Chapter 15 -- A Global Tax on Capital

Thomas Piketty, Capital in the 21st Century (Harvard University Press 2014)

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Financial Reform for the 21st Century

- Policies to preserve the welfare state:
  - 1. financial **transparency** and international **cooperation**
  - 2. a **global and progressive** tax on capital
- **Progressive taxation** — the greater the base, the greater the tax rate
- The challenge of a global tax on capital:
  - 1. a tax schedule applicable to global wealth
  - 2. rules to apportion revenues
  - 3. democratic support
- This **Utopia** could start with information sharing between the United States and the European Union.

A Global Tax on Net Wealth

- The tax base would be **'net wealth'**, the market value of financial and non-financial assets — bank deposits, stocks, bonds, partnerships, equity in listed and unlisted firms, patents, real estate — ***net of debt***.
- A progressive tax schedule:
  - 1% on net assets between €1M and €5M
  - 2% on net assets above €5M
- A more progressive tax schedule:
  - 1% on net assets between €1M and €5M
  - 2% on net assets between €5M and €1B
  - 5% on net assets above €1B
  - 10% on net assets above €10B

A Global Tax on Net Wealth

- **Objectives**:
  - 1. reduce inequality of wealth
  - 2. regulate the financial and banking system
  - 3. set rules for valuing assets, liabilities, and net wealth
  - 4. share financial and banking data
- Some European countries tax wealth — France, Switzerland, Spain, and until recently Germany and Sweden — but these taxes are riddled with exemptions and asset values are too far from market values.
- Existing taxes on wealth are based on **gross wealth** — a heavily indebted person is taxed in the same way as a person with no debt.

Automatic Transmission of Banking Information

- With existing tax loopholes, rich individuals and large corporations essentially "set their own taxes".
- The amount of wealth hidden in tax havens is staggering.
- Tax havens defend bank secrecy because their clients evade taxes, not because privacy is valued per se.
- Free trade and a welfare state are inconsistent with tax havens.
- The first step towards the regulation of banking and financial markets is the automatic transmission of banking data across countries.
- Free trade in goods, services, and capital requires international exchange of financial information.

FATCA

FATCA - The Foreign Account Tax Compliance Act - in force since 2015.

Automatic Transmission of Banking Information

- Since 2015, the **Foreign Account Tax Compliance Act** (FATCA) requires all foreign banks to inform the United States Treasury Department about bank accounts and investments held abroad by US taxpayers.
- **FATCA** remains insufficient:
  - Sanctions are small — a 30% surtax on income that noncompliant banks derive from their US operations.
  - While large banks that need to do business in the US comply with FACTA, smaller banks specialize in "non compliance" — a profitable niche as long as business with US financial institutions is small.

Automatic Transmission of Banking Information

- The 2003 **European Union Savings Directive** (EUSD) required the automatic exchange of information between member states on private savings income, and introduced a 'witholding tax' to be deducted from interest earned by European Union residents on investments made in another member state.
- The 2003/48/EC directive concerned only interest-bearing deposit accounts — with large fortunes held in equity consequently exempted.
- In 2016, directive 2014/107/EU extended the scope of directive 2003/48/EC to include interest, dividends and other types of income.
- Andorra, Austria, Liechtenstein, Luxembourg, Monaco, San Marino, and Switzerland to be included, with temporary delays and exemptions.

Why Should We Tax Wealth?

- 1. A progressive tax on net wealth is **fair**:
    - Income is not a well-defined concept at the very top.
    - Liliane Bettencourt, the L'Oréal heiress whose wealth is €30B, has never declared annual income above €5M. Even a 100% income tax achieves little redistribution.
    - One solution is to expand the income tax base to include income held in trusts, holding companies, and partnerships. Another solution is to tax wealth rather than income.
    - Since return on wealth is increasing in wealth, a progressive tax offsets this inequity, and is more 'fair' than a flat tax.

Why Should We Tax Wealth?

- 2. A progressive tax on net wealth preserve **incentives**:
  - A wealth tax creates incentives to seek high returns.
  - A wealth tax discourages inefficient investments, encourages risk-taking — a 2% wealth tax is reasonable if capital earns 10%, but confiscatory if it earns less than 2%.
  - A tax system based solely on wealth and ignoring profit would put disproportionate pressure on loss-making companies.
  - The ideal tax system balances the incentive to take risk (which is at the heart of investment) and the incentive to smooth revenue (which is at the heart of consumption).
  - The ideal tax system combines income and wealth taxes.

How Should We Tax Wealth?

- An inheritance tax can be high, because it is collected only once a generation. Figure 14.1 shows the top marginal rate on inheritance exceeded 60% between 1940 and 1980 in both the US and UK.
- But the average rate cannot be too high — if it were set at 50%, nearly all wealth would be taxed after 2 generations.
- It makes more sense to tax heirs incrementally throughout their lives (income, profit, wealth taxes), rather than once and for all at the time of inheritance (the estate tax).
- A progressive tax on capital would reassert control over capitalism, while preserving the efficiency of private property and competition.
- Each type of capital would be taxed in the same way.

How Should We Tax Wealth?

- A progressive, annual tax on wealth, even at modest rates, could generate large tax revenues.
- Because on average wealth is worth more than 5 years of GDP and, in the top centiles, even more.
- An EU-wide wealth tax of 1% on €1M-€5M and 2% above €5M would affect 2.5% of the population and raise revenue of 2% of EU GDP.
- In 2012, Italy introduced a tax on wealth — a 0.8% flat rate on real estate and 0.1% flat rate on bank deposits and other financial assets ... except stocks! The overall rate was ... regressive and led to electoral defeat!
- It is difficult for one country alone to impose a wealth tax, **it mut be a coordinated effort**.

Oil Rents

Aramco Oil Refinary, Saudi Arabia.

Oil Rents

- The geographic distribution of natural resources and especially of **oil rents** depends on country borders. In the middle east, these were arbitrarily drawn by occupying powers.
  - Saudi Arabia — population 20M — have annual production 12M barrels per day (approx 100 litres), an annual revenue of $438B at $100 per barrel — equivalent to $22,000 per person, and half that at $50 per barrel.
  - Qatar — population 300,000 — have 2M barrels per day, an annual revenue of $73B at $100 per barrel — equivalent to $243,000 per person, and half that at $50 per barrel.

Immigration

Chinese immigrants in the United States, circa 1890. Source: Unknown.

Immigration

Polish immigrants working in fields near Baltimore. Source: Lewis Hine, colorized by Wikipedia user Robek, based on public domain photo, dated 1909.

Immigration

Syrian refugees on the island of Lesbos, Greece, 10 September 2015. Source: Petros Giannakouris, Associated Press, published in Los Angeles Times.

Immigration

- Immigration shares the economic benefits of free trade and globalization, and reduces inequality.
- In the United States, immigration has been a key force behind wealth distribution: population rose from 3M in 1776 to 320M in 2016, largely thanks to successive waves of immigration.
- The less developed countries would benefit most from a transparent international tax system.
- In Africa, the outflow of capital exceeds the inflow of foreign aid!