# Wealth tax and its effects on the rise of inequality in the US

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## Introduction

The rise of wealth inequality in the last four decades has been a growing problem in the US. Today, the top 1% owns 33.8% of total wealth in the US. It is essential to mention that the bottom 90% of households own 30.6% of the total wealth, and the bottom 50% only owns 1.1% of that share (Realtime Inequality). Despite less wealth inequality in the mid-20th century, the bottom 50% share of wealth has always been close to zero. With the current distribution of wealth in the US, it is obvious that poor people have less lobbying power than the rich. With the enormous wealth that corporate owners have, they will continue to lobby against progressive policies at  the expense of the poor. It will continue like that if the policymakers fail to reform the tax policy.

Some scholars have asked whether it is the fault of capitalism that we have surging wealth concentration today. Although it is not necessarily a trait of capitalism to bring about extreme inequality in a society, Polychroniou (2022) argues that: "Capitalism ... lacks the trait to solve the inequality problem. Therefore, democratic governments should interfere and enact policies to form a somewhat equal society". The US in the mid-20th century and many European countries in the last two centuries were able to do that. However, democratic societies started to lose control of a somewhat equal distribution since then which surged many economists and policymakers to advocate for a wealth tax to mitigate this problem. Their main motive is to reduce wealth accumulation at the very top. Saez and Zucman (2019a), who advise many candidates on tax policies, argue that a wealth tax is naturally very progressive because wealth is more concentrated than income (p. 2). Democratic government officials have introduced different wealth taxes in recent years. Their main targets are the rich, owning more than $30 to $50 million. It is, therefore, essential to analyze their proposed policies' long-term impact on wealth concentration and to answer the critical question: How would the wealth gap in the US shrink if the government imposed a more progressive fiscal policy that includes taxes on wealth? This paper argues that a moderate wealth tax of 2.5 percent at the top decile can better reduce the wealth concentration at the top than the policies proposed by politicians. It will first go over the history of wealth inequality in the US and compare it to other regions and countries. Then it will introduce a moderate wealth tax to compare it with other proposed tax policies, and will analyze their impact on wealth accumulation and tax evasion. Finally, counter arguments against a wealth tax will be discussed in this paper.

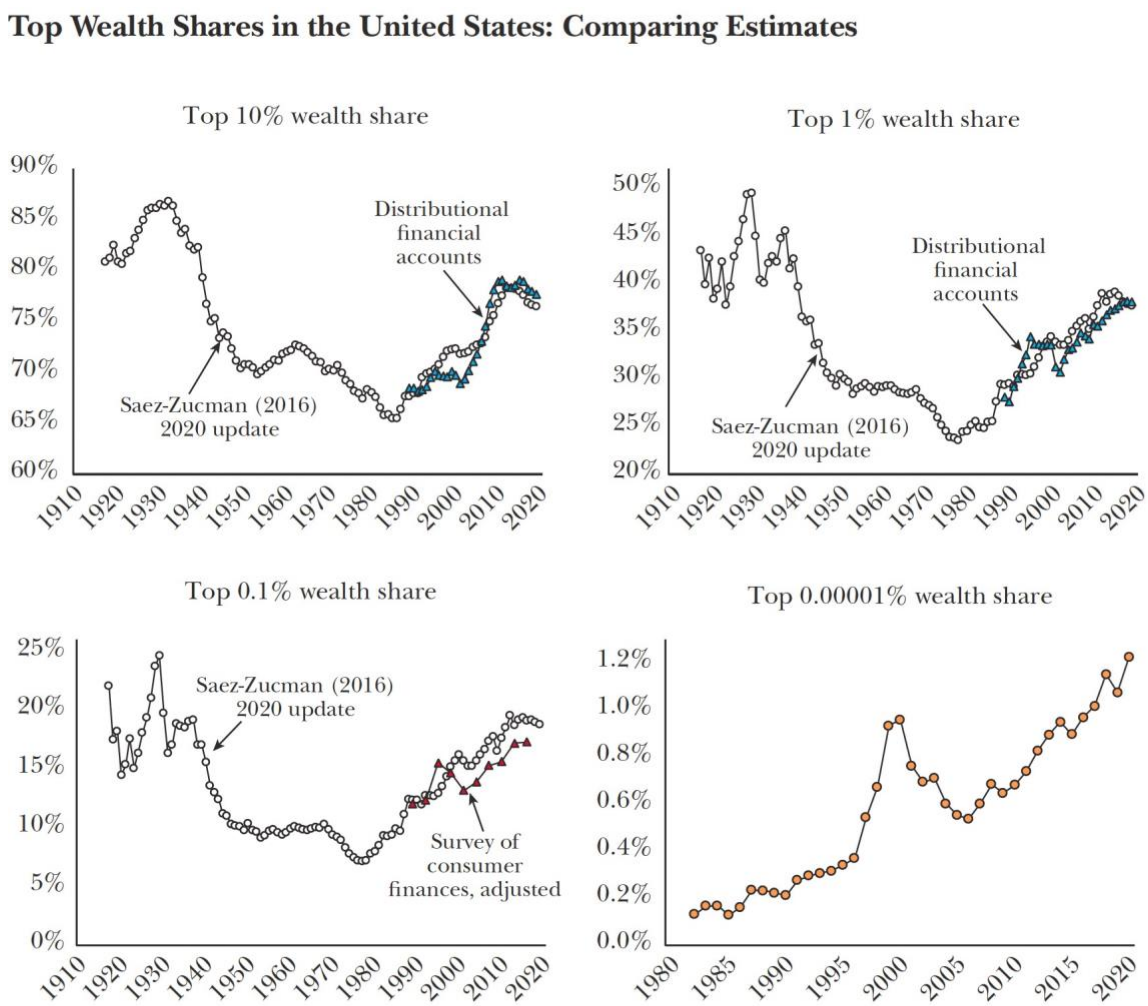
## Methodology

In this article, data from secondary sources will be mainly used. First, recent updates on inequality are taken from the World Inequality Report and RealTimeInequality, two reliable sources containing accurate information about the current state of inequality in the world and the US. Data on the early 20th century will be taken from the works of experts in the field, including Gabriel Zucman, Emmanuel Saez, and Thomas Piketty. They have used the income capitalization method to estimate the shares of wealth in US history. The fact that they studied the methods of other scholars in calculating wealth inequality and pointed out their shortcomings makes these papers more reliable. Finally, I will use a simulation formed by Thomas Blanchett to calculate the effects of wealth taxes on wealth distribution and revenue generation. I will compare the results from different policies. To keep the focus solely on the wealth tax and its effects, I will not talk about whether the government will pass the proposed policy or not. However, tax evasion, a big part of our calculations, is included in the simulation.

## History of Wealth Inequality in the US

According to the estimates of Saez and Zucman (2020), wealth concentration in the US has been very high in the early 20th century (p. 10). Although the last four decades have been an era of rising wealth and income inequality, the top 0.1% share of wealth was highest in 1929 at close to 25% (Saez & Zucman, 2020, p. 450). It followed a declining period from 1929 to 1978 but has constantly increased since 1978. Figure 1 shows the share of wealth for the top 10%, top 1%, top 0.1%, and top 0.00001% of households in the last century have followed a U-shaped line. The top 0.1% has contributed the most to the rise of wealth concentration since 1978.

**Figure 1**




(Saez & Zucman, 2020, p. 10)

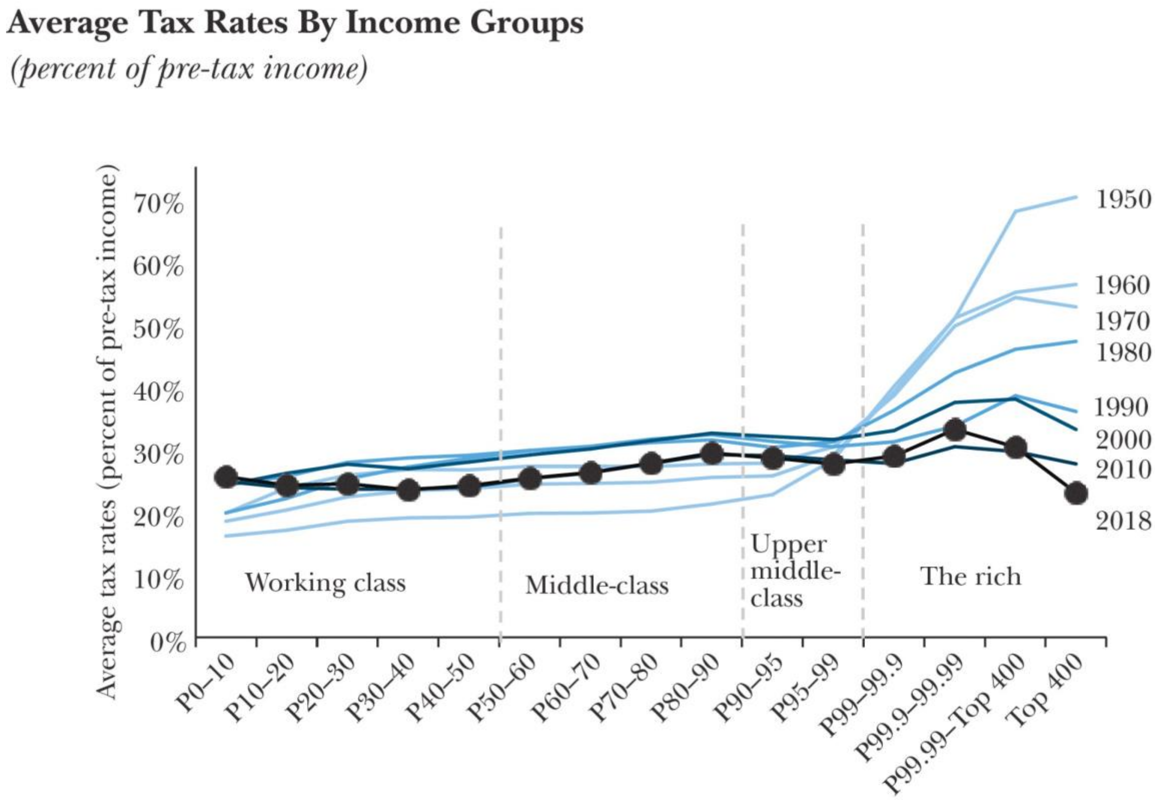
Saez and Zucman (2016) estimated that the bottom 90% share of wealth has increased from 20% to 35% by the 1980s but fell back to 23% in 2012 (p. 523). What is concerning academics is that the last four decades have witnessed more rapid wealth accumulation than any other period in the modern history of the US. Saez and Zucman (2020) named the period between 1980 to 2020 as the “era of extraordinary wealth accumulation among the rich in the US” (p. 11). Therefore, it is necessary to analyze what factors have caused this rapid rise in wealth inequality and what has helped the rise of equality in the first place.

According to Piketty (2020), the fall of the “left-right cleavage” that altered the 20th century’s decline in inequality and the shortcomings of the Social Democratic Party allowed an environment for wealth concentration to rise again. His paper also regards “the Conservative revelation of the 1980s and the development of neo-proprietarian ideology” as the main causes of inequality in the 21st century (p. 966). In contrast, Blanchett (2022) has pointed out very specific drivers that caused the rapid rise in wealth inequality. He argues that the main factors driving inequality have been “in decreasing level of importance, higher savings at the top, higher rates of return on wealth (essentially in the form of capital gains), and higher labor income inequality” (p. 5). Similarly, Saez and Zucman in their paper argue that the surging income at the top since 1980 has caused a snowball effect on the top wealth (2016, p. 523). But what has been the main reason for the rise in top income? Although it is not mentioned in this paper, in a later work, they pointed out the decline in income tax progressivity at the top starting in 1950, as shown in figure 2. We can see in the above figure that the top 400 pay less in taxes than any other group, which is very concerning. In addition, the top inheritance tax rate in the  US has also declined from around 75% in 1950 to 40% in 2020 (Piketty et al., 2020, p. 35).

In fact, this topic is very likely why inequality declined in the first place in the mid-20th century. Saez and Zucman (2019b) argue, "In the first part of the twentieth century, the United States invented very progressive income and estate taxation, combined with heavy corporate taxation. This led to a large and sustained reduction in income and wealth concentration that reversed after-tax progressivity went away" (p. 438). It is astonishing to see how much wealth concentration has declined during tax progressivity. According to Saez and Zucman (2016), in

1980, “the average real wealth of top 0.01% families ($44 million in constant 2010 prices) was half its 1929 value” (p 554).

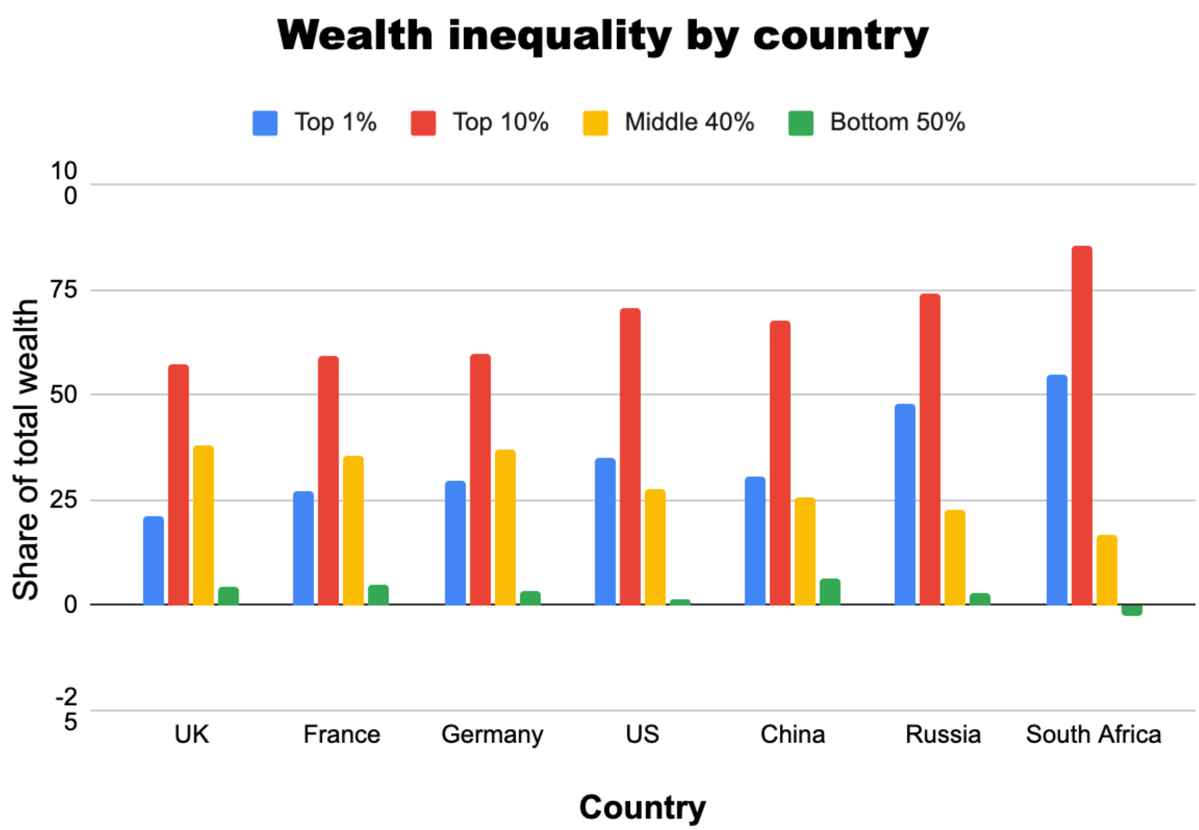
Figure 2. Shows the average tax rates for different income percentiles at different times. The top income tax was progressive in 1950, but that progressivity started to decline since then. In 2018, the Average tax rate of the Top 400 earners was less than people in the first decile.




(Saez & Zucman, 2020, p. 20)

Other countries, especially Russia, have also experienced a surging rise in inequality in the last couple of decades. The US is only a tiny part of the wealth inequality topic. Each country has its history of wealth mobilizations and tax policies. The figure below compares the wealth inequality of different countries. Some politicians argue that the US is the most unequal country in terms of wealth. However, there are countries with a much worse distribution of wealth than the US. This figure can help policymakers to realize how unequal and equal wealth distribution can be and where the US is headed if we do not take action (World Inequality Report).

Figure 3




World Inequality Report

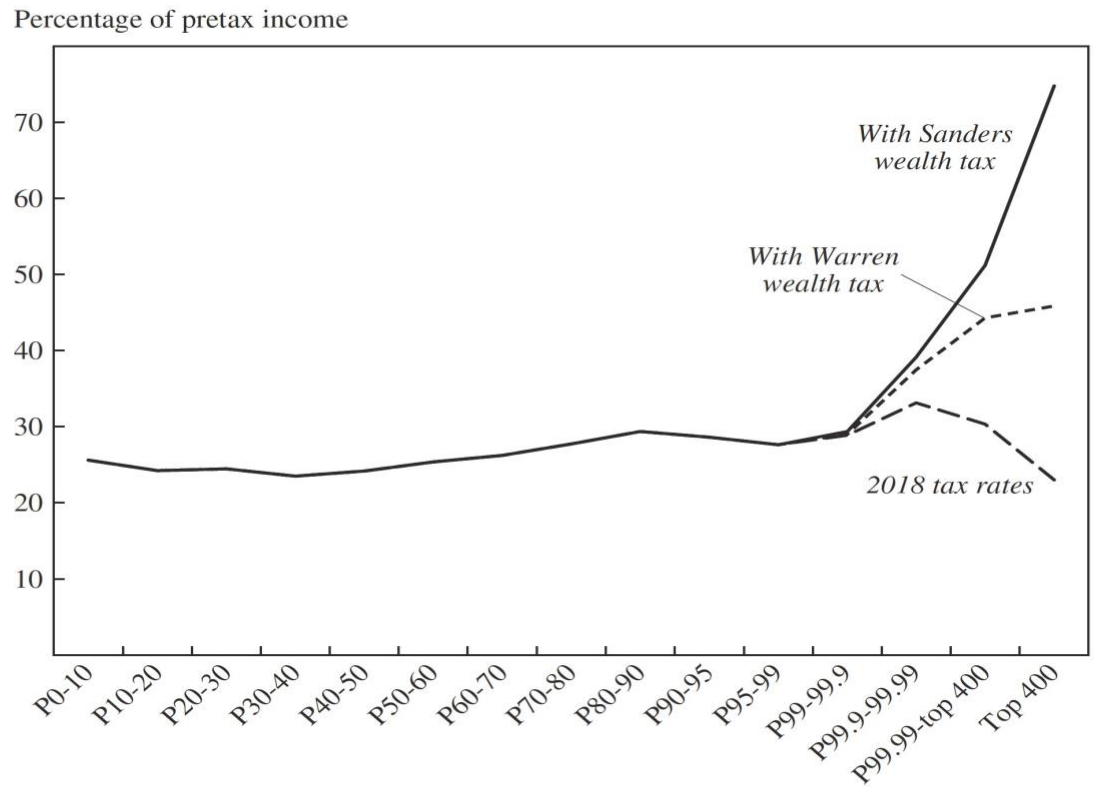
### What would a wealth tax look like?

The current wealth tax in the US is easily avoidable and contributes almost nothing to the annual government revenue. According to Cowen (2013), wealth taxes in the US consist of only property and estate taxes. The IRS website states that the current threshold for estate tax is around $12 million in net wealth. According to Americans for Tax Fairness estimates, 1 out of 700 deaths are subject to estate tax. In 2012, estate taxes only tax less than one percent of the inherited wealth, although estate tax is around 35% to 40% (2014). Like estate tax, property tax is also negligible in revenue generation.

Government officials and economists have thought about these issues and proposed different wealth taxes in the last couple of years. Saez and Zucman (2019b) argue that wealth tax is required, especially for the top 400 wealthiest people, because they easily avoid paying taxes by not realizing their income in the current tax system(p. 439). The lack of wealth tax in the US has provided an excellent opportunity for the rich to avoid paying taxes.

Two notable tax proposals are Bernie Sanders' 2019 wealth tax and Elizabeth Warren's 2019 wealth tax. Senator Sanders proposed a wealth tax on the top 0.1% of households, consisting of 180,000 households with a net worth of more than $32 million. Net worth between $32 million and $50 million will be subject to a 1 percent wealth tax. "The tax rate would increase to 2 percent on the net worth from $50 to $250 million, 3 percent from $250 to $500 million, 4 percent from $500 million to $1 billion, 5 percent from $1 to $2.5 billion, 6 percent from $2.5 to $5 billion, 7 percent from $5 to $10 billion, and 8 percent on wealth over $10 billion" (Bernie Sanders). According to his office, this wealth tax plan will generate more than $4 trillion in a decade. However, even if perfectly enacted, these numbers might not be accurate because his website also mentioned that the US is the most unequal country, which is not valid. Senator Warren's tax plan will target a net worth of $50 million and higher. There will be a 2 percent annual tax on a net worth of $50 million up to $1 billion and a 6 percent annual tax on a net worth of more than $1 billion. According to their estimates, this wealth tax would generate $3.75 trillion in a decade (Warren Democrats). All assets are included in both proposals to mitigate tax evasion and ensure enough revenue is generated. Figure 3 shows how the Sunders and Warren wealth tax would raise the average income tax rate in the top deciles.

Figure 4. The Effects of Wealth Tax Policies on Overall Tax Progressivity




(Saez & Zucman, 2019b, p. 468)

In contrast, Piketty (2020), introduces a very progressive tax only on inheritance and property and argues in favor of temporary ownership of wealth in society. However, he does not recommend the starting point to be the same policy he proposed. The summary of his proposed idea is shown in table 1 below (p. 982).

Table 1

| Multiple of avg wealth | Annual property tax | Inheritance tax |
|---|---|---|
| 0.5 | 0.10% | 5% |
| 1 | 1% | 20% |
| 5 | 2% | 50% |

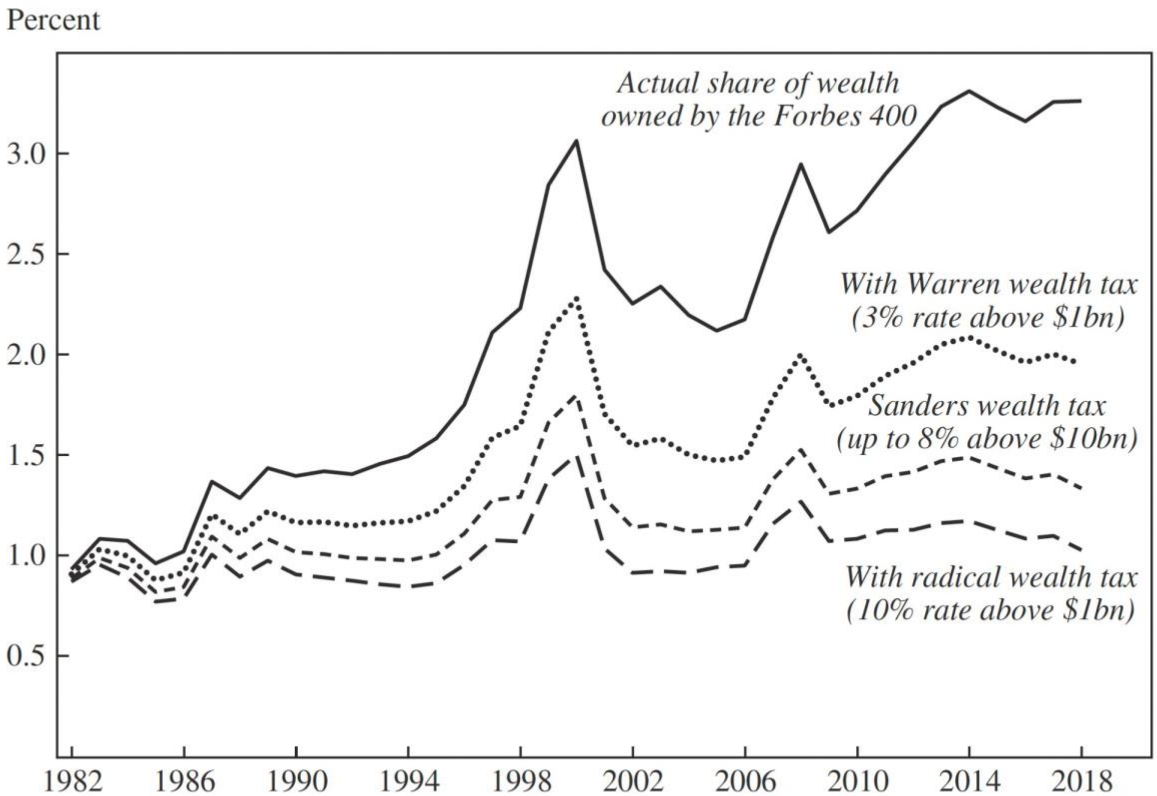
| | | |
|---|---|---|
| 10 | 5% | 60% |
| 100 | 10% | 70% |
| 1,000 | 60% | 80% |
| 10,000 | 90% | 0% |

The wealth tax I propose in this paper is a flat 2.5 percent tax on net wealth with a threshold of $500,000. This threshold is much lower than the proposed policies because I wanted to target the top decile. In addition, this wealth tax will target all assets, including financial, non-financial, and liquid non-liquid assets. My Islamic beliefs inspire the above-mentioned wealth tax. Islam has a wealth tax of 2.5 percent, but only on liquid and financial assets. However, since taxing only liquid and financial assets will allow for tax evasion, I decided to cover all types of assets in the proposed policy.

## How would a wealth tax reduce wealth concentration?

It is crucial to analyze the impact of wealth taxes in the long term. Wealth taxes' impact in the short run can hardly be recognized. Figure 5 shows how much the tax proposals of Senator Warren and Senator Sanders would have affected the top 400 wealth concentration if it was enacted in 1982. Senator Sanders argues that his proposed wealth tax will cut billionaires' wealth in half after 15 years (Bernie Sanders). However, it still needs to be determined how much the top 10% will be affected by these policies. This paper will later show the impact of their policies in the simulation.

Figure 5




(Saez & Zucman, 2019, p. 501)

Piketty (2020) states that his proposed wealth tax on property and inheritance will generate 5 percent of national income annually. His calculations show that his proposed wealth tax would redistribute to every adult, equivalent to 60% of average wealth. In other words, each adult in the US or Europe would have 120,000 Euros all of a sudden, thanks to his proposed wealth tax. He also argues that this policy would have excellent outcomes. For example, adults could start businesses or buy houses (p.983).

Thanks to the efforts of Thomas Blancett, who made it possible to analyze the effects on tax policies through a simulation. The model includes three behavioral parameters: the elasticity of tax avoidance, the elasticity of consumption, and mobility in wealth distribution. For the sake of simplicity, I will hold them equal to 1 in this simulation. The following table shows the effects of the different wealth taxes on wealth concentration in the long run (Data taken from Thomas Blanchet's website). In the third and fourth columns, we can see that the wealth taxes of Saunders and Warren only have notable effects at the very top. In the long run, the top 10% remains almost unchanged. That means the bottom 90% also does not enjoy any significant increase in their share of wealth.

In contrast, the tax law I proposed in this paper significantly reduces the share of wealth for the top 10%, from 70% to around 59%. That means the bottom 90% will see an increase of more than 10% in their share of wealth. In other words, the policies proposed by Sanders and Warren only affect the very top, while the proposed law in this paper will significantly affect the bottom 90%.

Table 2

| Class rank | Current Share of wealth | Wealth share under Sanders policy | Wealth share under Warren's policy | Wealth share under flat 2.5% tax |
|---|---|---|---|---|
| Top 0.01% | 8.90% | 6.10% | 6.40% | 3.20% |
| Top 0.1% | 18% | 14% | 15% | 7.70% |
| Top 1% | 35% | 32% | 32% | 20% |
| Top 5% | 57% | 55% | 55% | 43% |
| Top 10% | 70% | 69% | 69% | 59% |

## Arguments against a wealth tax

*Wealth tax* is a very controversial topic that some even call it unconstitutional. Opposition parties argue that there are side effects that come with wealth taxes which will be harmful to the economy in the long run. Better distribution of wealth, raising revenue, and economic growth, are the three goals that governments try to achieve by reforming tax policies. While all three are vital for stable governments, governments can only achieve two in tax reform and possibly hurt the last one. Therefore, there are fears that wealth tax might harm the economy's growth. However, history shows us that this is not the case. The US had a very progressive tax in the mid-20th century, and inequality was going down rapidly; however, economic growth was at its peak during this era. The US had high economic growth from the 1940s until the 1980s (Crestmont Research). Piketty (2020) mentions that the extreme wealth concentration in the early 20th century did not serve any general purpose. The progressive period that followed did not have any reduction in economic growth, as some people argue (p. 976).

Another concern that has been brought to the table is the effect of wealth tax on capital stocks. It is feared that the decreasing wealth concentration would reduce capital stock in the economy. However, Saez and Zucman (2019b) asserted that the result would be smaller than expected because the US is an open economy. Moreover, outside investors finance the majority of domestic investments. As a result, a reduction in wealth accumulation will not cause a reduction in capital stock. In addition, the savings from the rest of the population will counteract the reduction in capital stock (p. 488).

The final notable issue that has attracted debate is whether wealth tax negatively affects entrepreneurial innovation. Since many billionaires and wealthy households were once innovators, it is essential to answer this question. Saez and Zucman (2019a) argue that a wealth tax might be good for innovation because it will hit the wealthy people who have already established their businesses and not affect new emerging entrepreneurs (p. 12). However, there needs to be more empirical evidence to have a clear answer to this question.

## Conclusion

This essay argued that wealth tax is a valuable tool the US government can use to mitigate the further rise in wealth inequality without diminishing economic growth, capital stock, and innovation. The US can even reach a better wealth distribution than some European countries. However, if policymakers fail to take action, the wealth will become even more concentrated at the top. Fortunately, a couple of years ago, some of the wealthiest people in the US urged the government to enact a wealth tax to fight the climate crisis, create opportunities, and improve the economy (Hotten, 2019). There was a glimmer of hope from that. However, more research is needed to encourage policymakers, and wealthy individuals to support this act or at least not oppose it.

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