Income Concentration and Top Income Tax Rates

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MEASURING INEQUALITY

Inequality matters because public cares about inequality

$\Rightarrow$ Economists need to provide transparent inequality measures (top income shares rather than Gini coefficient)

Ideal goal: create Distributional National Accounts that split National Income by quantiles (top 1%, top 10%, etc.)

Two key concepts:

(a) Pre-tax, pre-transfer National Income

(b) Post-tax, post-transfer National Income

We are still far from this ideal goal as National Accounting and Inequality Studies have followed different paths

Large administrative micro-data will help bridge this gap

TOP INCOME SHARES

Simple way to measure inequality: what share of total **pre-tax market income** goes to the top 10%, top 1%, etc.

Individual income tax statistics are the only source

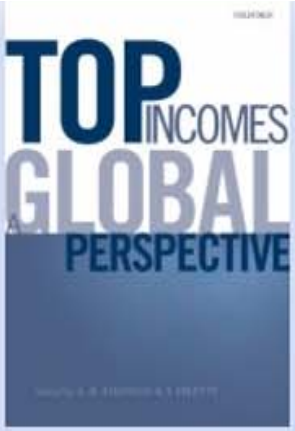
(a) covering long-time periods

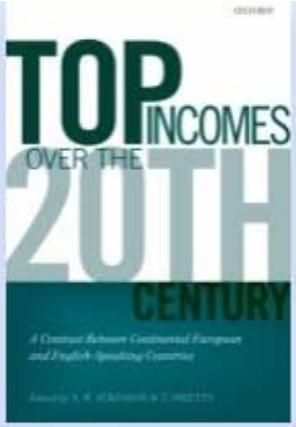
(b) capturing well top incomes

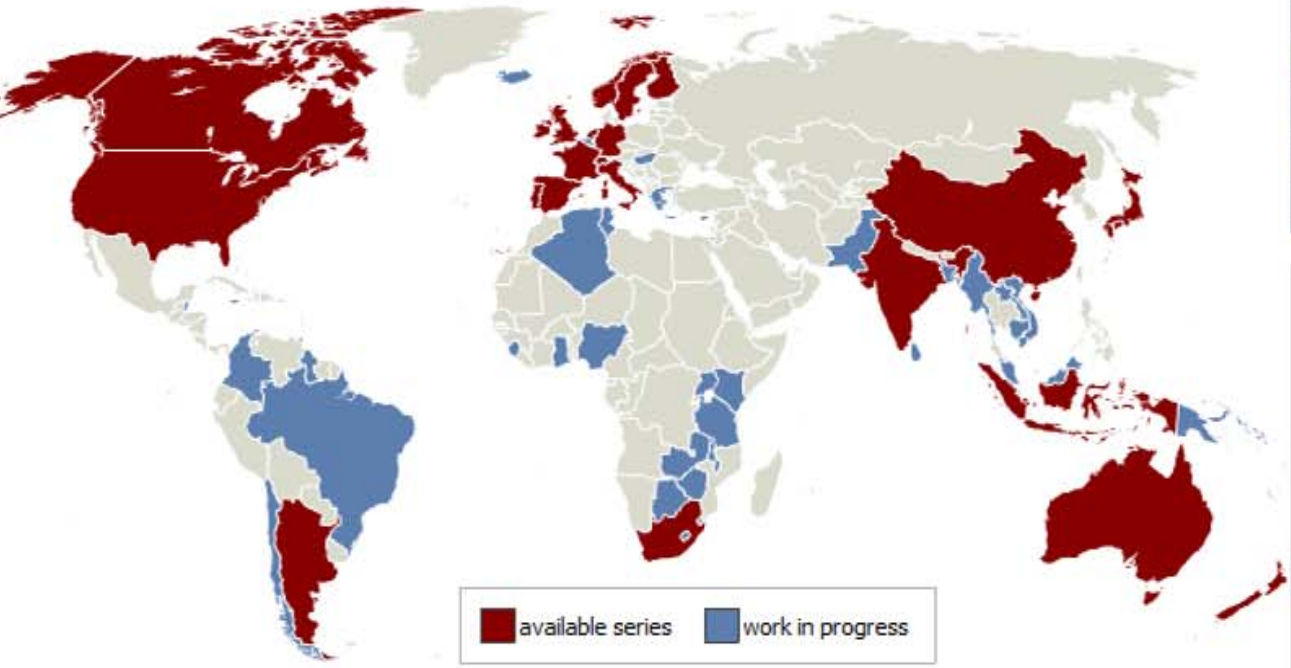
25 countries have been analyzed in the on-going **World Top Incomes Database**

Caveats: Income concept used is narrower than National Income and focus is solely on pre-tax, pre-transfer income

THE TOP INCOMES DATABASE







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PARIS SCHOOL OF ECONOMICS

Institute for New Economic Thinking

CENTER FOR EQUITABLE GROWTH

INSTITUTE FOR ECONOMIC MODELLING

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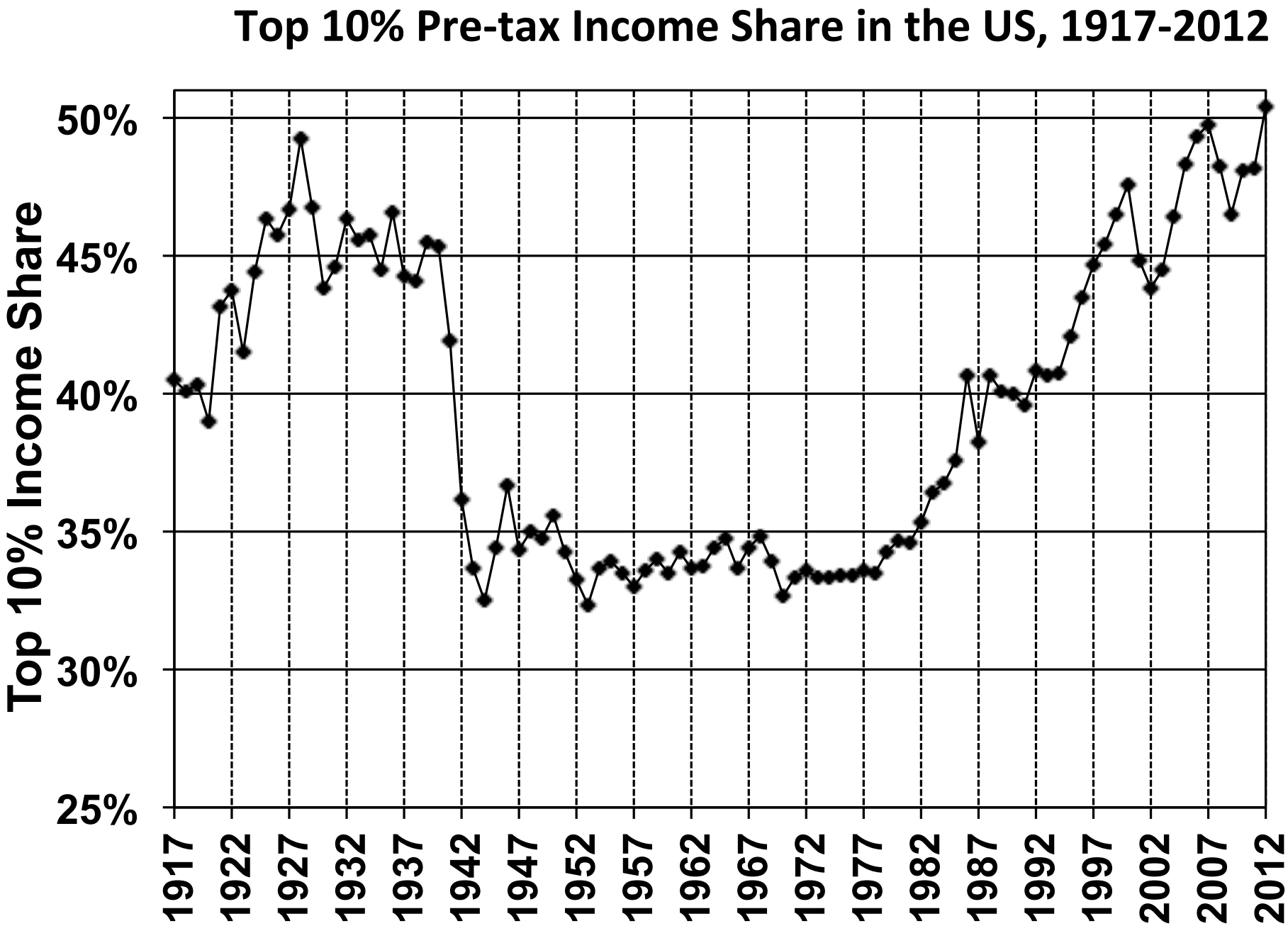

Source: Piketty and Saez, 2003 updated to 2012. Series based on pre-tax cash market income including realized capital gains and excluding government transfers. 2012 data based on preliminary statistics

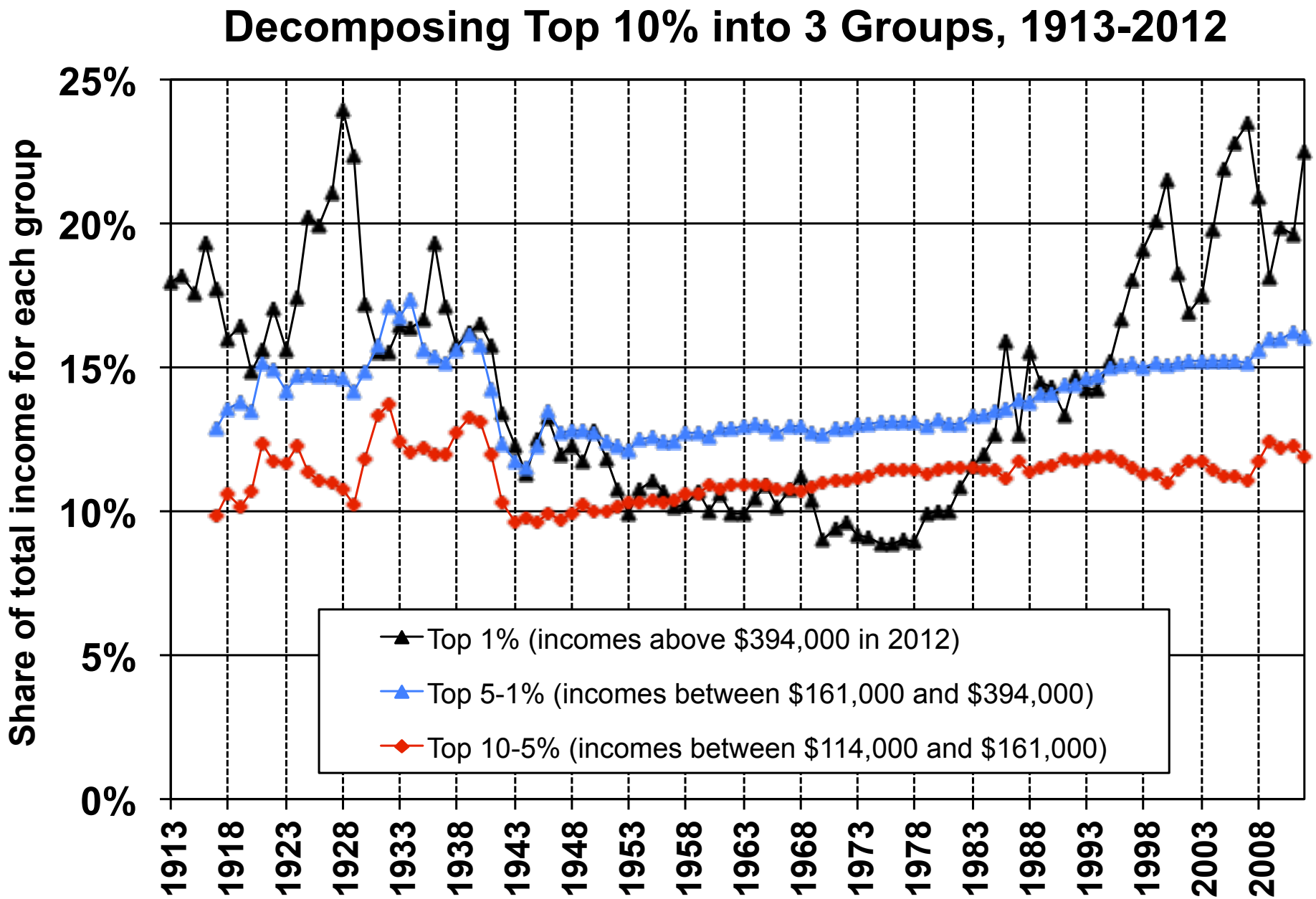

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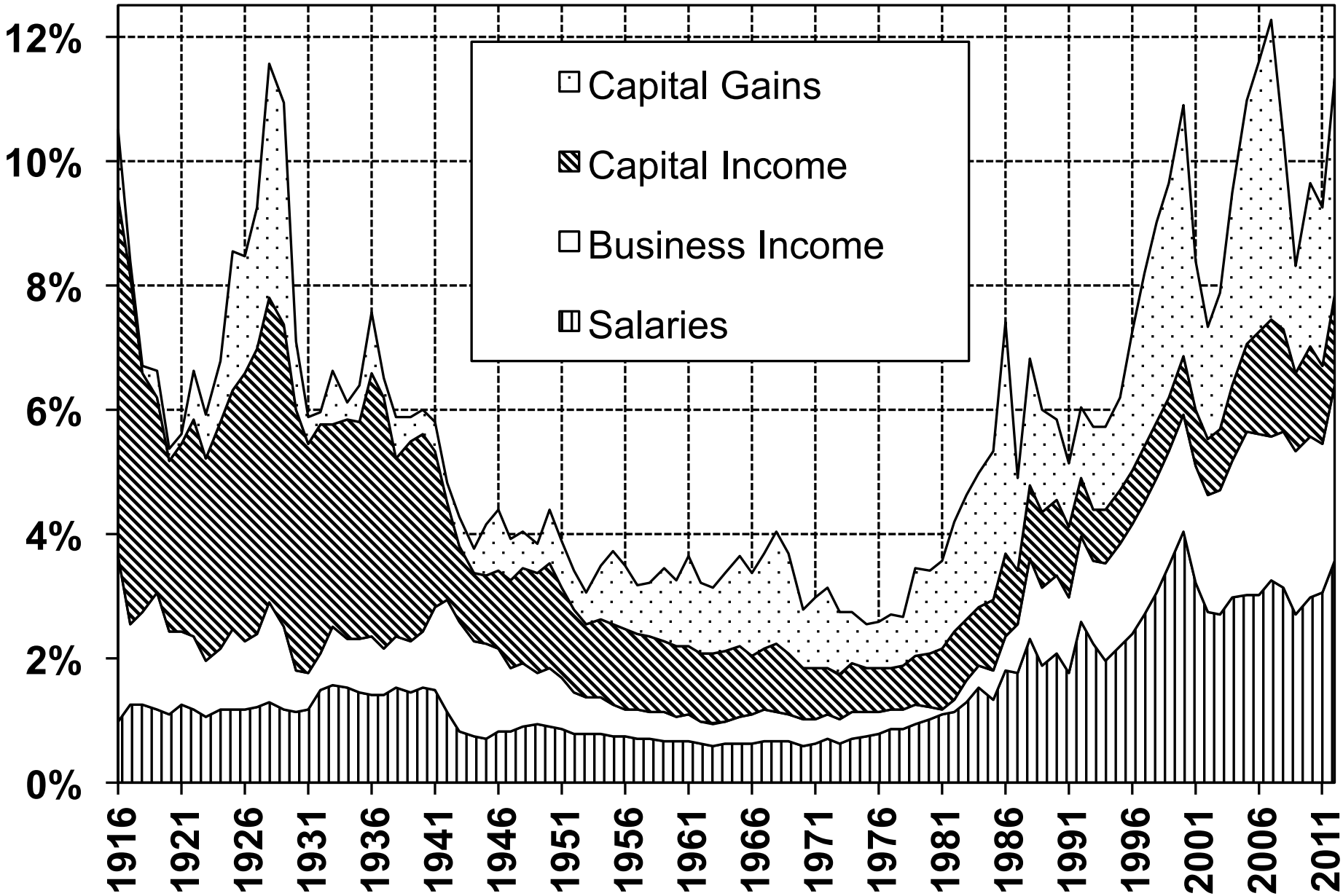
Table 1. Real Income Growth by Groups

	Average Income Real Growth (1)	Top 1% Incomes Real Growth (2)	Bottom 99% Incomes Real Growth (3)	Fraction of total growth (or loss) captured by top 1% (4)
Full period 1993-2012	**17.9%**	**86.1%**	**6.6%**	**68%**
Clinton Expansion 1993-2000	31.5%	98.7%	20.3%	45%
2001 Recession 2000-2002	-11.7%	-30.8%	-6.5%	57%
Bush Expansion 2002-2007	16.1%	61.8%	6.8%	65%
Great Recession 2007-2009	-17.4%	-36.3%	-11.6%	49%
Recovery 2009-2012	6.0%	31.4%	0.4%	95%

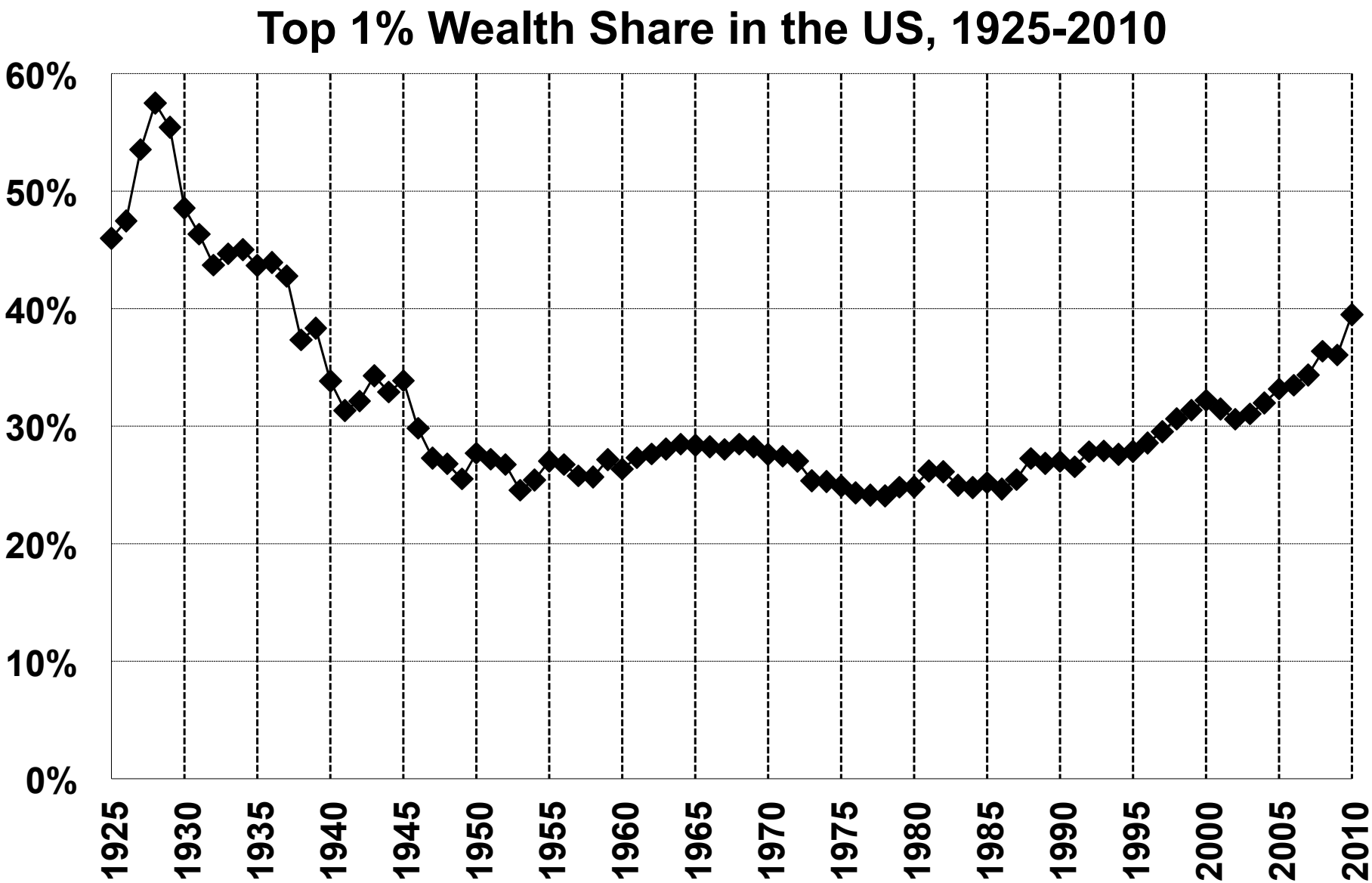
Computations based on family market income including realized capital gains (before individual taxes).
Incomes exclude government transfers (such as unemployment insurance and social security) and non-taxable fringe benefits.
Incomes are deflated using the Consumer Price Index.
Column (4) reports the fraction of total real family income growth (or loss) captured by the top 1%.
For example, from 2002 to 2007, average real family incomes grew by 16.1% but 65% of that growth accrued to the top 1% while only 35% of that growth accrued to the bottom 99% of US families.
Source: Piketty and Saez (2003), series updated to 2012 in August 2013 using IRS preliminary tax statistics for 2012.

US Top 0.1% Pre-Tax Income Share and Composition



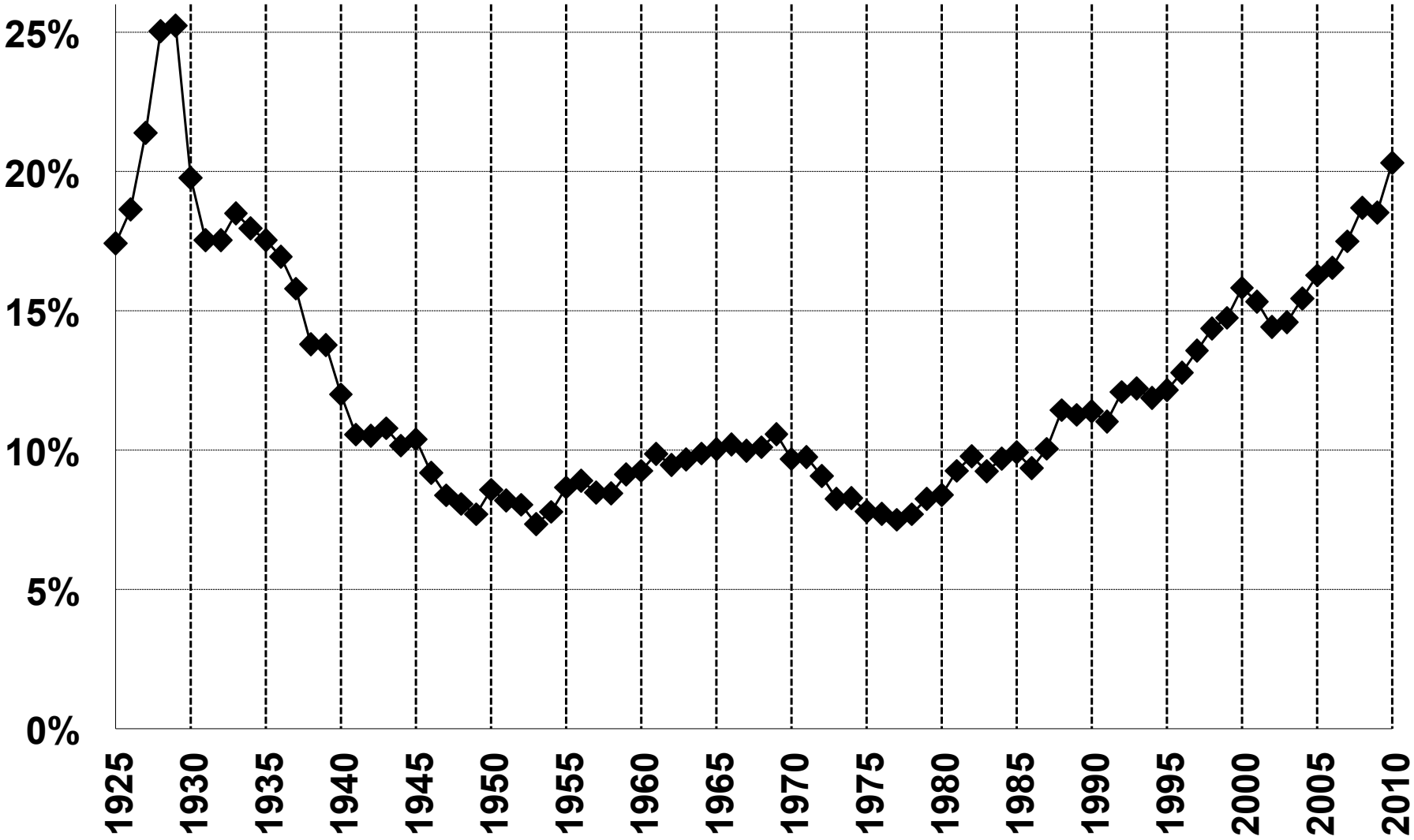
Source: Piketty and Saez, 2003 updated to 2012

. Series based on pre-tax cash market income including or excluding realized capital gains, and always excluding government transfers



Source: Saez and Zucman (2014). Estimates based on capitalizing capital income from individual income tax returns. Wealth includes all net worth of households (except durables)

Top 0.1% Wealth Share in the US, 1925-2010



Source: Saez and Zucman (2014). Estimates based on capitalizing capital income from individual income tax returns. Wealth includes all net worth of households (except durables)

TOP INCOMES AND TAXES

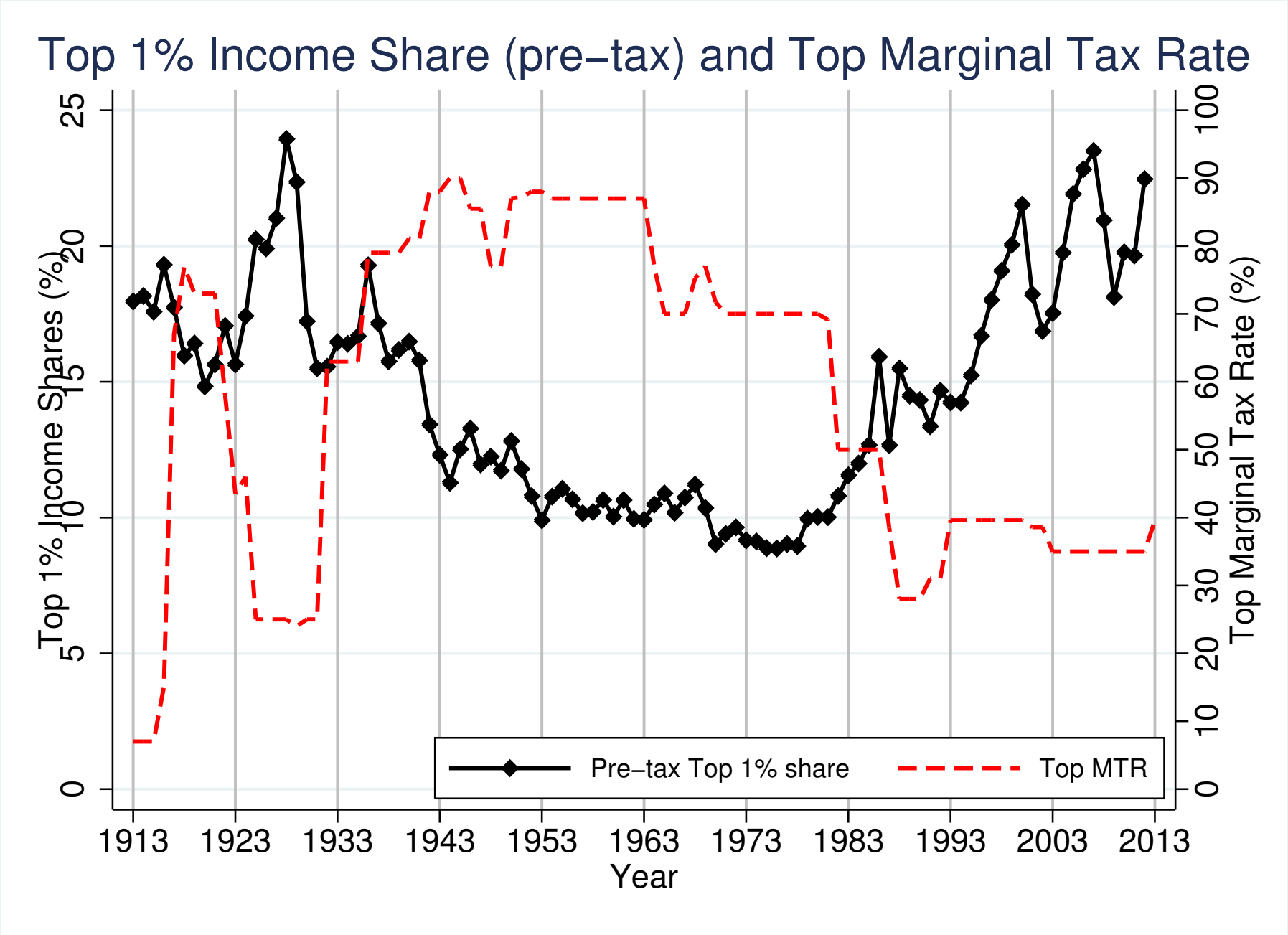
Pre-tax top US incomes have surged in recent decades: top 1% income share increased from 9% in 1970 to 22% in 2012

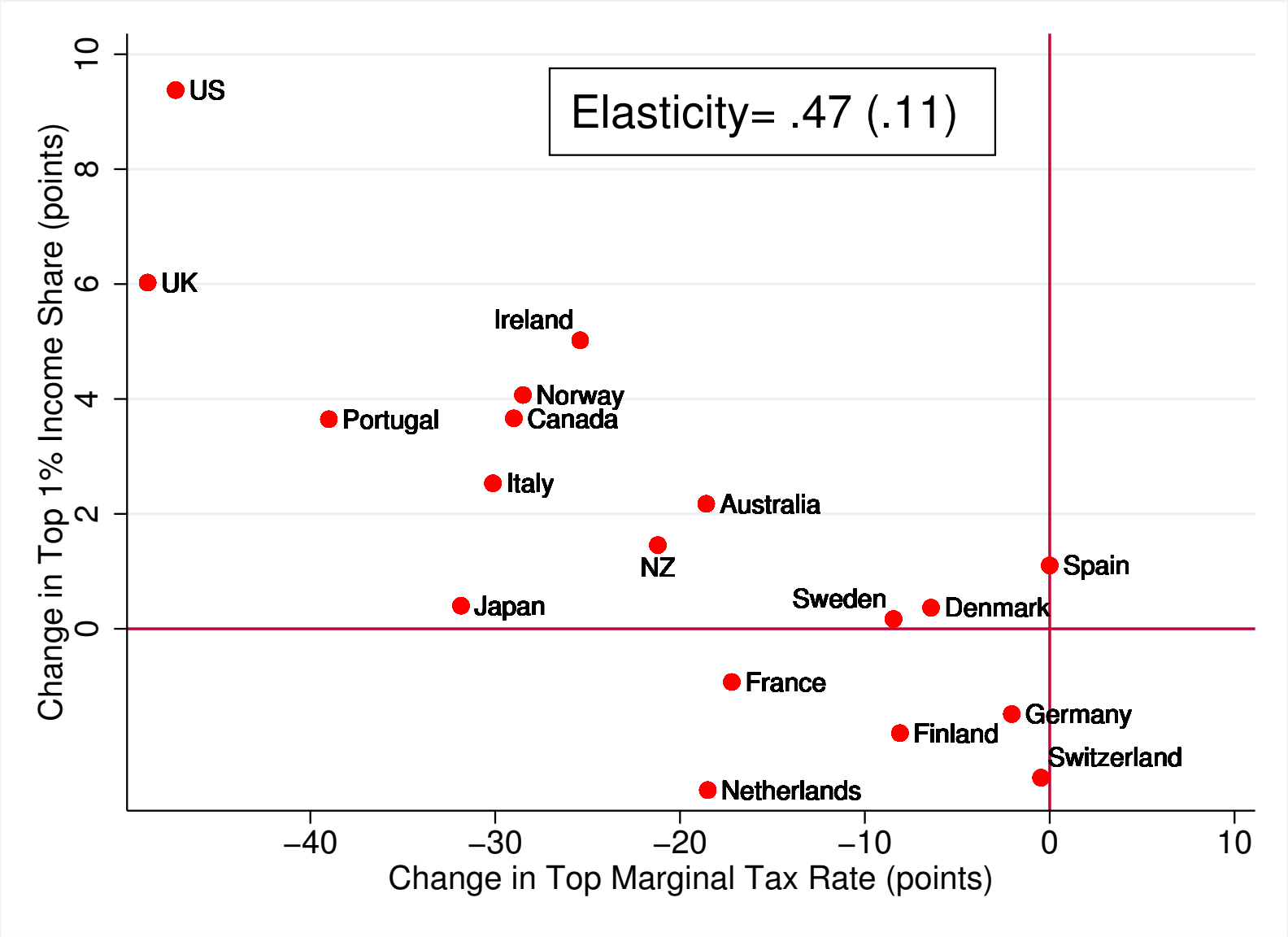
In 2012, top 1% income earners paid average Federal individual tax rate of 22% = 3.0 GDP points

Increasing the Federal individual tax rate on top 1% from 22% to 33% would **mechanically** raise 1.5 GDP points

In 2013, Federal individual tax on top 1% increases by about .5 GDP points

$\Rightarrow$ Top 1% has large **potential** tax capacity


Top 1% Income Share (pre–tax) and Top Marginal Tax Rate
Top 1% Income Shares (%)
Top Marginal Tax Rate (%)
Year
0
5
10
15
20
25
0
10
20
30
40
50
60
70
80
90
100
1913
1923
1933
1943
1953
1963
1973
1983
1993
2003
2013
Pre–tax Top 1% share
Top MTR



Change in Top Tax Rate and Top 1% Share, 1960-4 to 2005-9

ECONOMIC EFFECTS OF TAXING THE TOP 1%

Strong empirical evidence that **pre-tax** top incomes are affected by top tax rates

3 potential scenarios with very different policy consequences

1) Supply-Side: Top earners work less and earn less when top tax rate increases $\Rightarrow$ Top tax rates should not be too high

2) Tax Avoidance/Evasion: Top earners avoid/evade more when top tax rate increases

$\Rightarrow$ a) Eliminate loopholes, b) Then increase top tax rates

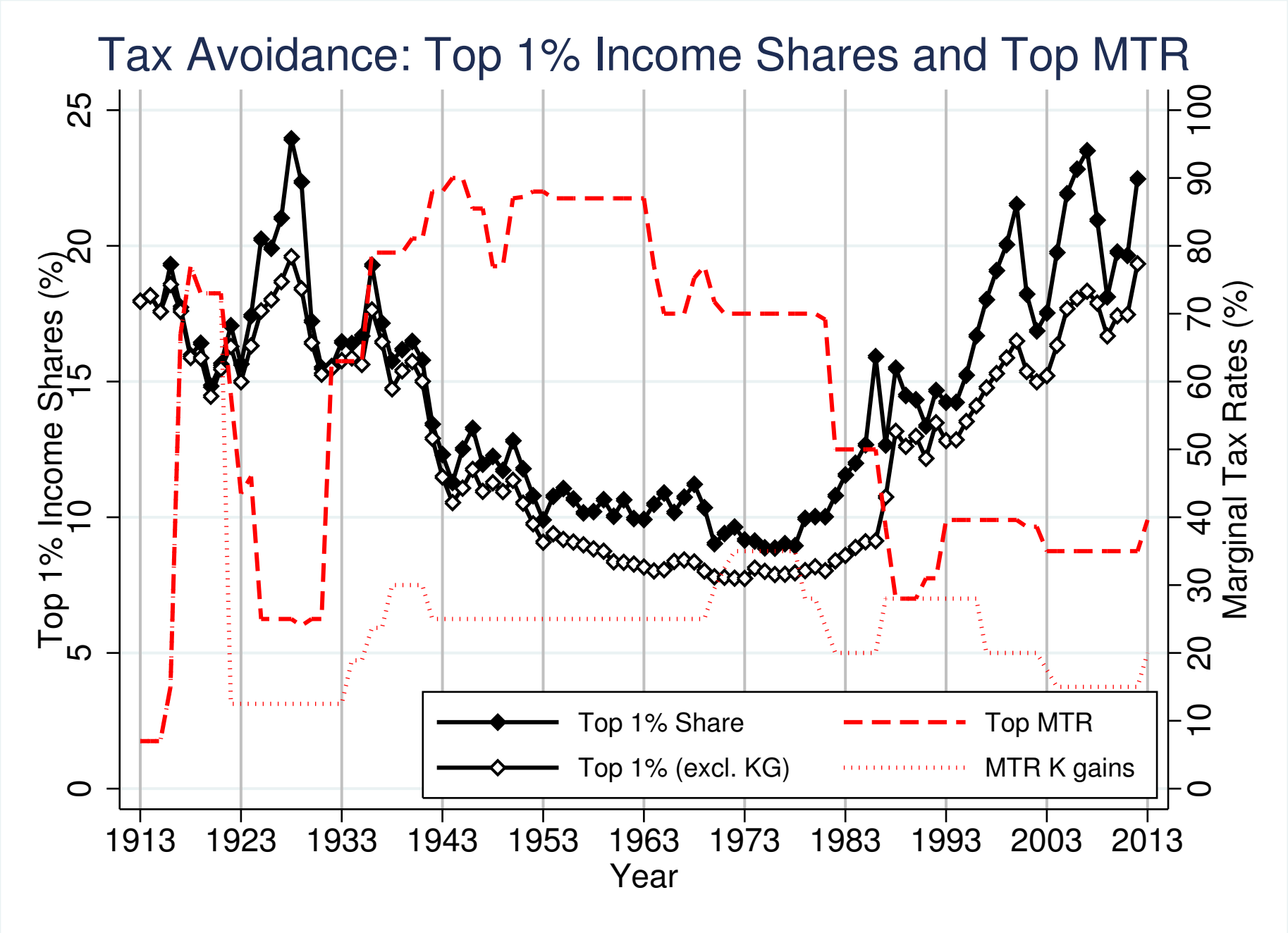
3) Rent-seeking: Top 1% earners extract more pay (at the expense of the 99%) when top tax rates are low $\Rightarrow$ High top tax rates are desirable

Real changes vs. tax Avoidance?

Under tax avoidance scenario, real top income shares were as high as today in the 1960s-70s but top earners reported a smaller fraction of their incomes

$\Rightarrow$ correlation between pre-tax income shares and top tax rate should be much stronger when using narrow taxable income definition than when using comprehensive income definition (including realized capital gains)

Empirical correlation is very similar ruling out the pure tax avoidance scenario


Tax Avoidance: Top 1% Income Shares and Top MTR
Top 1% Income Shares (%)
Marginal Tax Rates (%)
Year
0
5
10
15
20
25
0
10
20
30
40
50
60
70
80
90
100
1913
1923
1933
1943
1953
1963
1973
1983
1993
2003
2013
Top 1% Share
Top 1% (excl. KG)
Top MTR
MTR K gains

Reducing Tax Avoidance among Top Earners

Key principle: neutrality across income forms (broad base)

1) Integration of corporate tax and individual tax: corporate tax becomes a withholding tax refunded with a dividend tax credit

2) US Multinational accumulated profits abroad should be taxed to encourage repatriation

3) Realized capital gains should be taxed at ordinary rates with no step-up at death

4) Crack-down on off-shore tax evasion (FATCA rules and international exchange of information)

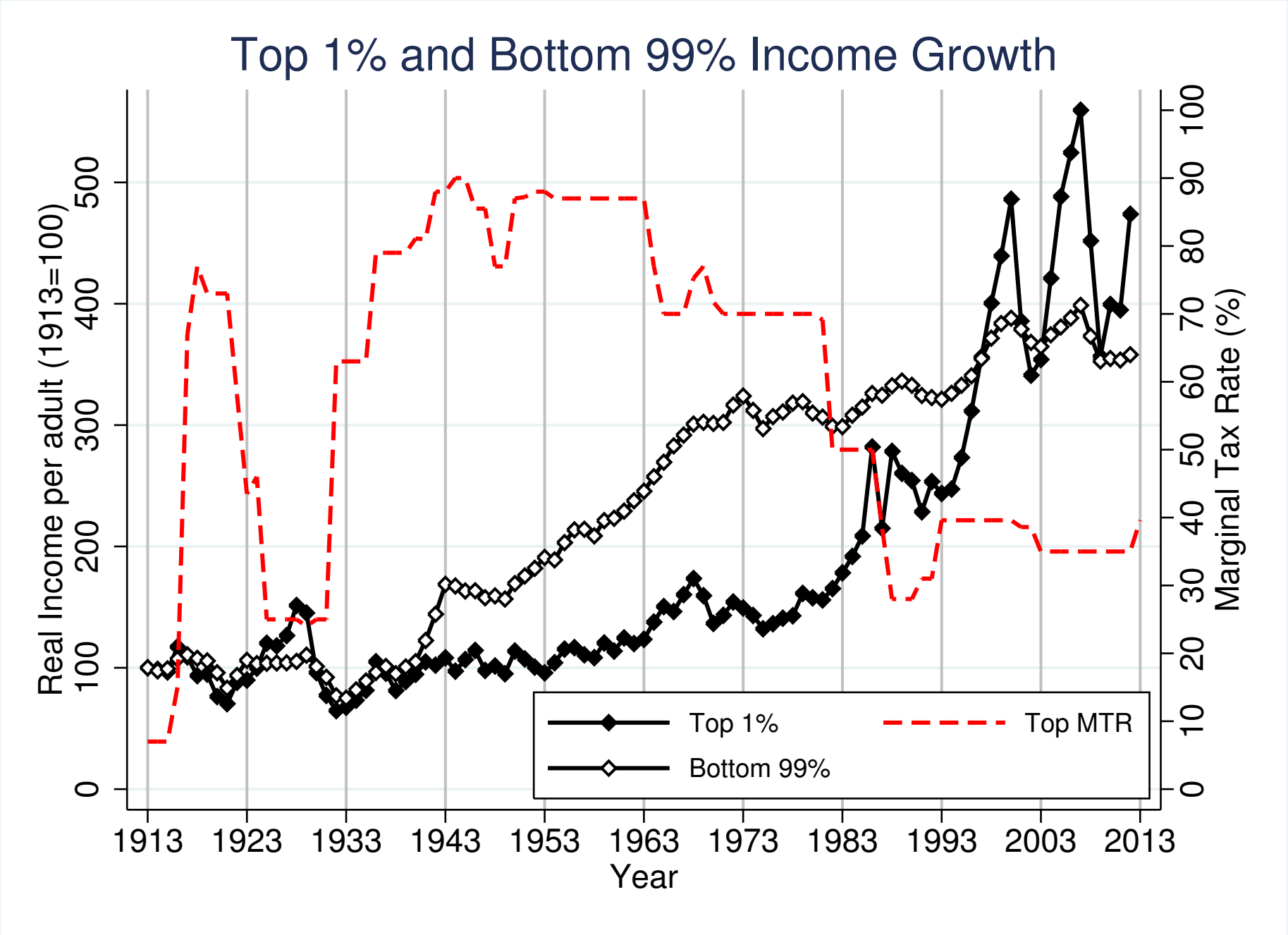
Supply-Side or Rent-Seeking?

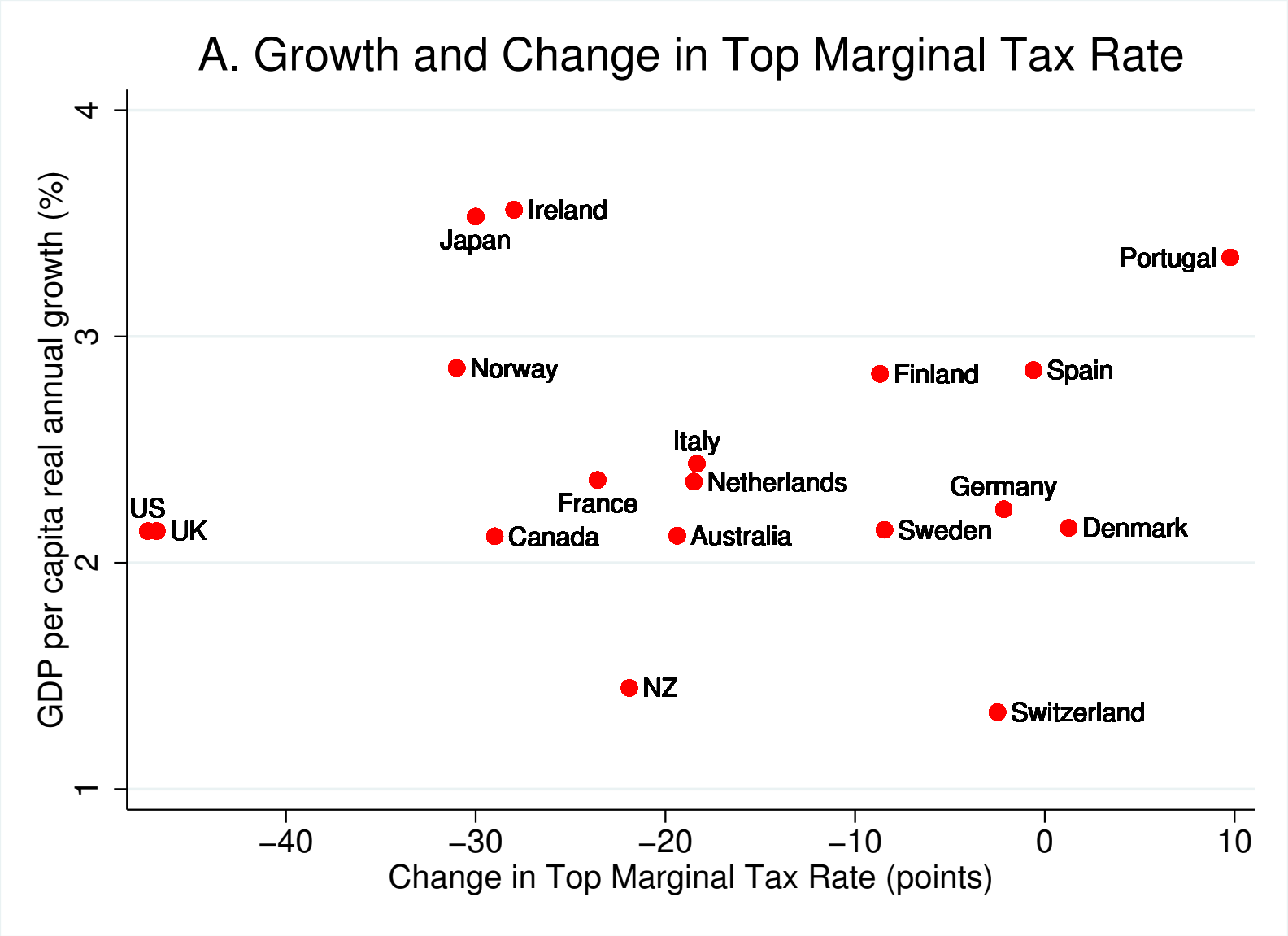
Under rent-seeking scenario, growth in top 1% incomes should come at the expense of bottom 99% (and conversely)

In the US, top 1% incomes grow slowly from 1933 to 1975 and fast afterwards. Bottom 99% incomes grow fast from 1933 to 1975 and slowly afterwards

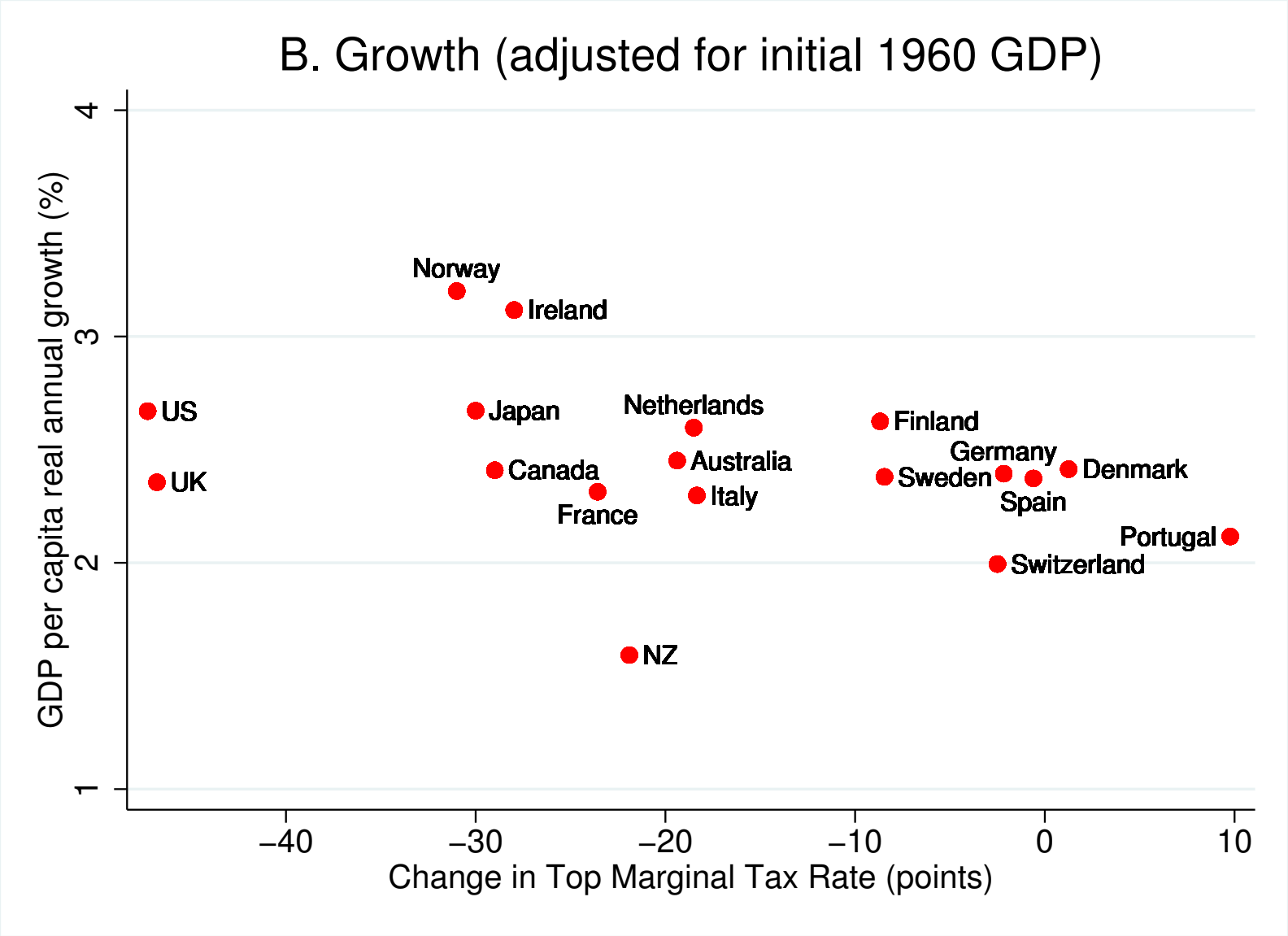
Internationally, no detectable effects on top rate cuts on GDP per capita growth

$\Rightarrow$ Consistent with rent-seeking effects


Top 1% and Bottom 99% Income Growth
Real Income per adult (1913=100)
0
100
200
300
400
500
Marginal Tax Rate (%)
0
10
20
30
40
50
60
70
80
90
100
1913
1923
1933
1943
1953
1963
1973
1983
1993
2003
2013
Year
Top 1%
Top MTR
Bottom 99%



Change in Top Tax Rate and GDP per capita growth since 1960



Change in Top Tax Rate and GDP per capita growth since 1960

POLICY CONCLUSIONS

US historical evidence and international evidence shows that tax policy plays a key role in the shaping the pre-tax income gap

1) High top tax rates reduce the **pre-tax** income gap with no detectable effects on macro-economic growth

$\Rightarrow$ Small top tax rate increases can raise revenue

$\Rightarrow$ Large top rate increases reshape pre-tax income distribution

2) In globalized world, progressive taxation will require international coordination to keep tax avoidance/evasion low

3) Public will favor more progressive taxation only if it is convinced that top 1% income gains are detrimental to the 99%