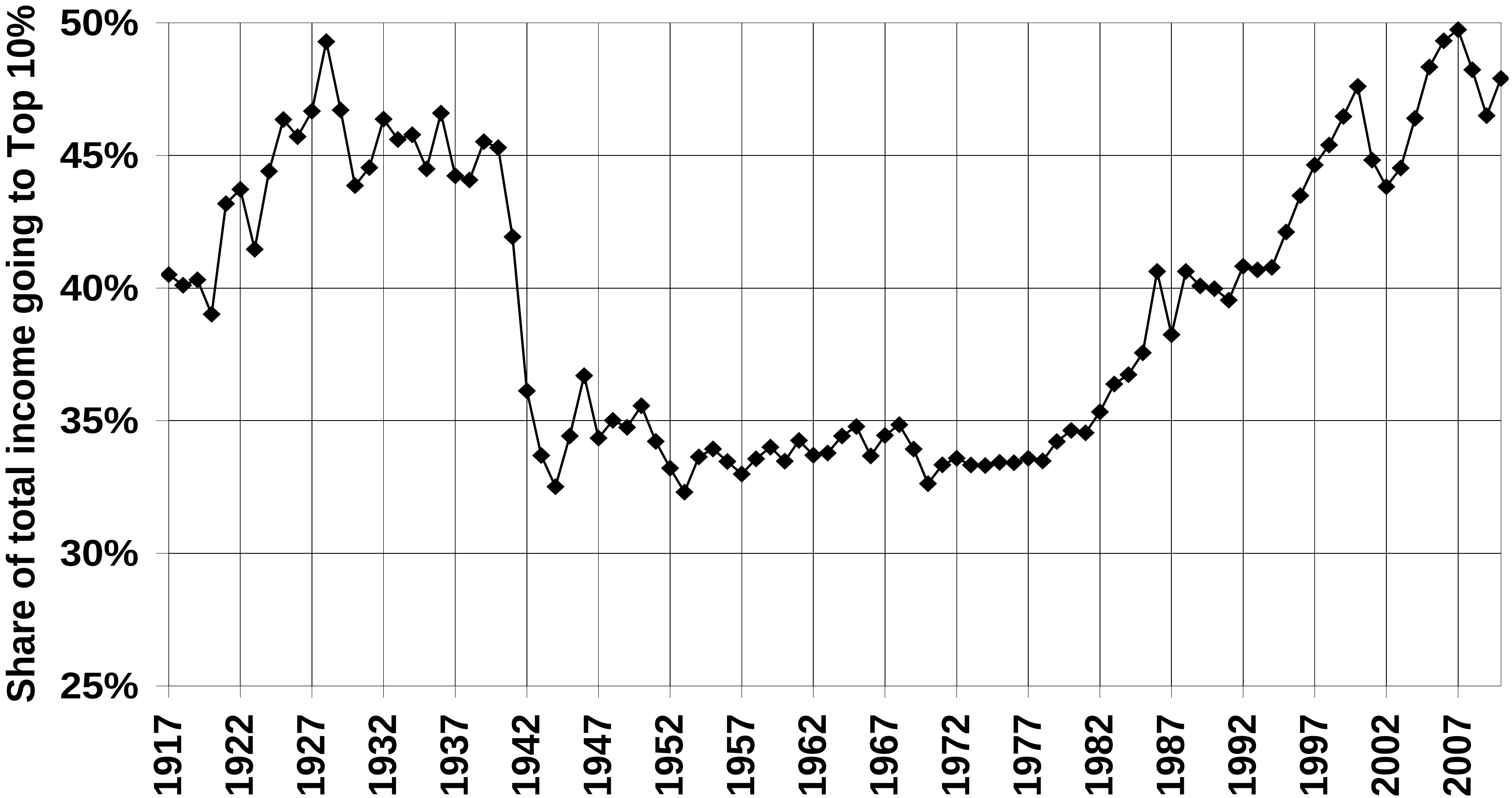


FIGURE 1

The Top Decile Income Share in the United States, 1917-2010

Source: Piketty and Saez (2003), series updated to 2010.
Income is defined as market income including realized capital gains (excludes government transfers).

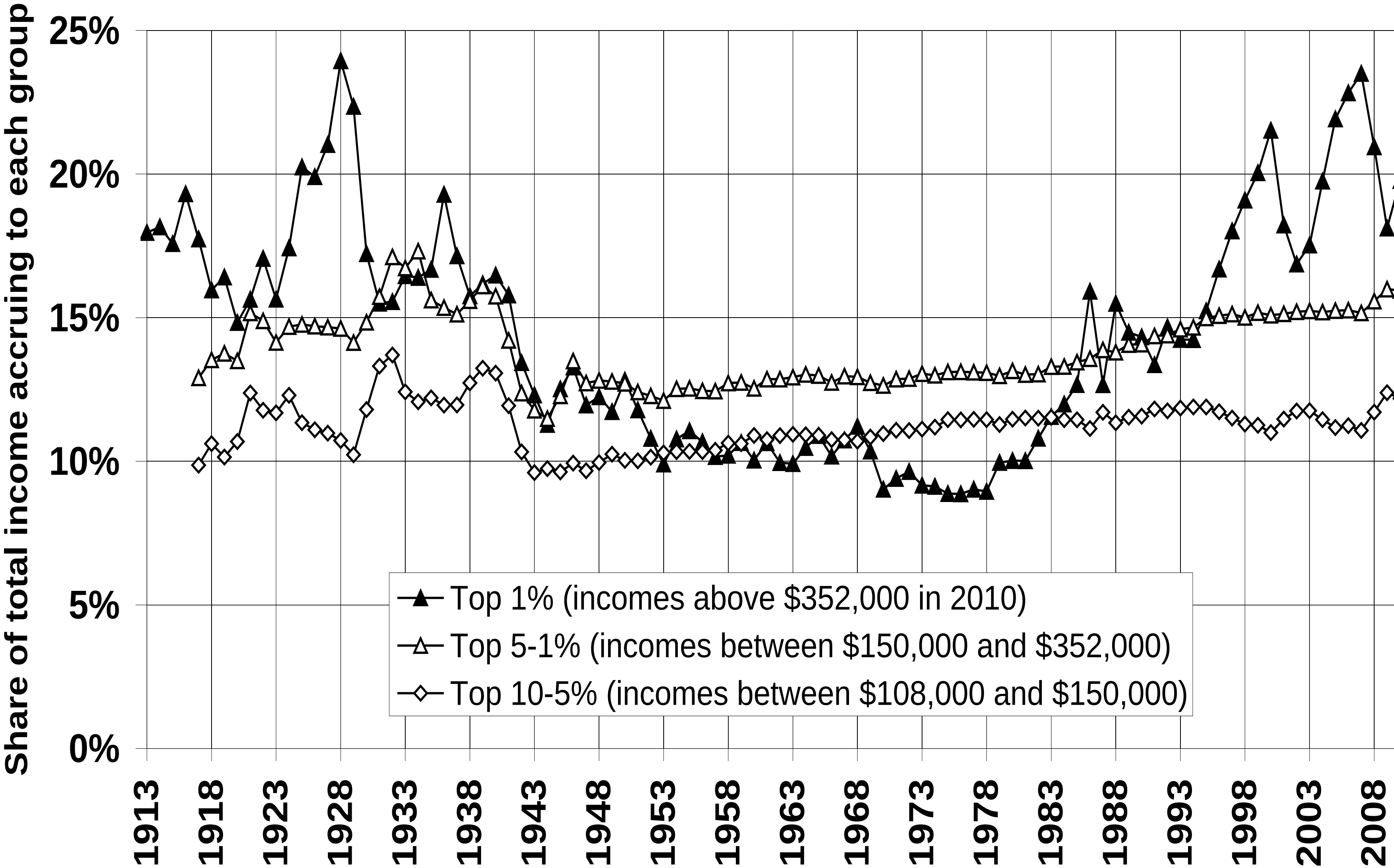
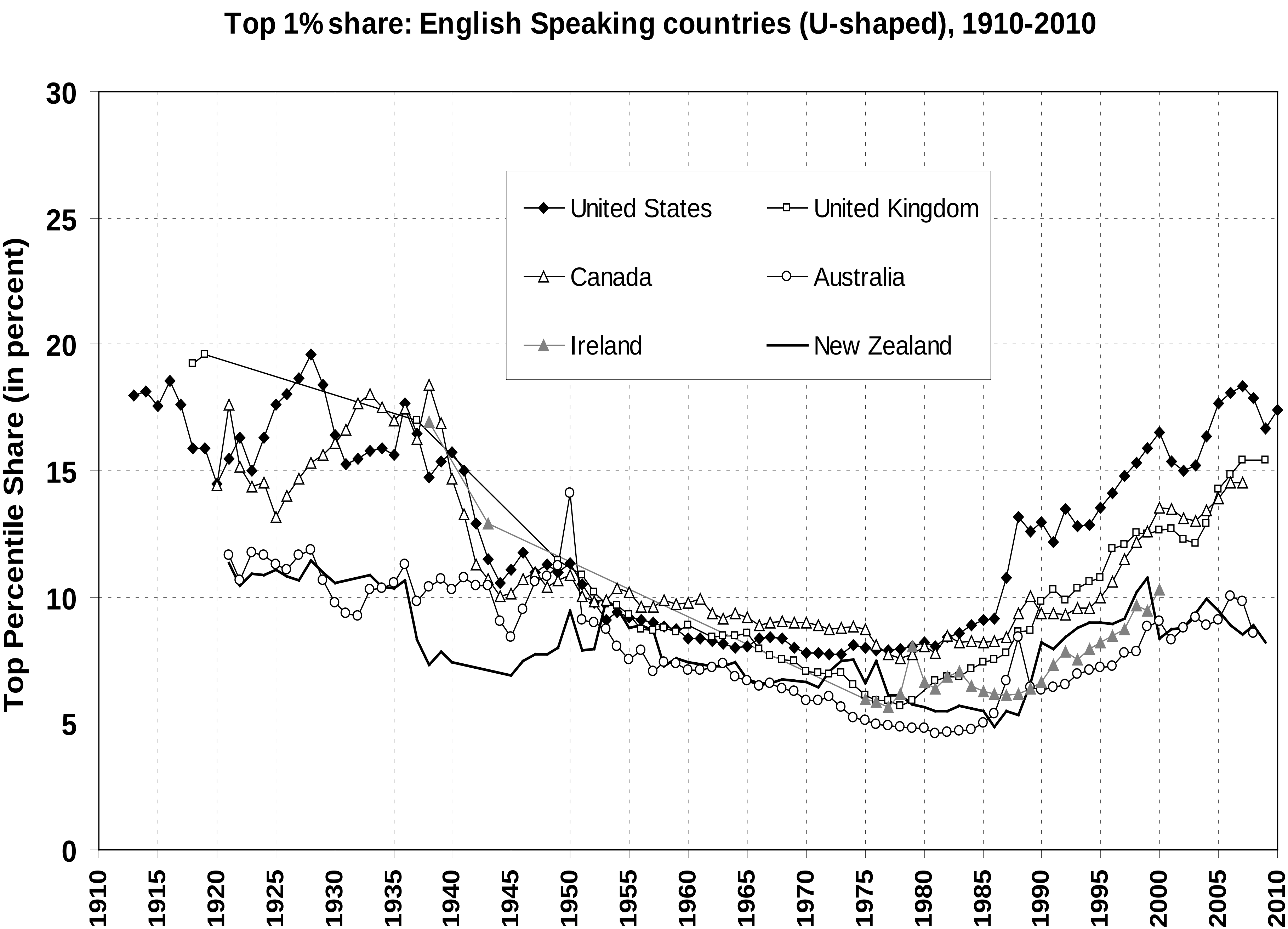
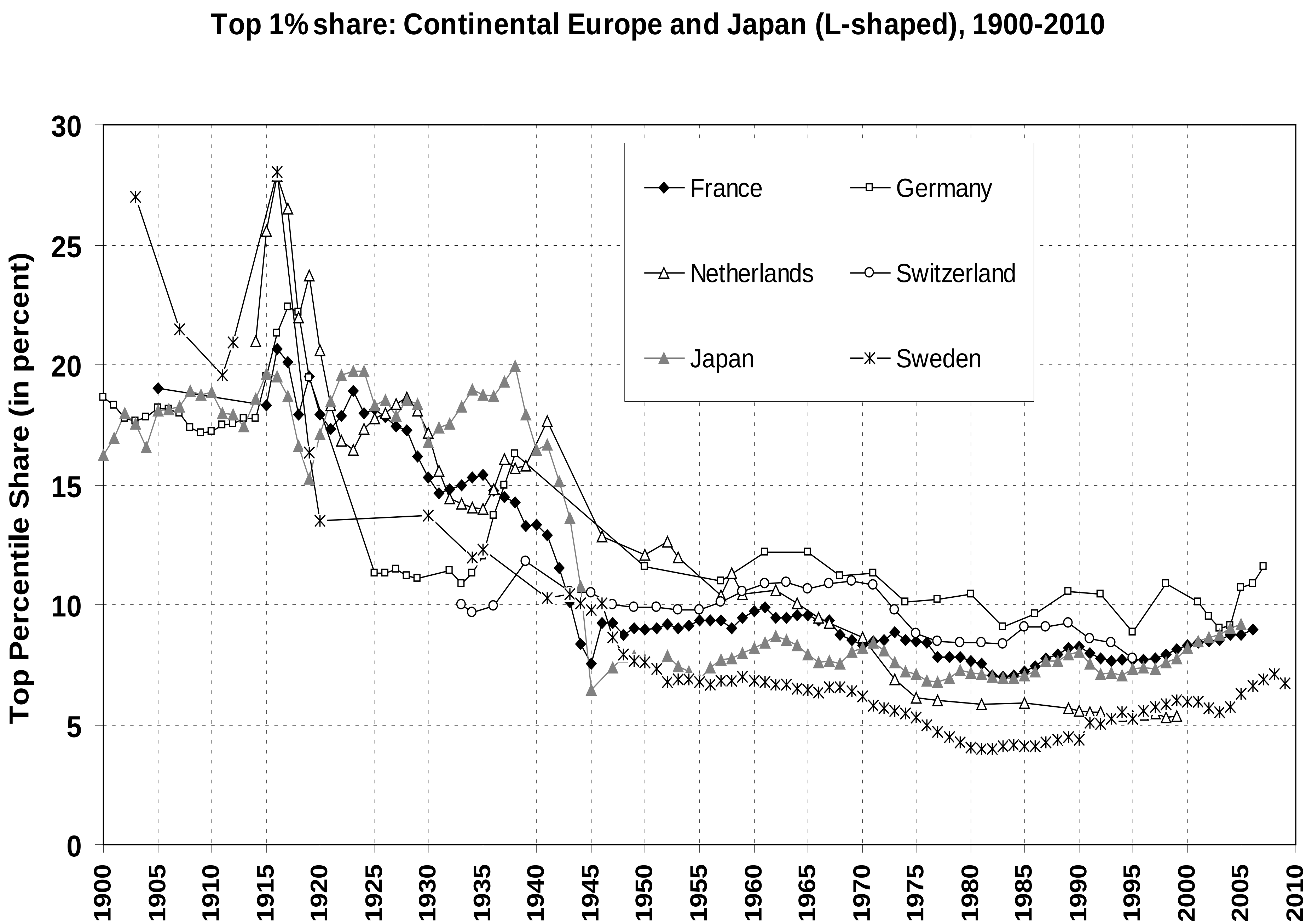


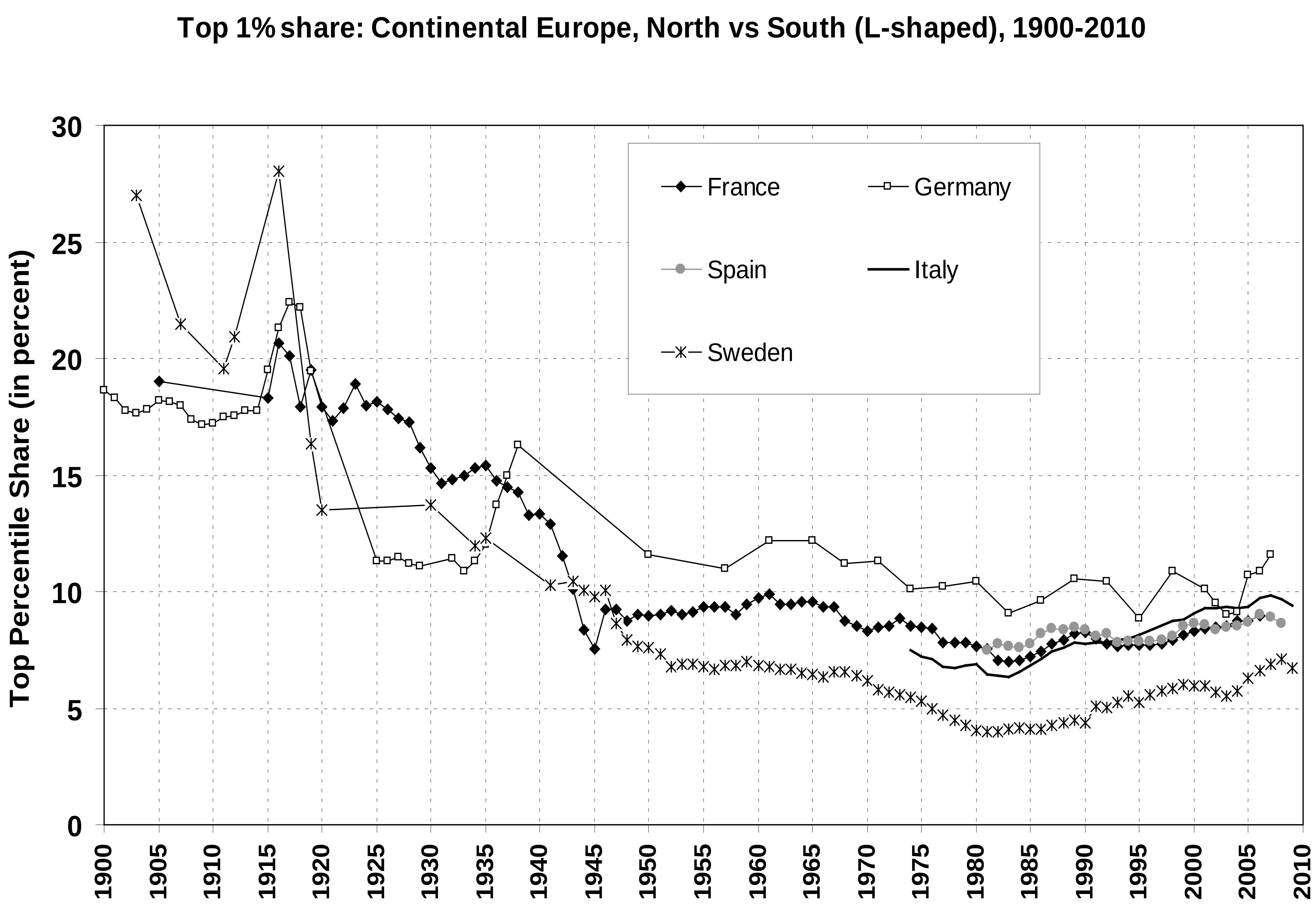
FIGURE 2

Decomposing the Top Decile US Income Share into 3 Groups, 1913-2010



Top 1% share: English Speaking countries (U-shaped), 1910-2010
Top Percentile Share (in percent)
United States
United Kingdom
Canada
Australia
Ireland
New Zealand
0
5
10
15
20
25
30
1910
1915
1920
1925
1930
1935
1940
1945
1950
1955
1960
1965
1970
1975
1980
1985
1990
1995
2000
2005
2010


Top 1% share: Continental Europe and Japan (L-shaped), 1900-2010
Top Percentile Share (in percent)
France
Germany
Netherlands
Switzerland
Japan
Sweden
0
5
10
15
20
25
30
1900
1905
1910
1915
1920
1925
1930
1935
1940
1945
1950
1955
1960
1965
1970
1975
1980
1985
1990
1995
2000
2005
2010


Top 1% share: Continental Europe, North vs South (L-shaped), 1900-2010
Top Percentile Share (in percent)
30
25
20
15
10
5
0
1900
1905
1910
1915
1920
1925
1930
1935
1940
1945
1950
1955
1960
1965
1970
1975
1980
1985
1990
1995
2000
2005
2010
France
Germany
Spain
Italy
Sweden

- **But wealth-income ratios ↑ much more in Europe**

- Results from Piketty-Zucman, « Capital is Back: Wealth-Income Ratios in Rich Countries 1700-2010 »
- **How do aggregate wealth-income ratios evolve in the long run, and why?**
- Until recently, it was impossible to adress properly this basic question: national accounts were mostly about flows on income, output, savings, etc., and very little about stocks of assets and liabilities
- **In this paper we compile a new data set of national balance sheets in order to adress this question:**

- 1970-2010: US, Japan, Germany, France, UK, Italy, Canada, Australia (= top 8 rich countries)
- 1870-2010: US, Germany, France, UK

(official national accounts + historical estimates)

- **Result 1**: we find in every country a gradual rise of wealth-income ratios over 1970-2010 period, from about 200%-300% in 1970 to 400%-600% in 2010
- **Result 2**: in effect, today's ratios seem to be returning towards the high values observed in 19^{c} Europe (600%-700%)
- This can be accounted for by a combination of factors:

- Politics: long run asset price recovery effect (itself driven by changes in capital policies since WWs)
- Economics: slowdown of productivity and pop growth

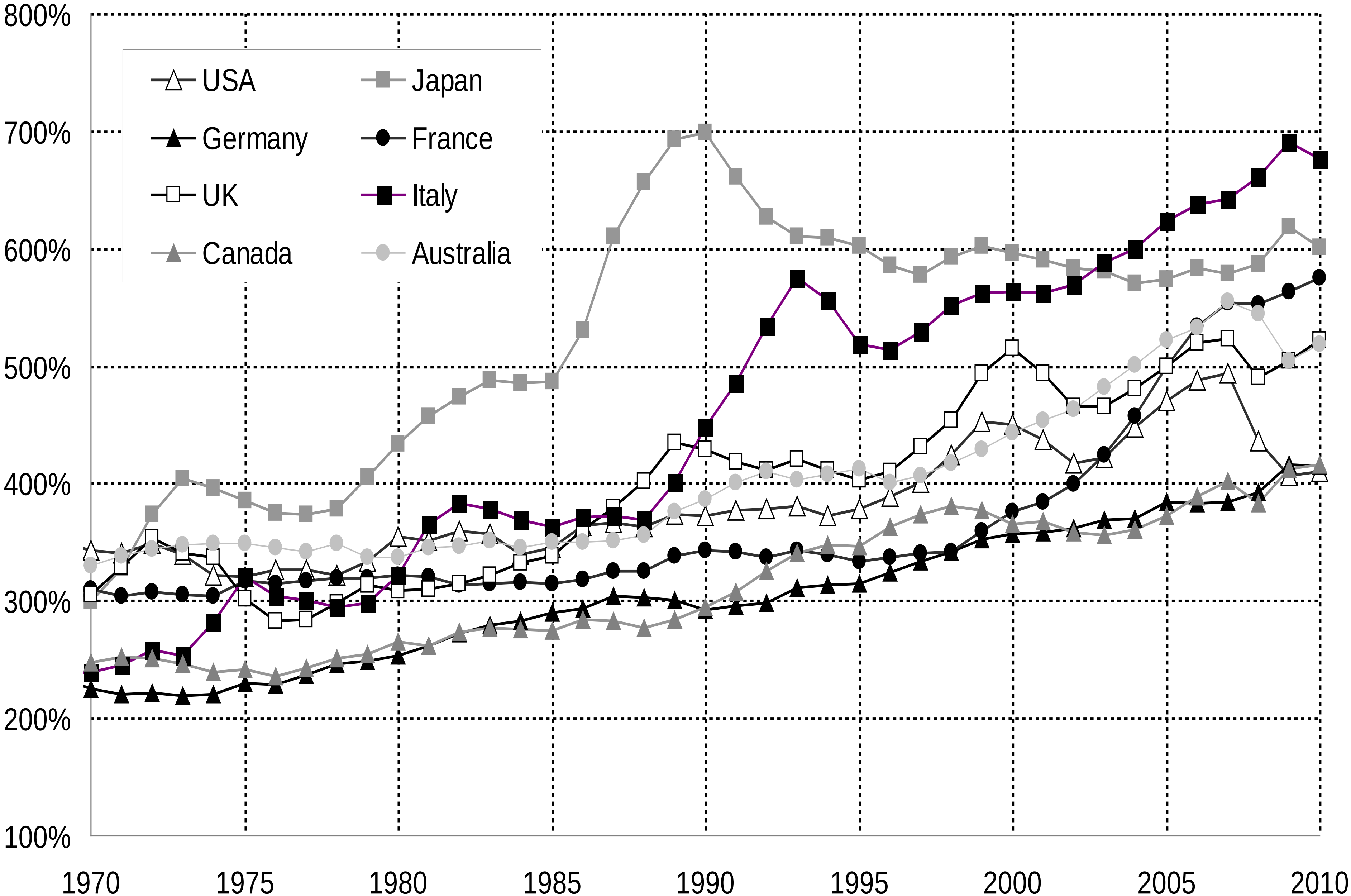
Harrod-Domar-Solow: wealth-income ratio $\boldsymbol{\beta = s/g}$

If saving rate s=10% & growth rate g=3%, then β≈300%

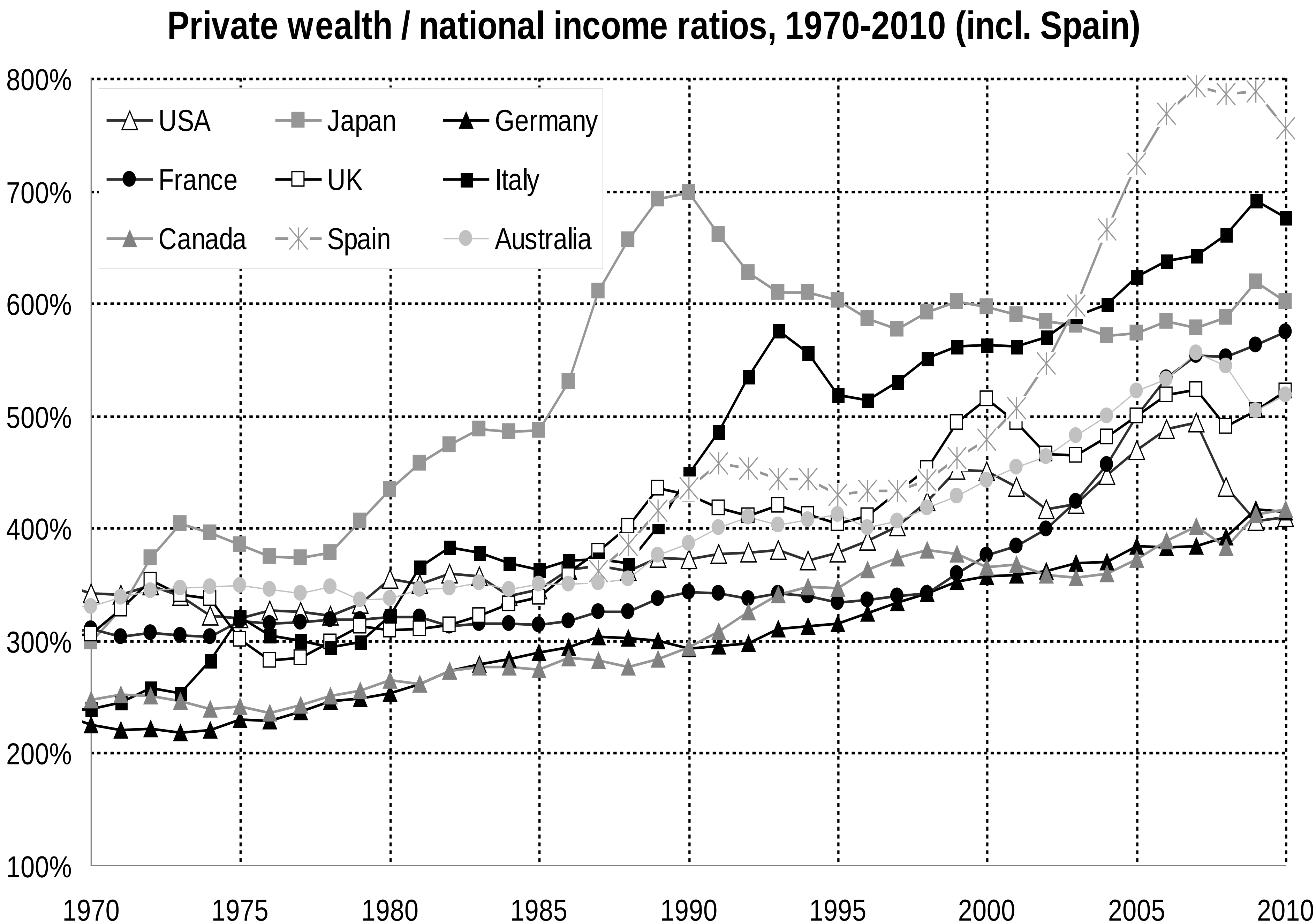
But if s=10% & g=1.5%, then β≈600%

Explains long run change & level diff Europe vs US

Private wealth / national income ratios, 1970-2010

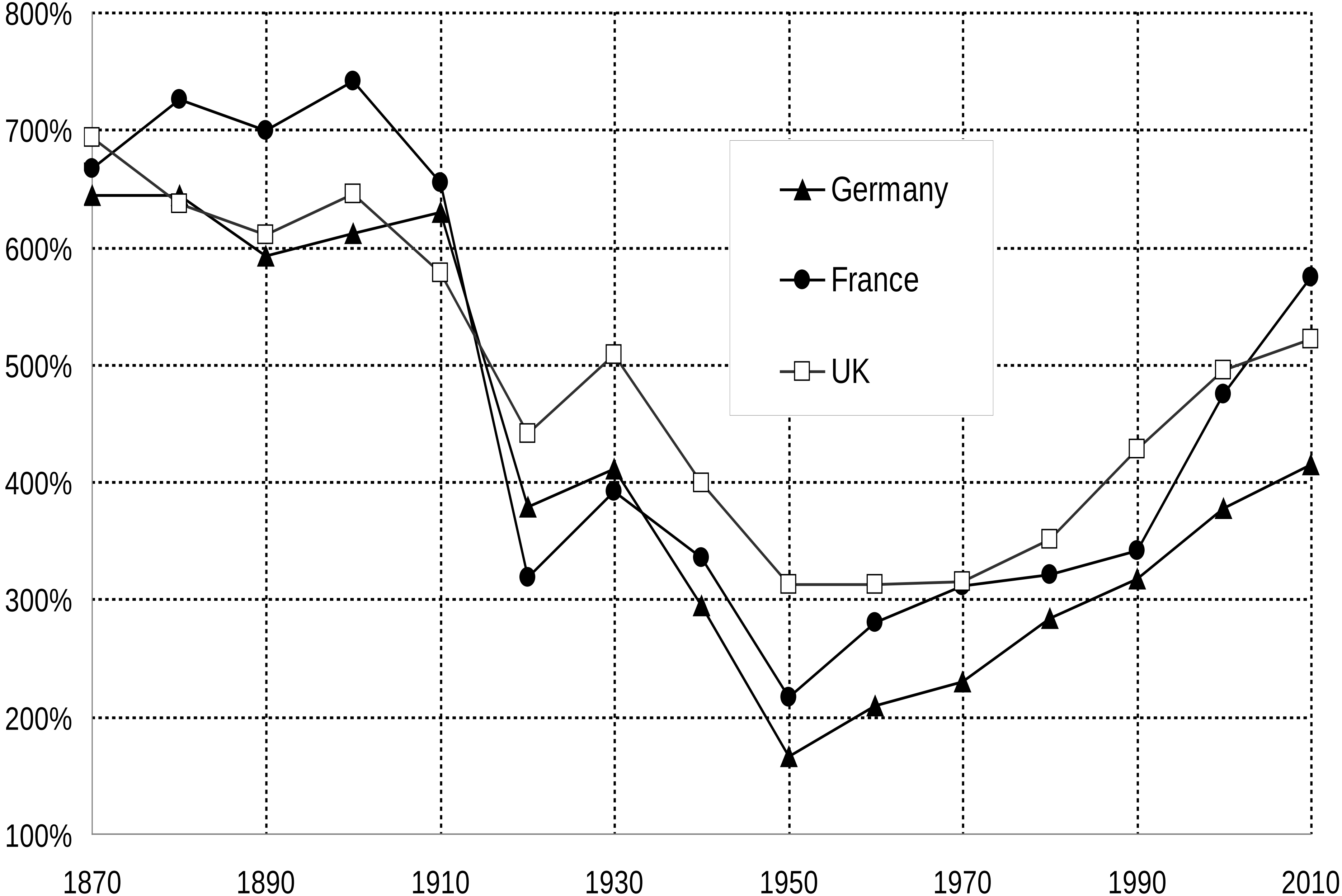


Authors' computations using country national accounts. Private wealth = non-financial assets + financial assets - financial liabilities (household & non-profit sectors)



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

Private wealth / national income ratios in Europe, 1870-2010



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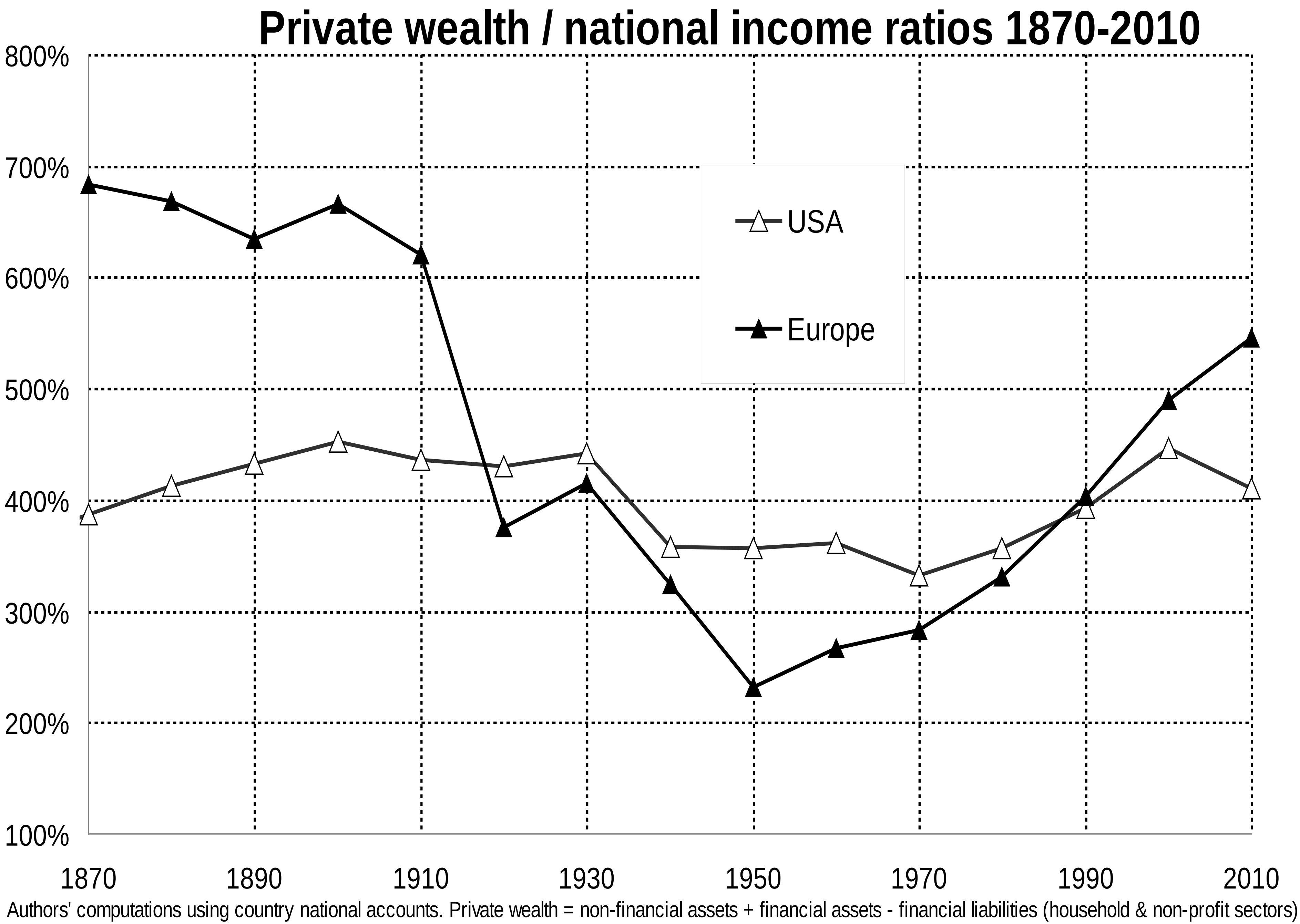
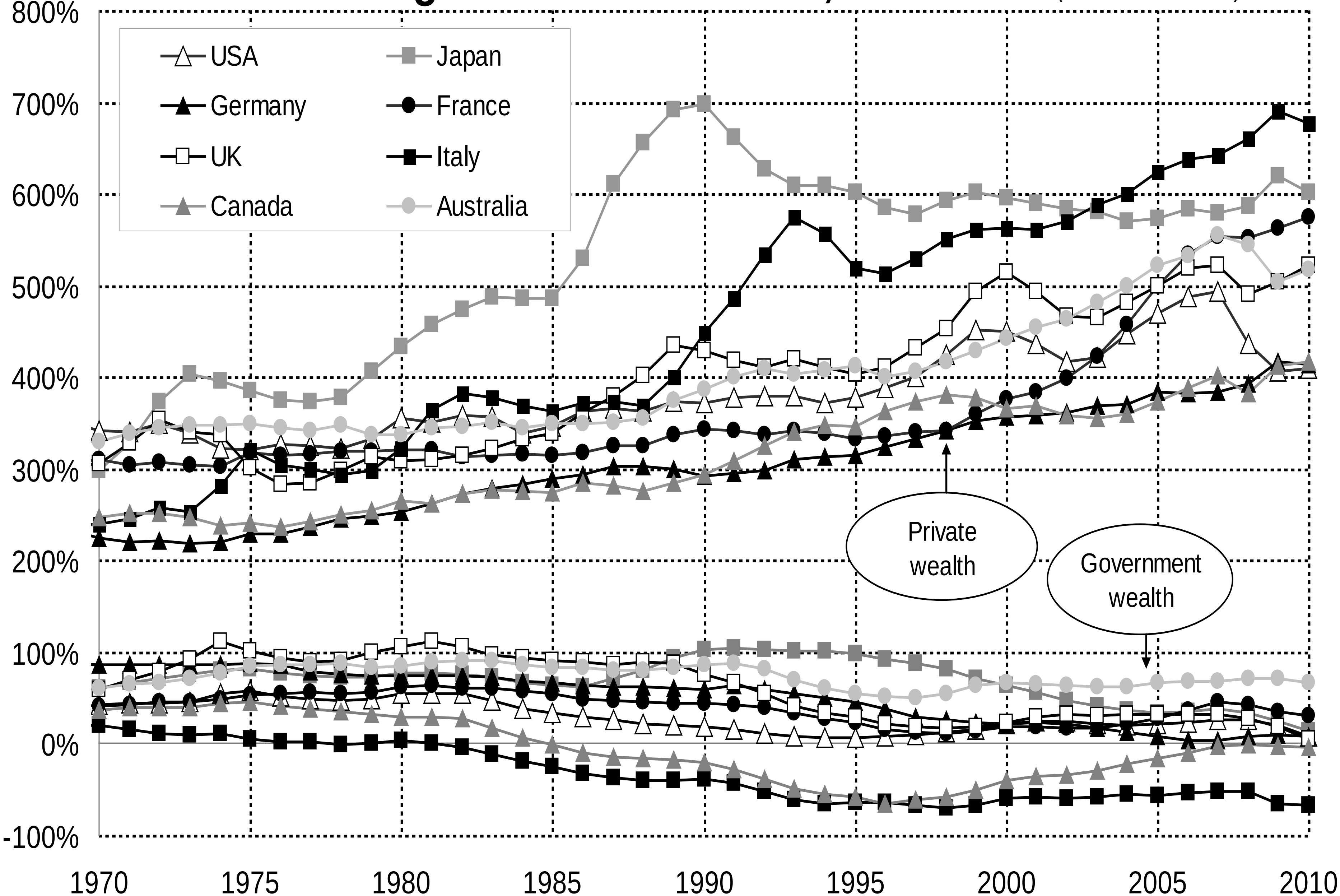

Private wealth / national income ratios 1870-2010
800%
700%
600%
500%
400%
300%
200%
100%
1870
1890
1910
1930
1950
1970
1990
2010
USA
Europe
Authors' computations using country national accounts. Private wealth = non-financial assets + financial assets - financial liabilities (household & non-profit sectors)

Private vs governement wealth, 1970-2010 (% national income)



Authors' computations using country national accounts. Government wealth = non-financial assets + financial assets - financial liabilities (govt sector)

2. A Proposal for a European Wealth Tax

- **Comprehensive wealth tax** based upon market-value personal net worth = non-fin. + financial assets – liabilities
- Very different from 19c style wealth tax based upon cadastral values (→repealed in Germany, Spain, Sweden..)
- Closer to French ISF (annual wealth returns with assets valued at market prices; ISF created in late 20c: inflation)
- But with a broader tax base than ISF, and with returns prefilled by tax administration on the basis of information transmitted by banks
- It requires a lot of information, but this is technically doable
- Key is political: we should not have free trade agreements without automated cross-border information exchange on financial assets and financial flows

- **An illustrative tax schedule**:
- Marginal tax rate = 1% if net wealth > 1m €

  (about 2,5% of EU pop)
- Marginal tax rate = 2% if net wealth > 5m €

  (about 0,2% of EU pop)
- Simulations: this would raise ≈ 2% of EU GDP
- Why so much revenue? For two reasons:
- (1) Aggregate private wealth is very large : 500% GDP
- (2) Wealth is highly concentrated: top 10% wealth holders have 60% of aggregate wealth, and top 1% have 25%
- I.e. top 1% wealth tax base = 125% of GDP

(top 2.5% wealth tax base = 200% GDP, top 0.1% = 50%)

Inequality in Europe 1910-2010

Shares in aggregate labor income or wealth	**Labor income 1910-2010**	**Wealth**	
		1910	**2010**
Top 10% "Upper Class"	**30%**	**90%**	**60%**
incl. Top 1% "Very Rich"	*6%*	*50%*	*25%*
incl. Other 9% "Rich"	*24%*	*40%*	*35%*
Middle 40% "Middle Class"	**40%**	**5%**	**35%**
Bottom 50% "Poor"	**30%**	**5%**	**5%**

- **Other options raise less revenue**
- FTT: less than 0,5% GDP (much less if successful) (double dividend illusion)
- Top income tax: about 0,5% GDP with a 20% supplementary tax rate on top 1% incomes (100 000+)

(top 1% income tax base = 5% GDP)

- Corporate tax: about 1% GDP with a 10% supplementary tax rate on corporate profits

(corporate tax base = 10%-12% GDP)

→ all these options are useful, especially corporate tax, given tax competition and large decline in rates;
but in the long run the wealth tax is even more useful

Summing up

- Eurotax can be useful if it helps member countries raise the tax revenue (1) that are adapted to their economic fundamentals; (2) which they cannot raise on their own
- Wealth tax meets the two criteria
- Top income or corporate tax meets also the two criteria; corporate tax is a tempting and useful option, especially given large decline in tax rate; but in the long run wealth tax is even more useful: it raises more revenue, and in a more efficient manner (better to tax stock rather than flow)
- VAT or general income or payroll tax increase meets none of the criteria: it is not adapted to economic fundamentals, and countries can easily raise them alone

Supplementary slides

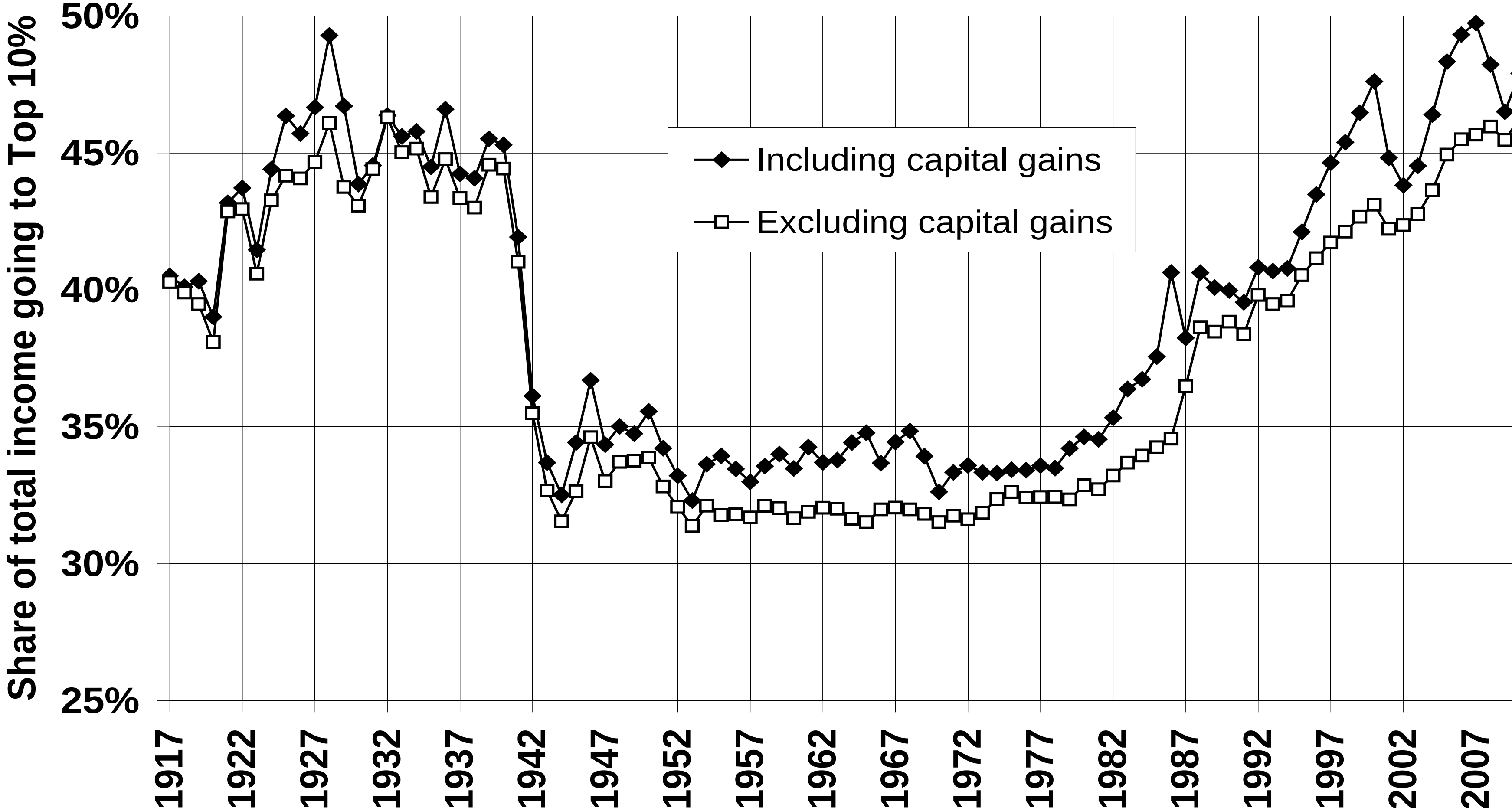


FIGURE 1

The Top Decile Income Share in the United States, 1917-2010

Source: Piketty and Saez (2003), series updated to 2010.
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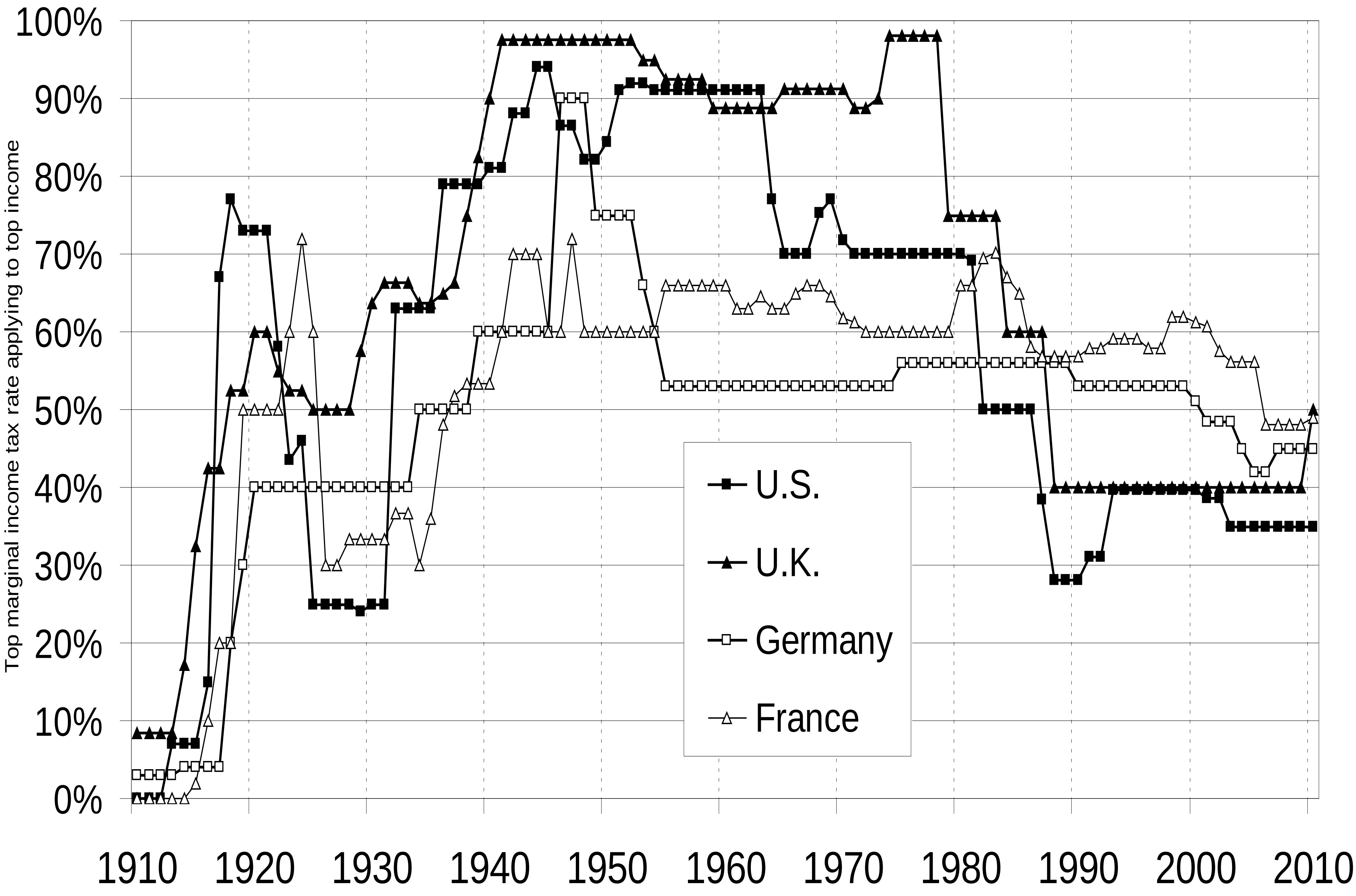
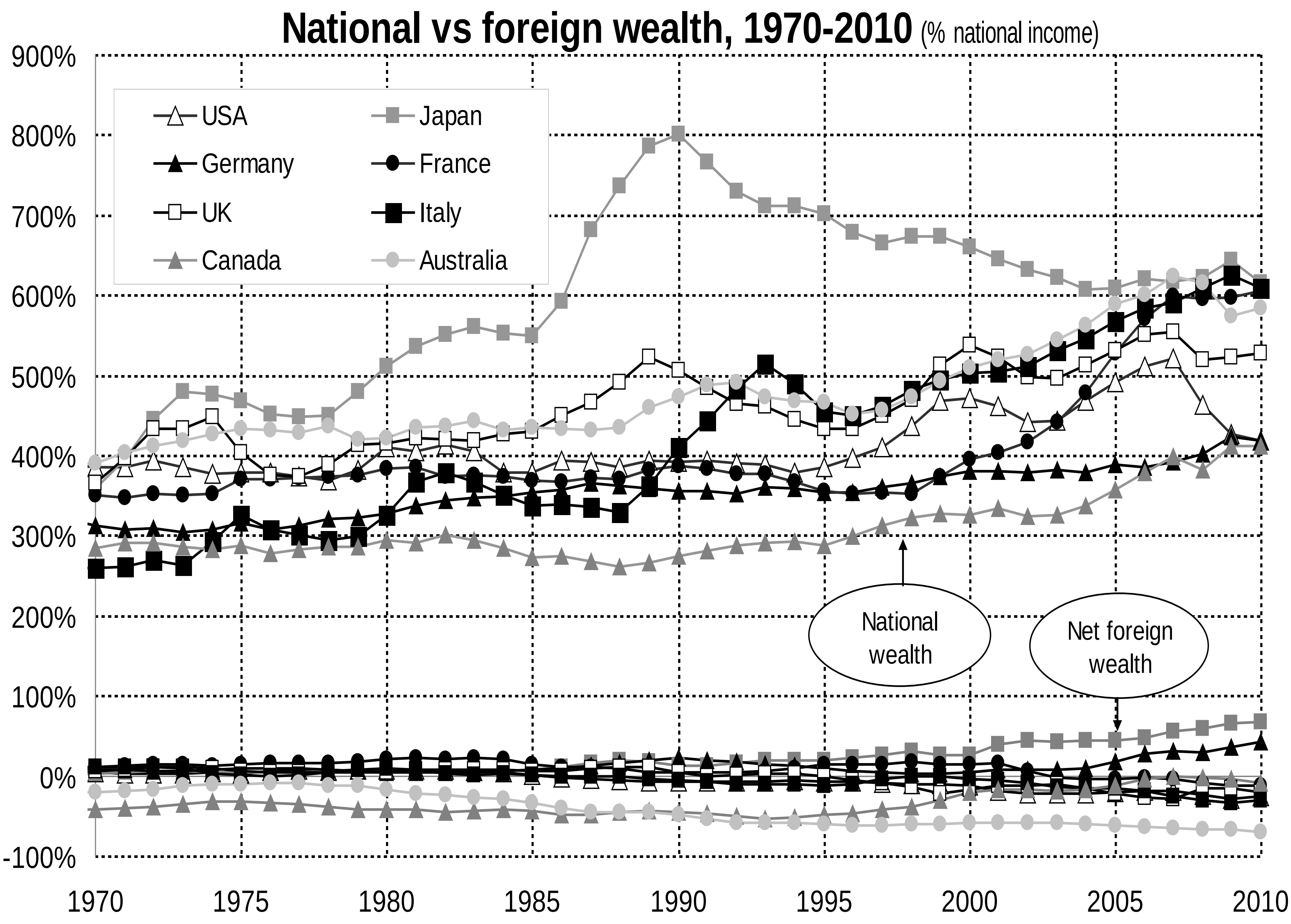
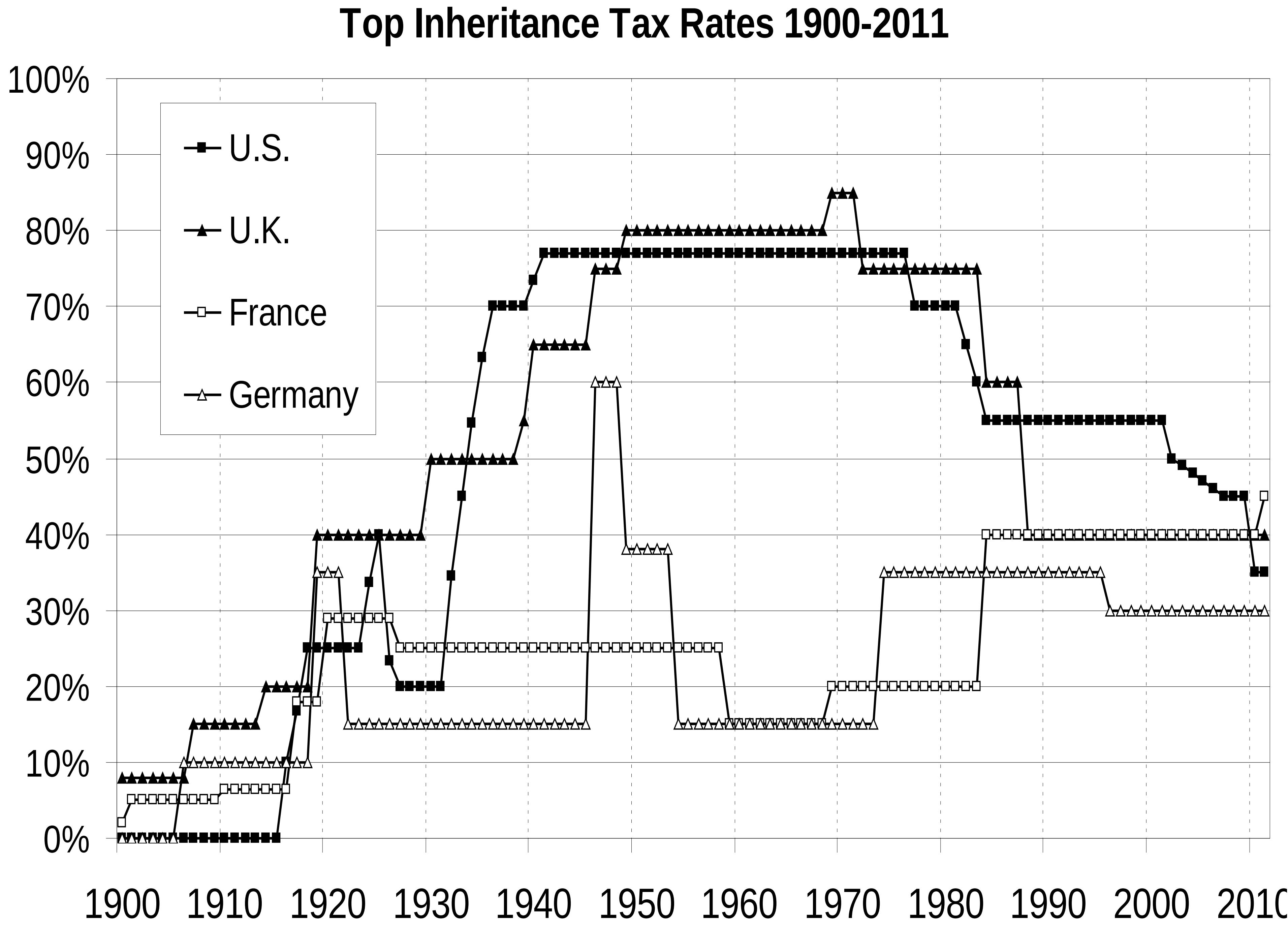
Top Income Tax Rates 1910-2010



Source: World Top Incomes Database, 2012.



Authors' computations using country national accounts. Net foreign wealth = net foreign assets owned by country residents in rest of the world (all sectors)


Top Inheritance Tax Rates 1900-2011
U.S.
U.K.
France
Germany
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
1900
1910
1920
1930
1940
1950
1960
1970
1980
1990
2000
2010