

Capital Taxation in the 21st Century

Alan J. Auerbach

April 15, 2015

The Setting: Two Economic Challenges

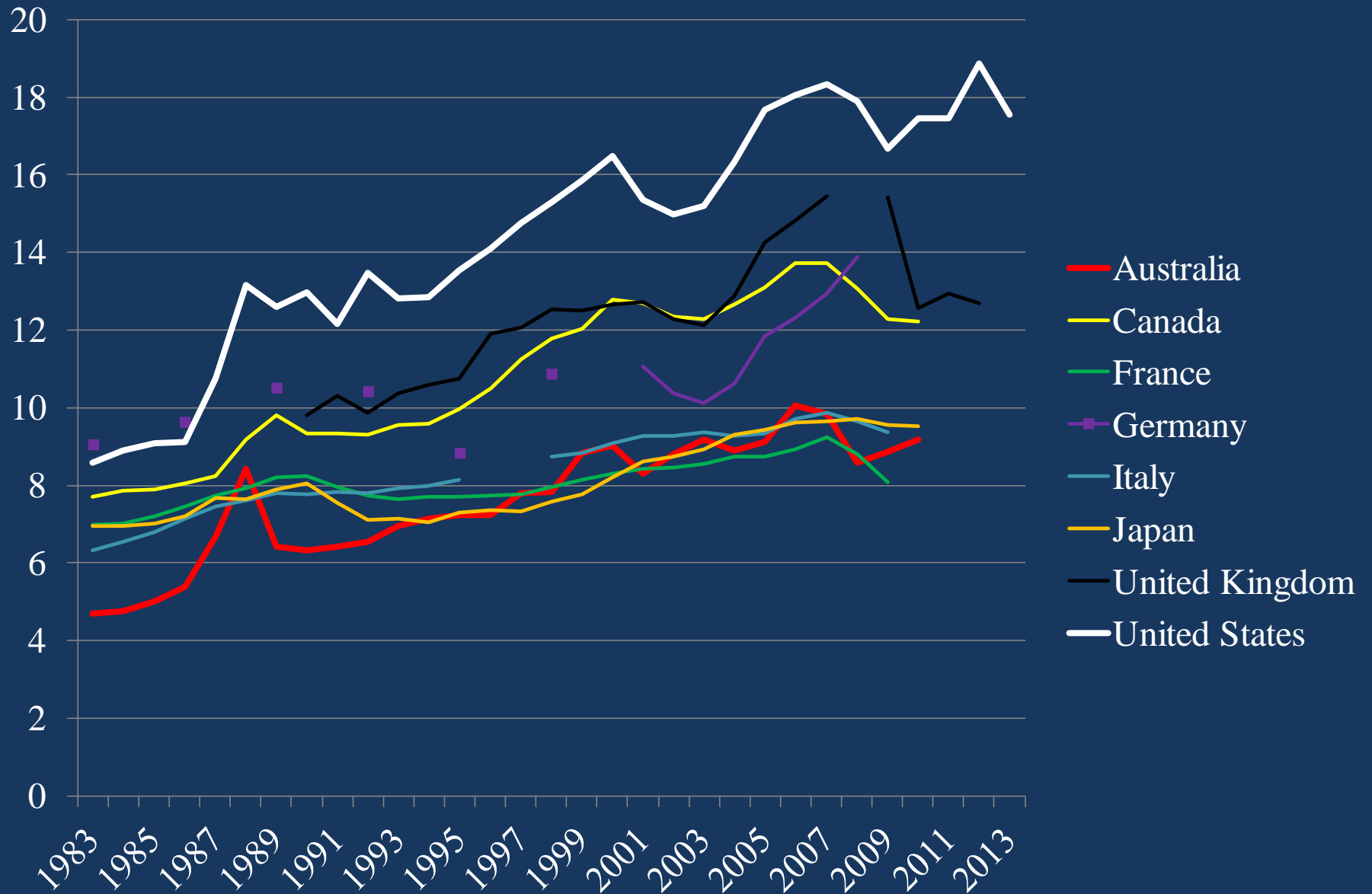
- Increasing Inequality

The Setting: Two Economic Challenges

- Increasing Inequality
- Increasing Fiscal Pressure

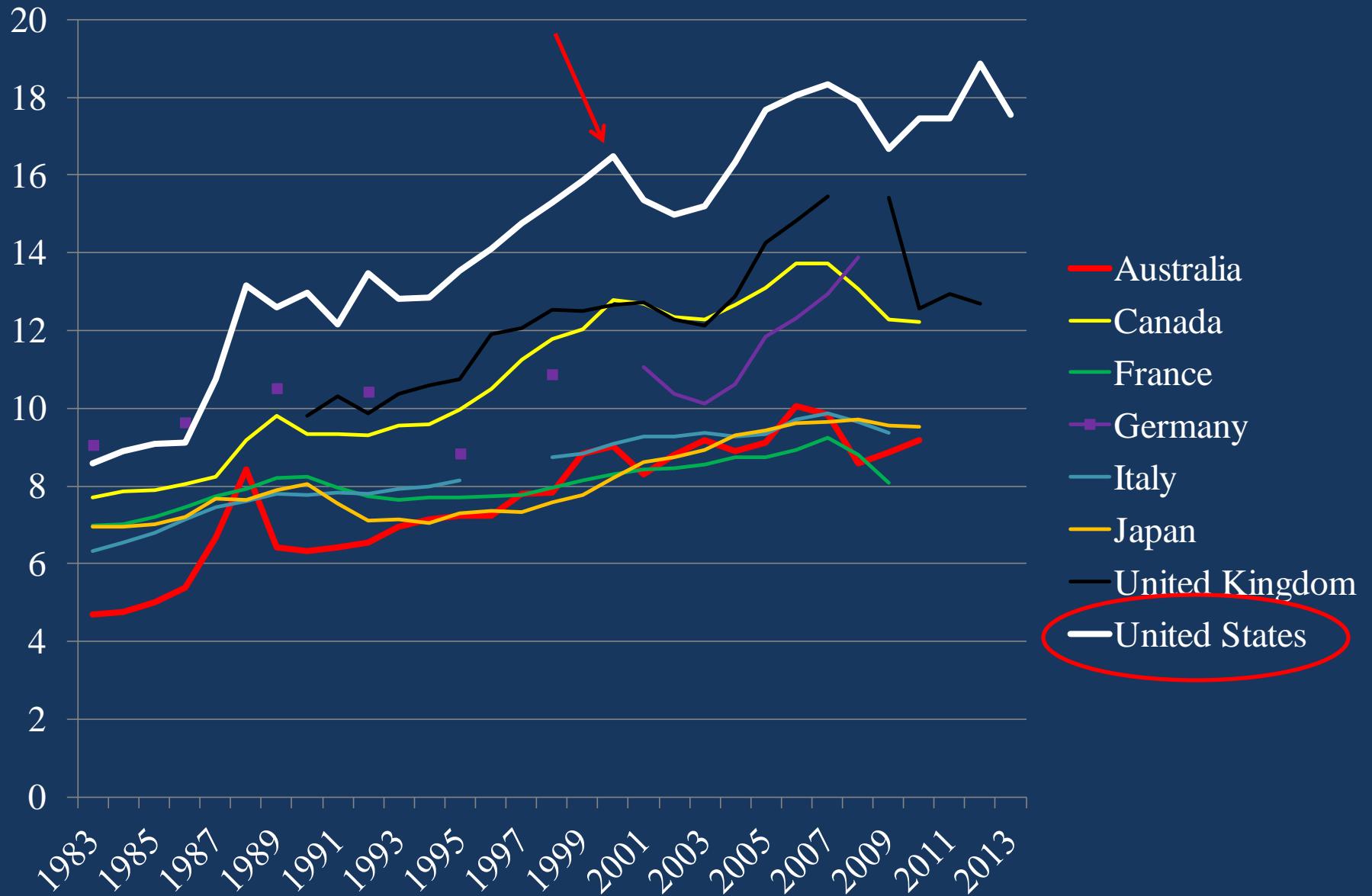
Increasing Inequality

Top 1% Income Share of Total Income (Percent)



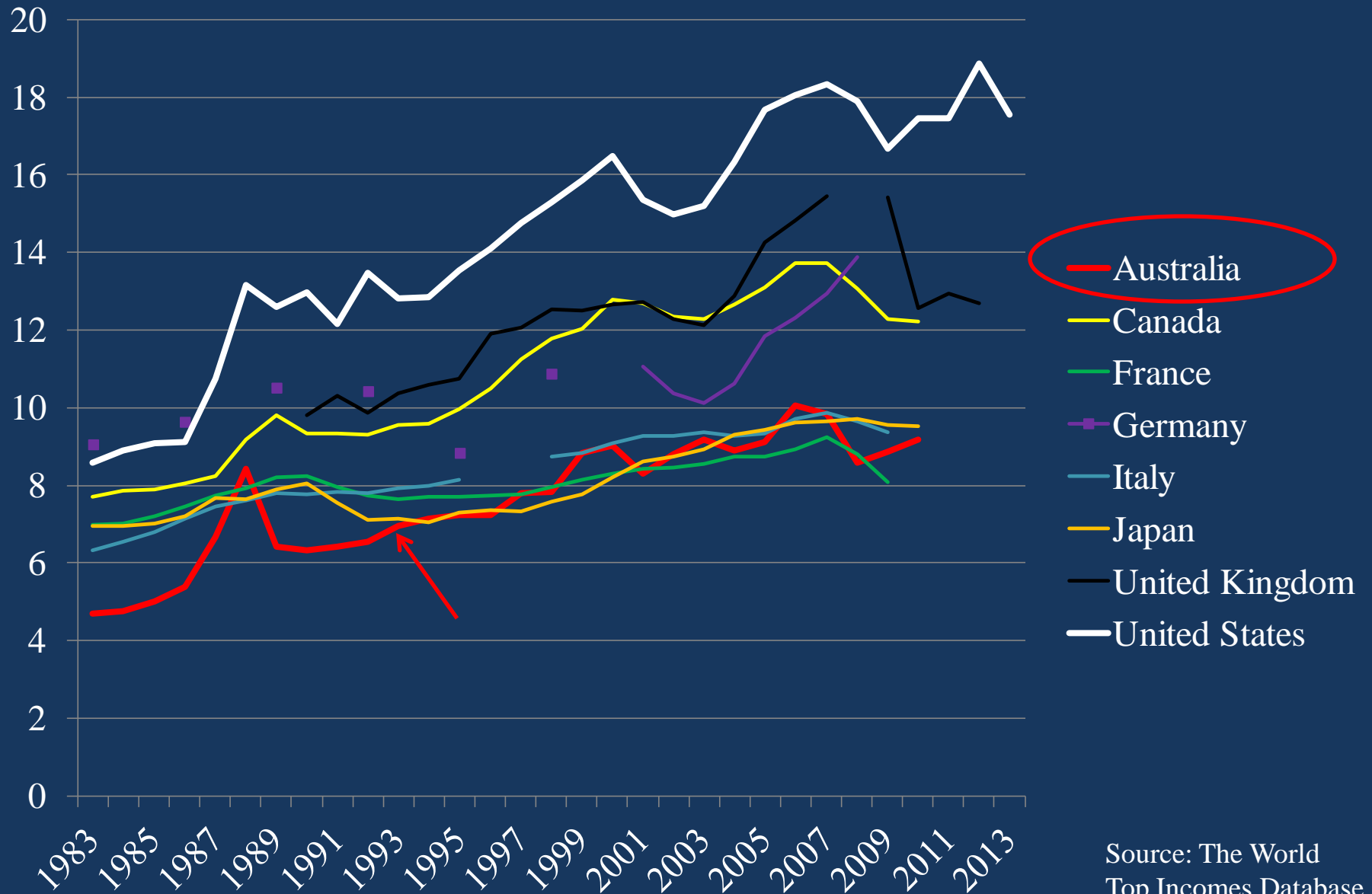
Source: The World Top Incomes Database

Top 1% Income Share of Total Income (Percent)



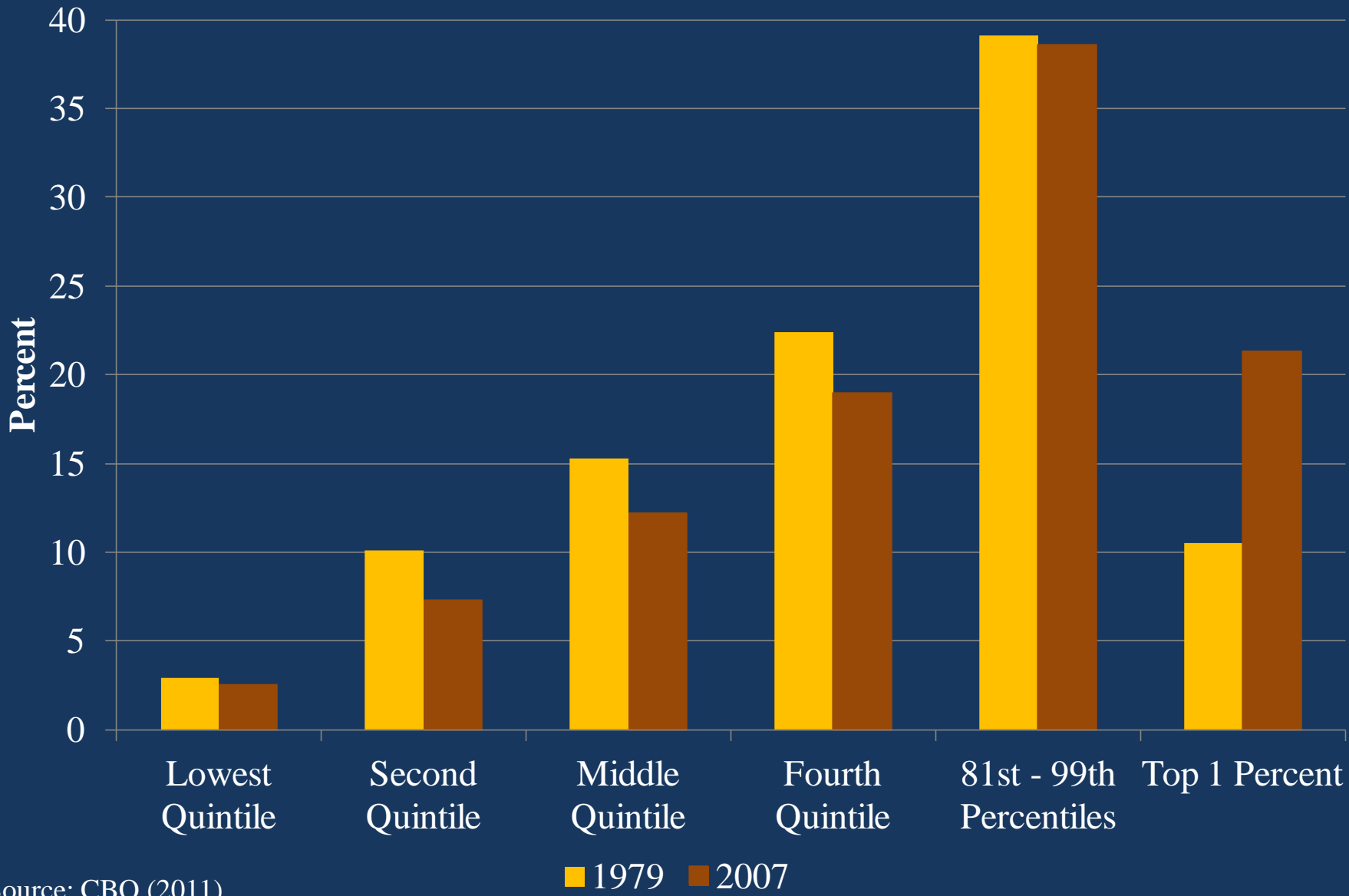
Source: The World Top Incomes Database

Top 1% Income Share of Total Income (Percent)



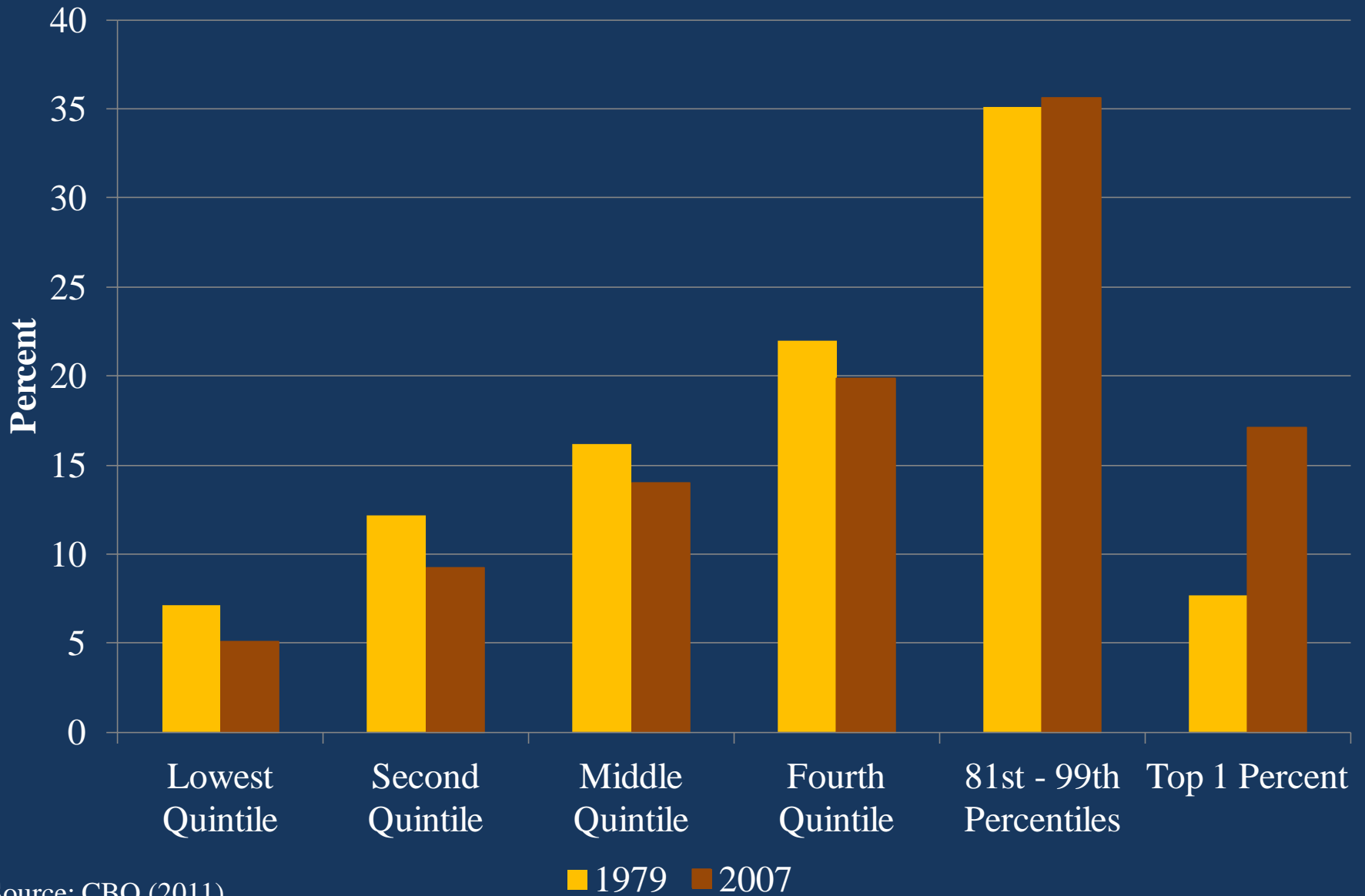
Source: The World Top Incomes Database

Shares of Market Income, US, 1979 and 2007



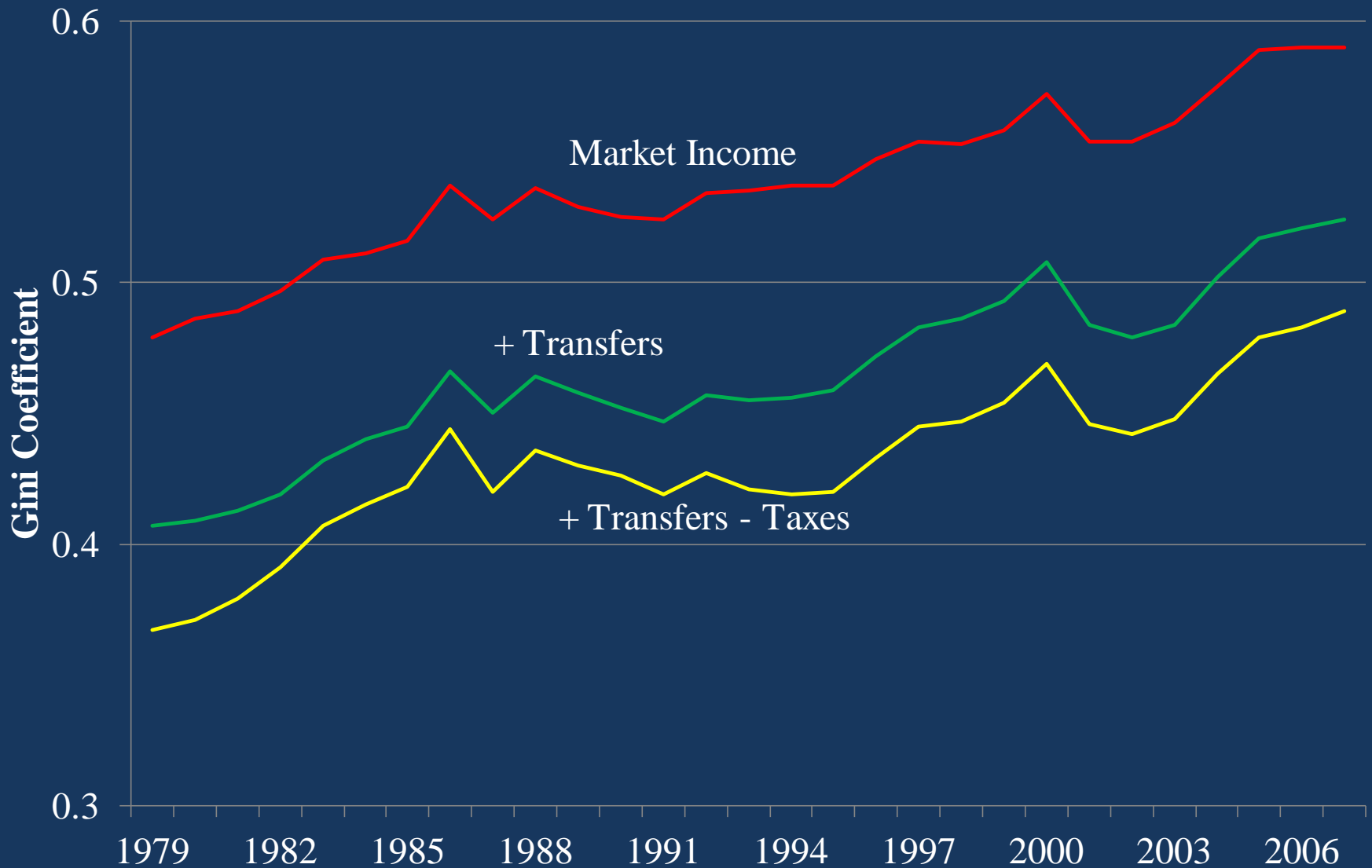
Source: CBO (2011)

Shares of Net Income, US, 1979 and 2007



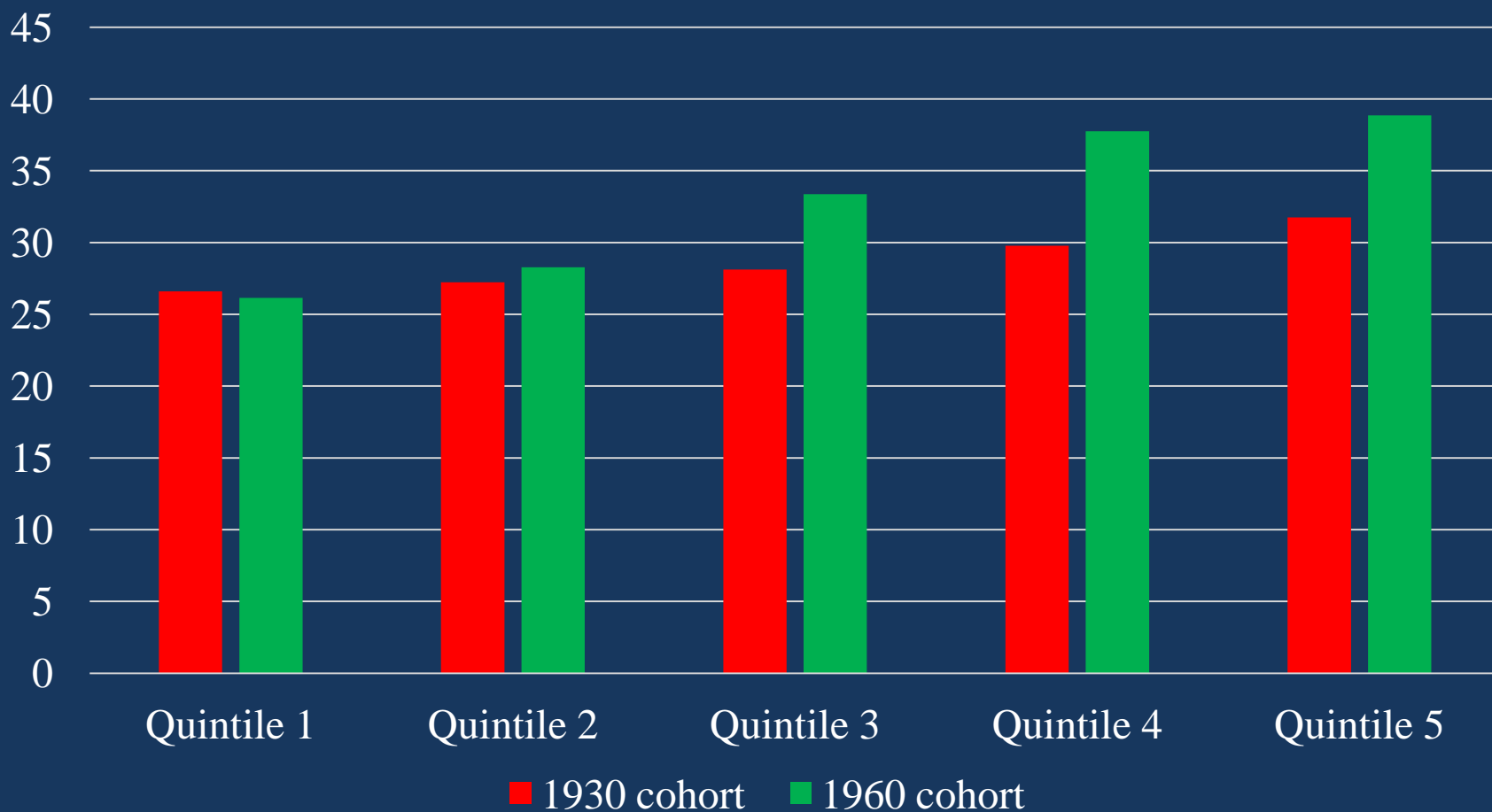
Source: CBO (2011)

Inequality: Effects of Taxes and Transfers, US



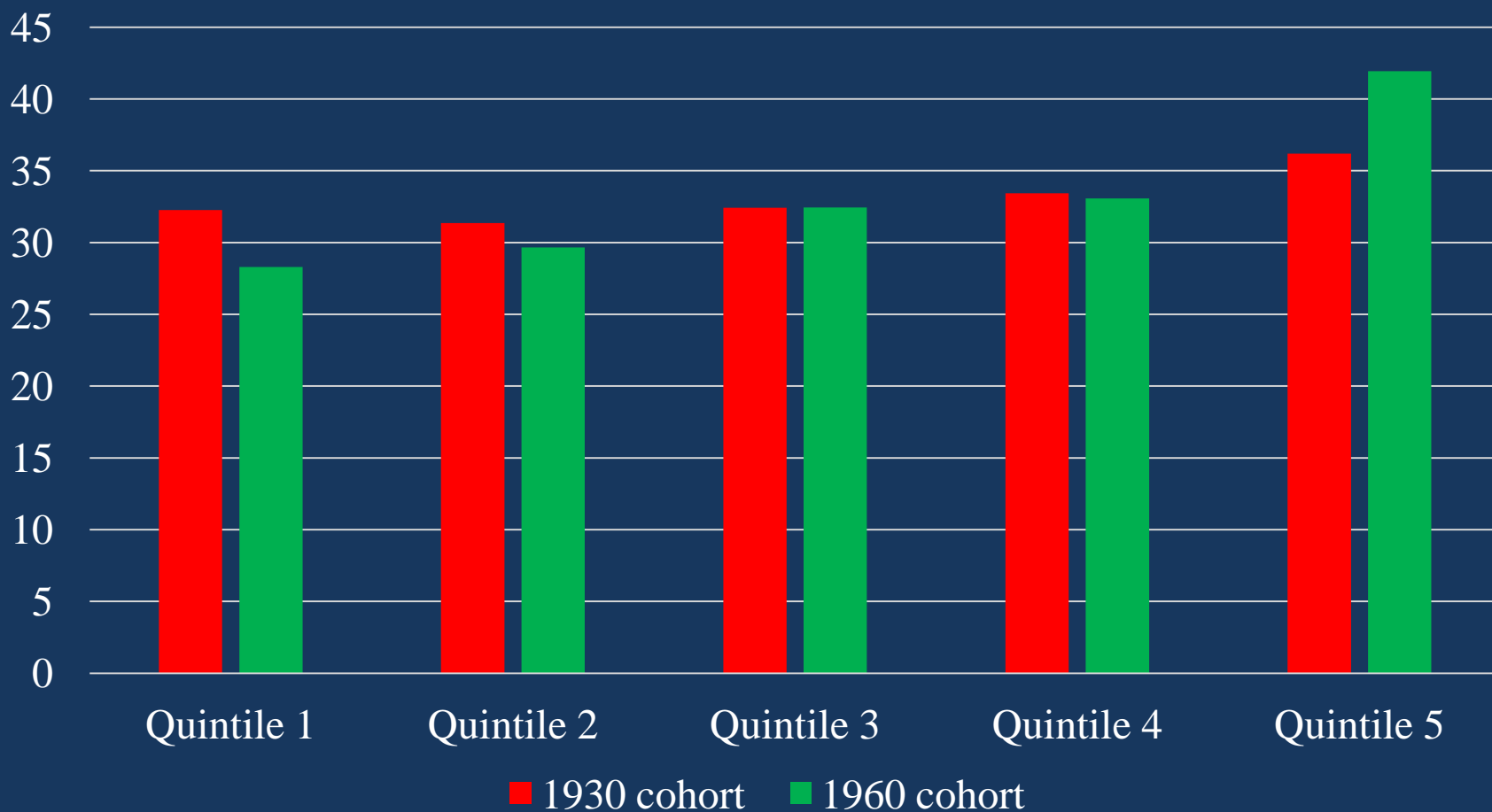
Source: CBO (2011)

US Life Expectancy at Age 50 by Lifetime Earnings, Males



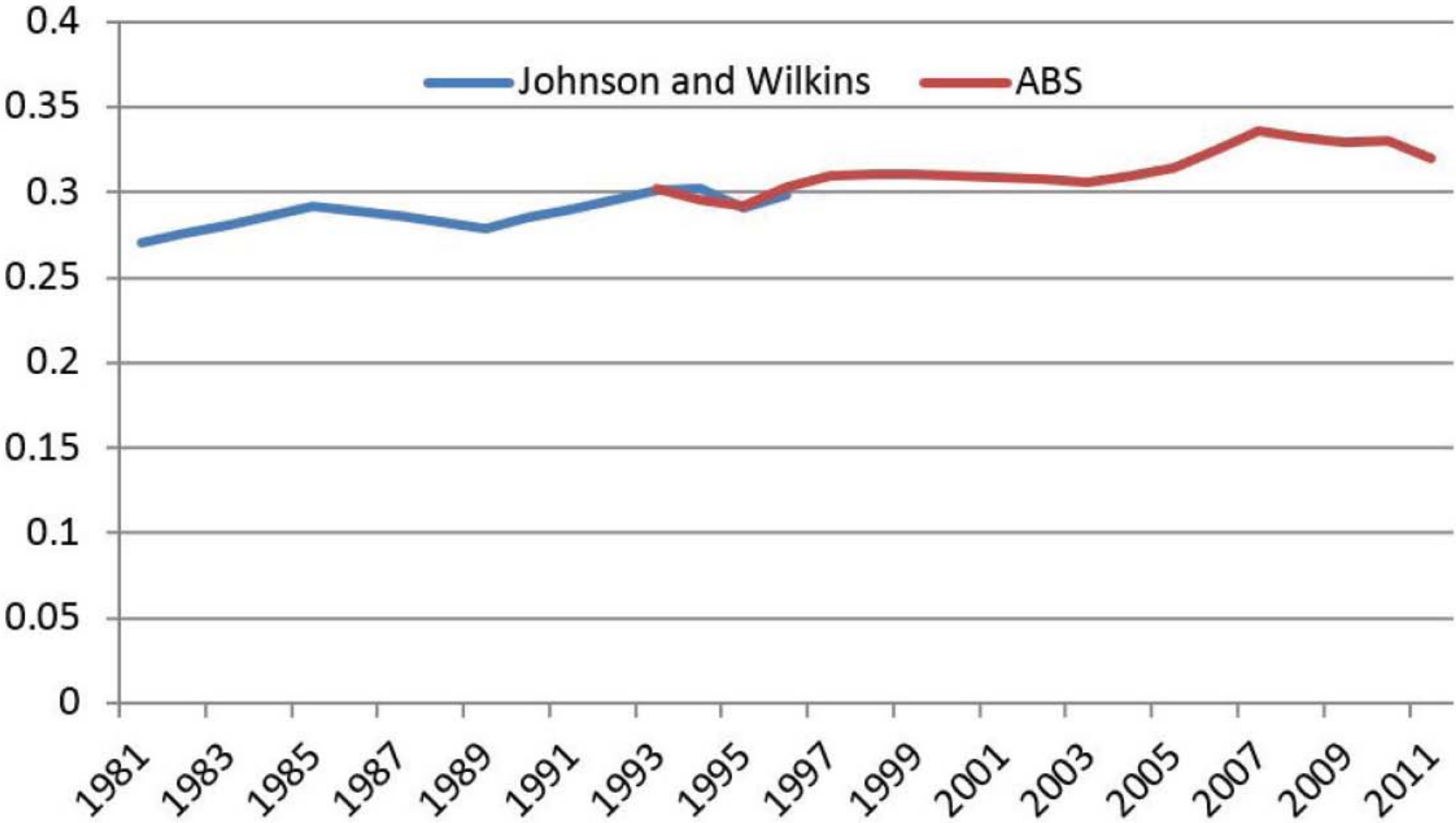
Source: NAS (forthcoming)

US Life Expectancy at Age 50 by Lifetime Earnings, Females



Source: NAS (forthcoming)

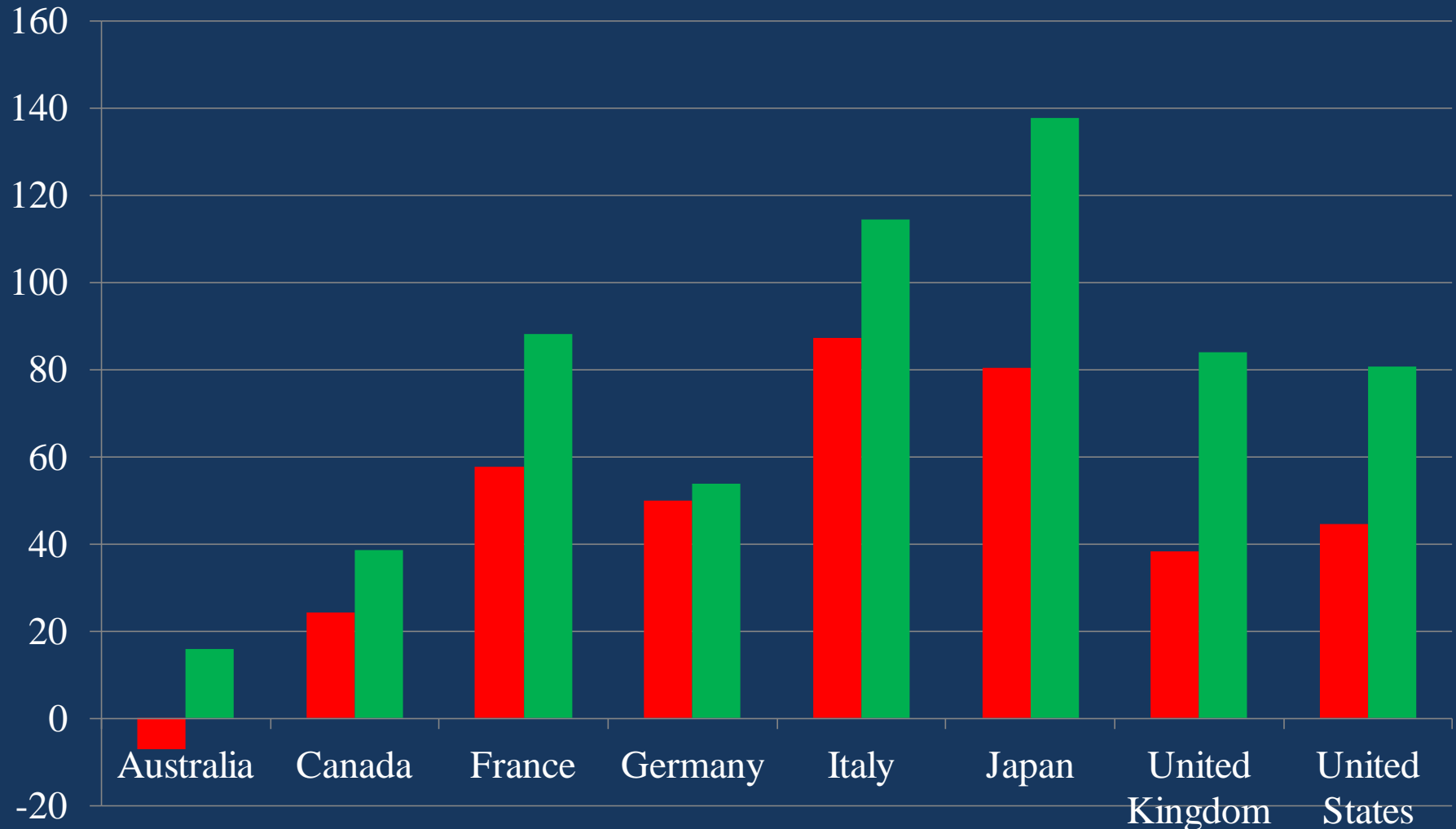
Trends in income inequality in Australia, Gini coefficient, 1981 to 2011



Source: Stewart et al. (2015)

Increasing Fiscal Pressure

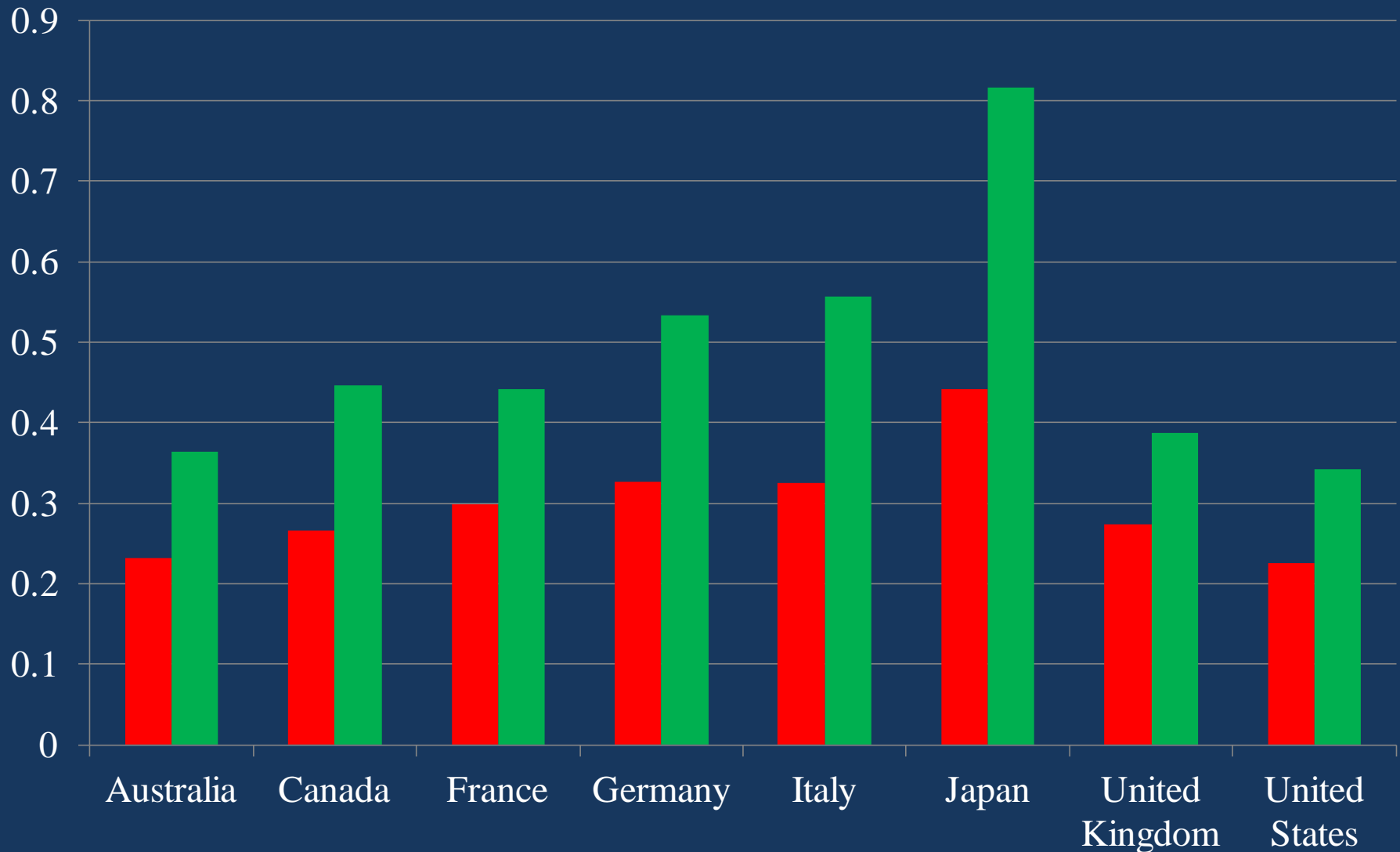
Net General Government Debt, 2007 and 2014 (Percent of GDP)



Source: IMF World
Economic Outlook Database

■ 2007 ■ 2014

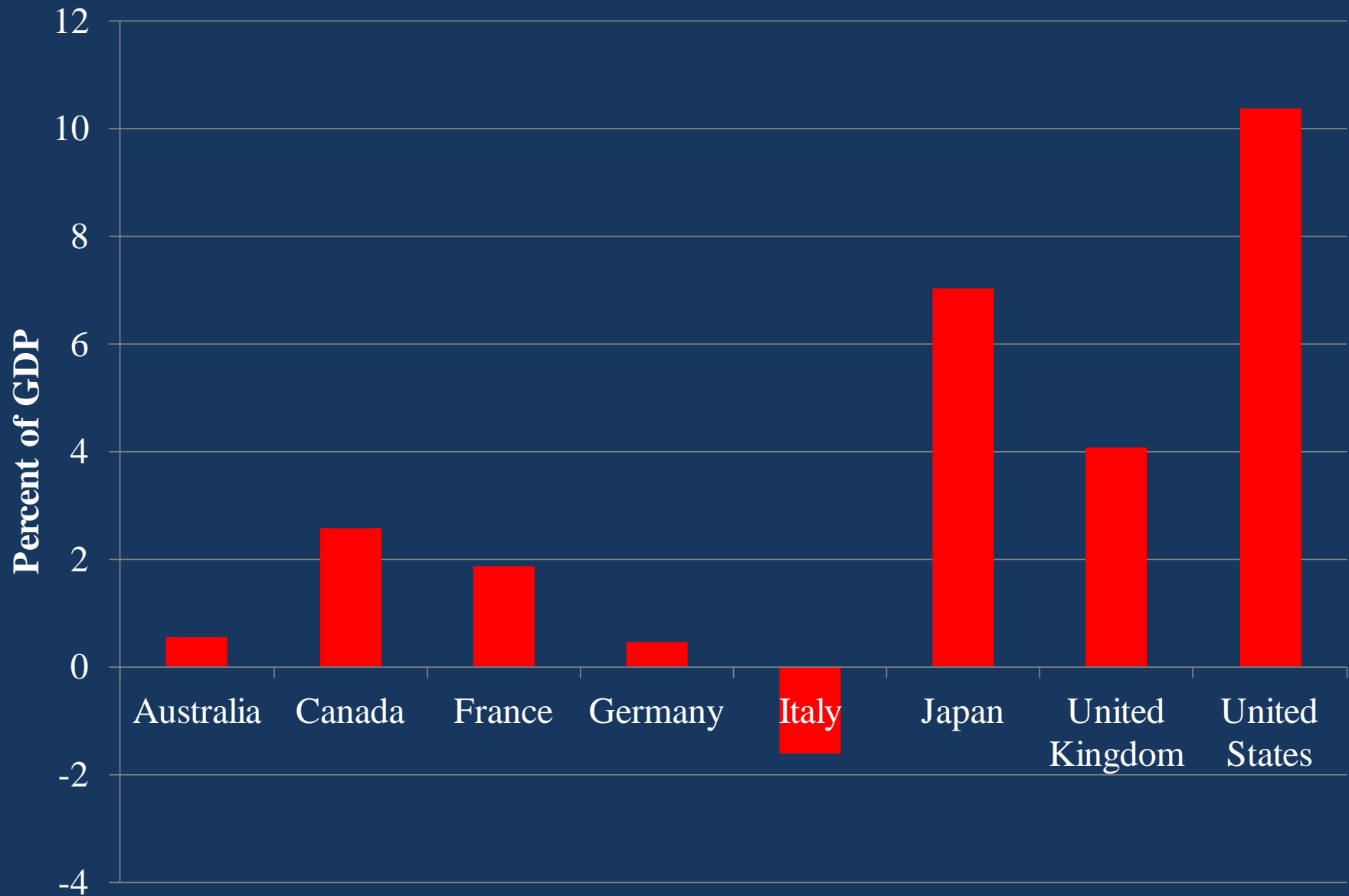
Old-Age Dependency Ratios, 2015 and 2050



Source: US Census Bureau,
International Data Base

■ 2015 ■ 2050

Fiscal Gaps, 60% Terminal Debt-GDP Ratio



Source: Auerbach (2015)

The Setting: Two Economic Challenges

- Increasing Inequality
- Increasing Fiscal Pressure

The Setting: Two Economic Challenges

- Increasing Inequality
- Increasing Fiscal Pressure
- A logical solution: progressive tax increases and expenditure reductions

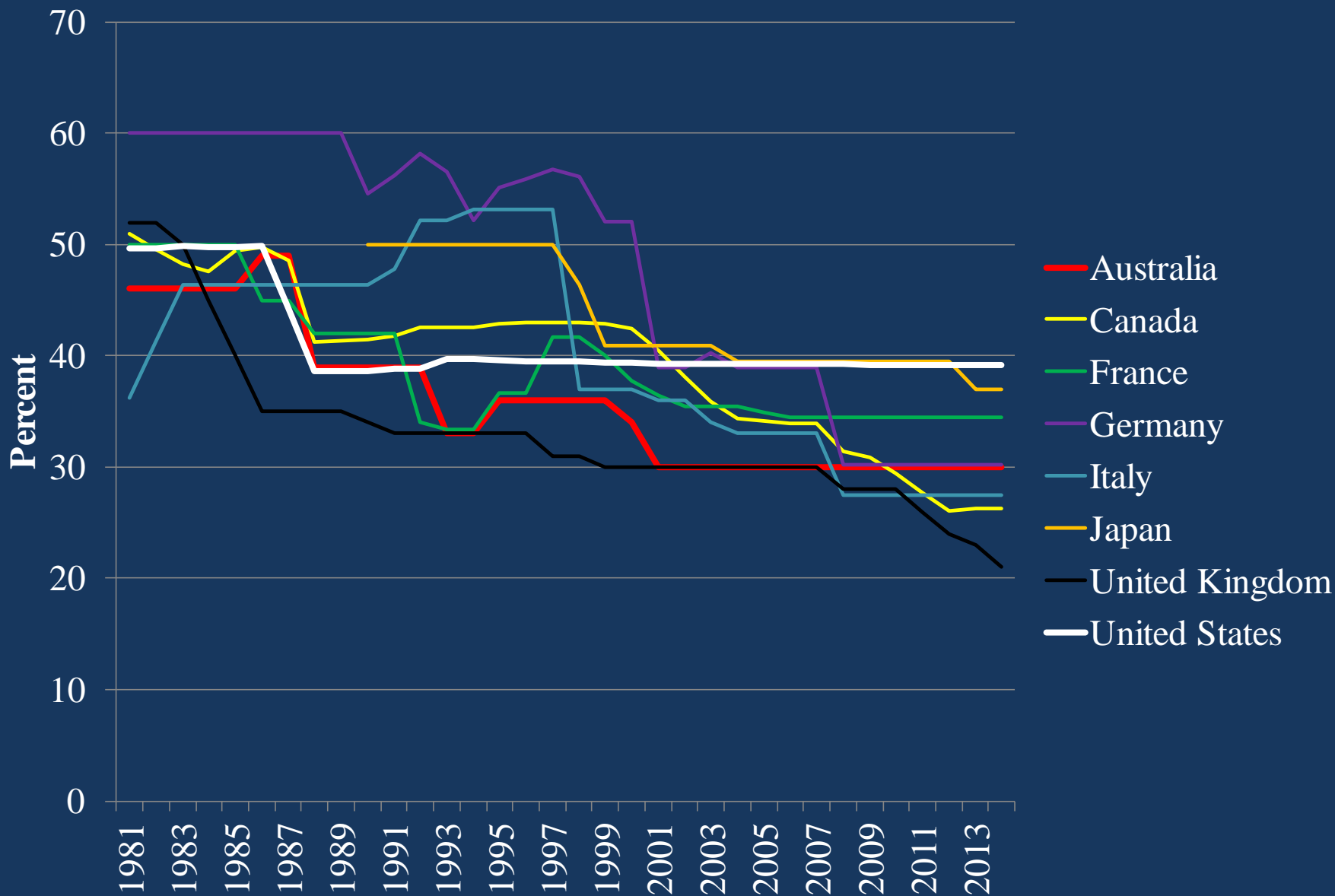
The Setting: Two Economic Challenges

- Increasing Inequality
- Increasing Fiscal Pressure
- A logical solution: progressive tax increases and expenditure reductions
 - Particular focus on taxation of capital income and wealth, as wealth more concentrated than income

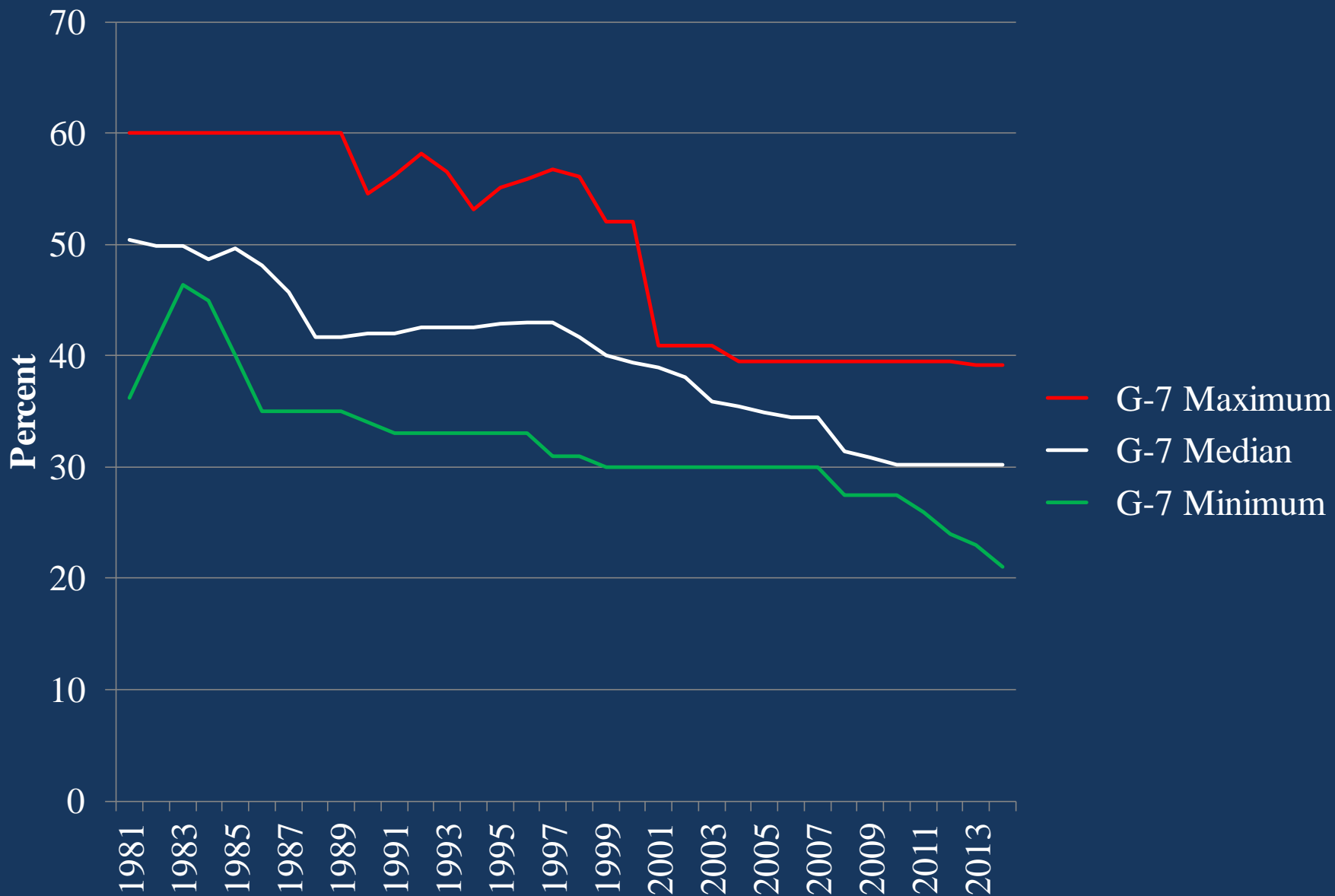
The Setting: Two Economic Challenges

- Increasing Inequality
- Increasing Fiscal Pressure
- 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



Statutory Corporate Tax Rates



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