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 20C, 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
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: Continental Europe and Japan (L-shaped), 1900-2010
Top 1% share: Continental Europe, North vs South (L-shaped), 1900-2010

Top Percentile Share (in percent)

- 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 address 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 address 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 19c 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 $\beta = \frac{s}{g}$

  If saving rate $s=10\%$ & growth rate $g=3\%$, then $\beta \approx 300\%$

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

  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)
Private wealth / national income ratios, 1970-2010 (incl. Spain)

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

Authors' computations using country national accounts. Private wealth = non-financial assets + financial assets - financial liabilities (household & non-profit sectors)
Private wealth / national income ratios 1870-2010

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. 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\%)
<table>
<thead>
<tr>
<th>Shares in aggregate labor income or wealth</th>
<th>Labor income 1910-2010</th>
<th>Wealth</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Top 10% &quot;Upper Class&quot;</strong></td>
<td>30%</td>
<td>90%</td>
</tr>
<tr>
<td>incl. Top 1% &quot;Very Rich&quot;</td>
<td>6%</td>
<td>50%</td>
</tr>
<tr>
<td>incl. Other 9% &quot;Rich&quot;</td>
<td>24%</td>
<td>40%</td>
</tr>
<tr>
<td><strong>Middle 40% &quot;Middle Class&quot;</strong></td>
<td>40%</td>
<td>5%</td>
</tr>
<tr>
<td><strong>Bottom 50% &quot;Poor&quot;</strong></td>
<td>30%</td>
<td>5%</td>
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• 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


Top marginal income tax rate applying to top income in:
- U.S.
- U.K.
- Germany
- France
National vs foreign wealth, 1970-2010 (% national income)

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