

Rising Top Income Inequality

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Econ520

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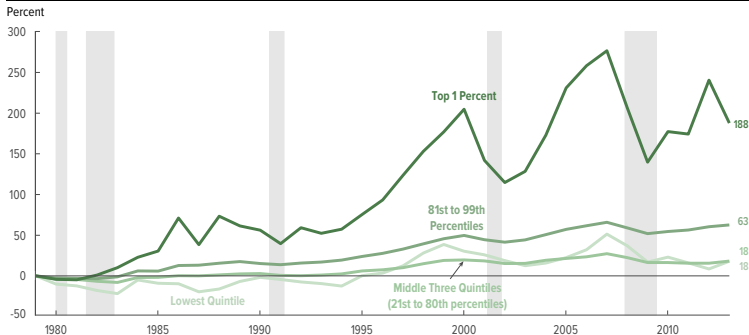
Facts: Inequality at the top

The Top 1% Pull Ahead

Figure 8.

[Return to Reference 1, 2, 3](#)

Cumulative Growth in Average Inflation-Adjusted Market Income, by Market Income Group, 1979 to 2013



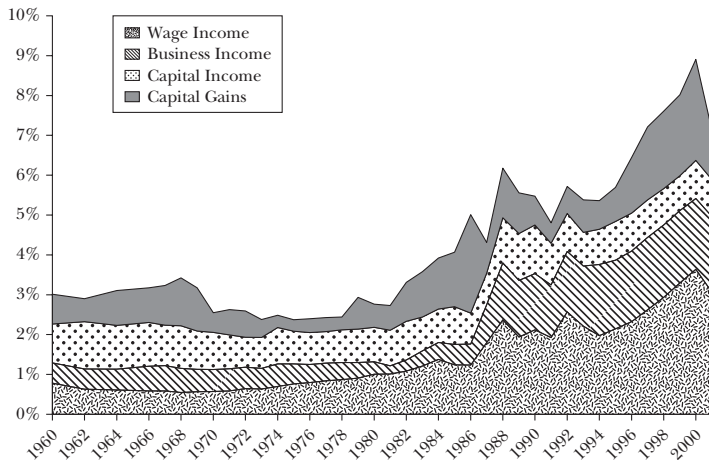
Source: Congressional Budget Office.

Source: Congressional Budget Office (2016)

The top 0.1% Pull Ahead

Figure 2

Income Share and Composition for the Top 0.1 Percent, 1960–2001



Source: Piketty and Saez (2007)

Long-run Perspective

Figure 1

Top 1 Percent Income Share in the United States

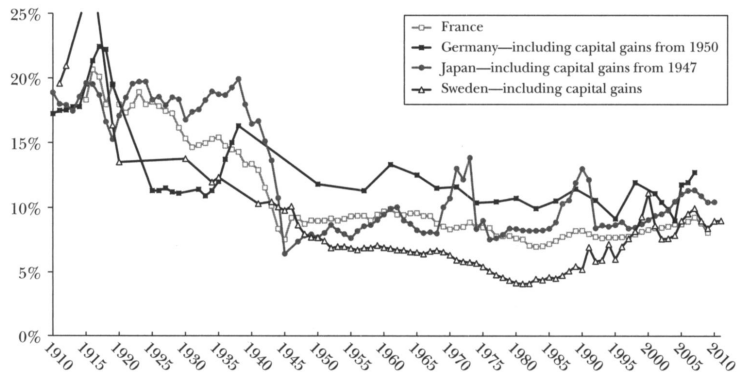


Source: Source is Piketty and Saez (2003) and the World Top Incomes Database.

Notes: The figure reports the share of total income earned by top 1 percent families in the United States from 1913 to 2011. Income is defined as pre-tax market income; it excludes government transfers and nontaxable fringe benefits. The figure reports series including realized capital gains (solid squares) and series excluding realized capital gains (hollow squares).

But Europe is different

B: Top 1 Percent Income Shares in Continental Europe and Japan (L-Shape)



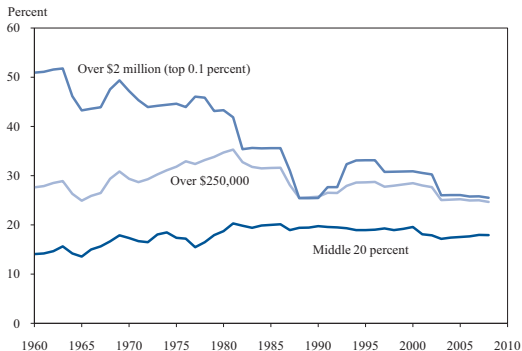
Source: The World Top Incomes Database.

Alvaredo et al. (2013)

Why Did Top Incomes Rise?

The tax system becomes less progressive

Figure 5-8
Evolution of Average Tax Rates



Notes: Average tax rates calculated each year for a sample of 2005 taxpayers after adjusting for average wage growth. Dollar figures in 2009 dollars.

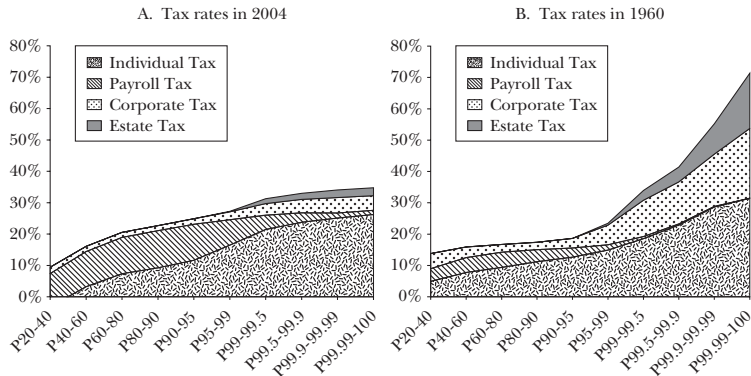
Sources: Department of the Treasury, Internal Revenue Service, Statistics of Income Public Use File 2005; National Bureau of Economic Research TAXSIM (Feenberg and Coutts 1993); CEA calculations.

Source: Economic Report of the President, 2010

Federal taxes are getting less progressive.

Figure 1

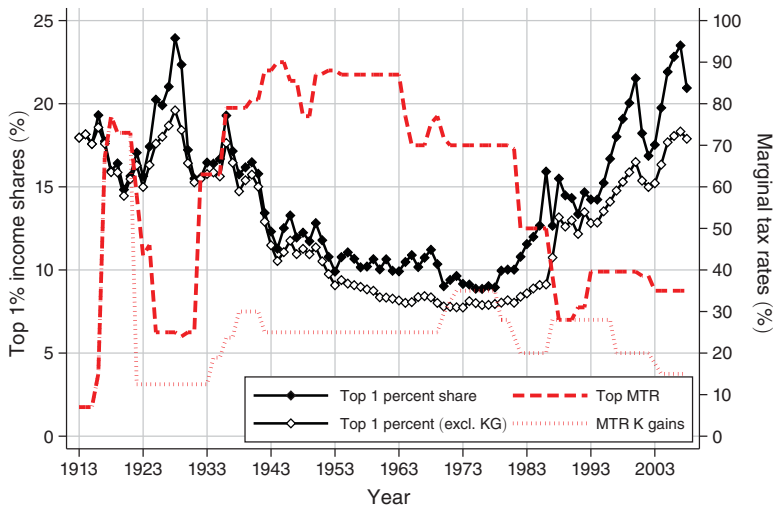
Federal Tax Rates in the United States in 2004 and 1960



Source: Piketty and Saez (2007)

Tax progressivity and top income shares

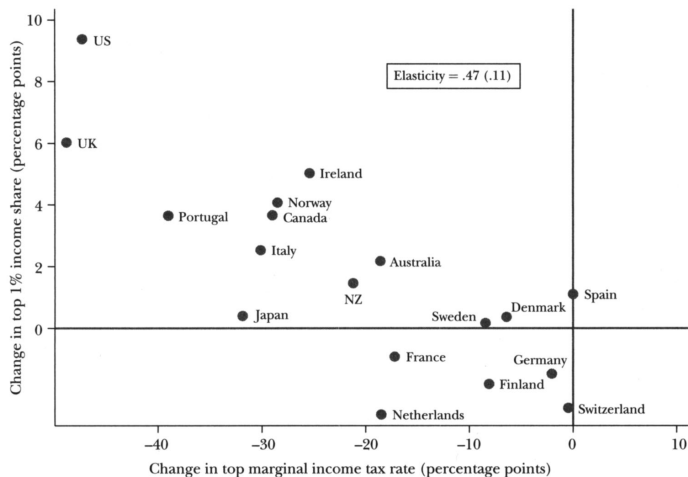
Panel A. Top 1 percent income shares and Top MTR



Source: Piketty et al. (2014)

International Data

Changes in Top Income Shares and Top Marginal Income Tax Rates since 1960 (combining both central and local government income taxes)



Source: Alvaredo et al. (2013).

Summary

Top income shares have increased in many countries, especially in the U.S.

At the same time top marginal tax rates have declined.

Countries with higher tax rates have less inequality.

All of the evidence suggests that taxes account for a share of the rising inequality.

But this is clearly not the only reason why the rich got richer...

Other Explanations

Superstars:

- ▶ The incomes of athletes and entertainers have risen much faster than the incomes of workers.

CEO pay:

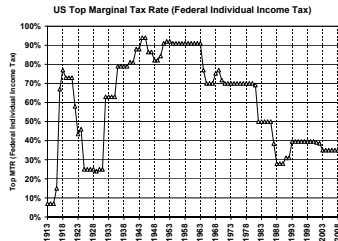
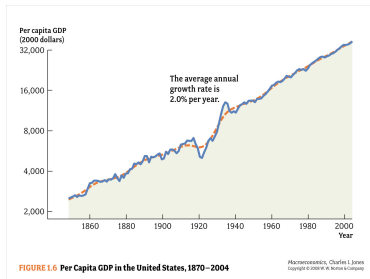
- ▶ A unique U.S. phenomenon: The average pay of CEOs rose from 27 times average worker pay to 300 times (1973-2000).
- ▶ Rent seeking?
- ▶ Or a consequence of larger firms?

How costly is redistribution?

What are the effects of higher (marginal) taxes?

- ▶ Reduced work effort / work hours
- ▶ Less investment?
- ▶ Misallocation of consumption
 - ▶ anything that can be called a business expense is tax deductible
 - ▶ e.g., meals, company cars, first class flights, ...

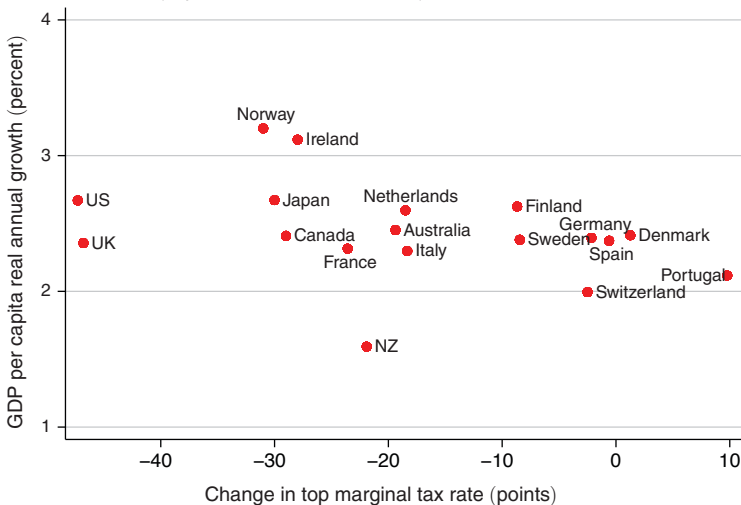
How Costly is Redistribution?



Given this data, it is hard to imagine that tax rates have large effects on growth.

How Costly is Redistribution?

Panel B. Growth (adjusted for initial 1960 GDP)



Source: Piketty et al. (2014)

Summary

High marginal tax rates distort choices:

- ▶ work effort, entrepreneurship, saving, ...

Strong evidence that high taxes reduce hours worked

Little evidence that high taxes reduce economic growth

A tricky question:

What is the optimal top marginal tax rate?

Reading

- ▶ Piketty and Saez (2007)
- ▶ Mankiw (2013): a thoughtful defense of a more conservative view on redistribution.

Advanced Reading

- ▶ Gordon, Robert J.; Dew-Becker, Ian (2007). "Selected Issues in the Rise of Income Inequality. Brookings Papers on Economic Activity, 2007, 2, pp. 169-190. DOI: 10.1353/eca.2008.0011
- ▶ Dew-Becker, Ian. Gordon, Robert J. (2005). "Where Did the Productivity Growth Go? Inflation Dynamics and the Distribution of Income." Brookings Papers on Economic Activity, 2005, 2, pp. 67-150. DOI: 10.1353/eca.2006.0004
- ▶ Piketty and Saez (2014) on optimal taxation.

References I

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- Congressional Budget Office (2016): "The Distribution of Household Income and Federal Taxes, 2013," Tech. rep., Washington, D.C.
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- (2014): "Inequality in the long run," *Science*, 344, 838–843.
- Piketty, T., E. Saez, and S. Stantcheva (2014): "Optimal taxation of top labor incomes: A tale of three elasticities," *American economic journal: economic policy*, 6, 230–271.