Capital Taxation in the 21st Century

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The Setting: Two Economic Challenges

• Increasing Inequality
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• Increasing Fiscal Pressure
Increasing Inequality
Top 1% Income Share of Total Income (Percent)

Source: The World Top Incomes Database
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Shares of Market Income, US, 1979 and 2007

Source: CBO (2011)

Source: CBO (2011)
Inequality: Effects of Taxes and Transfers, US

- Market Income
- + Transfers
- + Transfers - Taxes

Source: CBO (2011)
US Life Expectancy at Age 50 by Lifetime Earnings, Males

Source: NAS (forthcoming)
US Life Expectancy at Age 50 by Lifetime Earnings, Females

Source: NAS (forthcoming)
Trends in income inequality in Australia, Gini coefficient, 1981 to 2011

Source: Stewart et al. (2015)
Increasing Fiscal Pressure
(Percent of GDP)

Source: IMF World Economic Outlook Database
Old-Age Dependency Ratios, 2015 and 2050

Source: US Census Bureau, International Data Base

2015  2050
Fiscal Gaps, 60% Terminal Debt-GDP Ratio

Source: Auerbach (2015)
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- A logical solution: progressive tax increases and expenditure reductions
  - Particular focus on taxation of capital income and wealth, as wealth more concentrated than income
  - But another major challenge stands in the way
Statutory Corporate Tax Rates

Source: OECD Tax Database
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Source: OECD Tax Database
Fighting Back

• Initiatives to reduce tax evasion, particularly among high-wealth individuals
  – US FATCA legislation

• Initiatives to reduce corporate shifting of income and expenses among countries
  – OECD BEPS project
Will Such Approaches Work?

• Placing arbitrary rules on companies may restrict their ability to shift profits and expenses, but this may lead to more serious distortions
  – If can’t shift profits without moving productive activities, companies may move the activities themselves
  – Example: US inversions
Will Such Approaches Work?

• Basic problem: “solutions” without logic
• Trying to tax income where it is earned, where
  – This location is hard to determine
  – To the extent that it can be determined, doing so has negative economic consequences
More Fundamental Alternatives

• Can we do better by changing how we attempt to tax capital and profits?
Global Wealth Taxation

- Assessment at individual level, so gets around mobility of corporate activities; but…
Global Wealth Taxation

• Assessment at individual level, so gets around mobility of corporate activities; but…
  – Measuring and tracking wealth is challenging, and requires international coordination and cooperation
  – High taxes on wealth can impose large incentives not to save
  – Doesn’t get at pernicious uses of wealth
Consumption-Based Taxation

• Attractive from an enforcement perspective, since easier to track and measure than capital income or wealth
• And, does not discourage saving
• Raises revenue, but in the form of a VAT, doesn’t get at the problem of inequality
Consumption-Based Taxation

• But consumption-based taxation can be progressive
  – Can even extend to intergenerational wealth transfers, or other uses of wealth
Consumption-Based Taxation

• Can also use as a model for corporate tax reform (Auerbach et al. 2010; Auerbach 2010)
  – A destination-based corporate tax
  – Eliminates business opportunities to reduce taxes by shifting locations of expenses and income
  – Does not require international cooperation
  – Progressive (no tax on labor or shifting to labor)
  – Encourages domestic investment and production
Why Not?
We Can Do Better, and Need to