Global Wealth Tax and Discontents Reflection on Piketty Tax

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ABSTRACT:

Global wealth tax as it speaks for itself illustrates that a tax on the wealth accumulated by an individual all around the world should be taxed at a progressive rate. The question that needs to be proponed upon is why such a tax is being proposed? What solution does it provide? Whether the solutions provided are full proof? Piketty has based his study upon evidences from history and has done analysis on the trends depicted in UK, US and European continent. This paper while describing the problems that Piketty tries to solve by Global wealth tax, elucidates the flaws in the premises of Piketty's work.

I. INTRODUCTION

In Capital in the Twenty-First Century, Thomas Piketty presents a compelling story of the ascendency of capital and the powerlessness of the market forces of capitalism to arrest the growing threat to democracy from growing wealth and its increasing concentration in the hands of the few. Piketty prescribes a global, coordinated wealth tax as the antidote to this dystopian trend, arguing that only such a direct assault on wealth concentrations will succeed where the other policies of governments that already play large roles in their respective economies have failed. The essence of Piketty 's theory is that societal inequality arises from a combination of unequal capital ownership, a high rate of saving from capital income, and a high degree of substitutability between capital and labor that allows capital to accumulate without causing a fall in the rate of return to offset the growing share of capital income[1].

A case study would help us depict the strength and merits of Piketty's story, and also understand how does it exist in reality. The case study is of Bill Gate's, the founder of Microsoft and world's richest person as of date. Before stating the case study, there is an important fact about it, that Bill Gate's is trying to reduce his fortune as much as possible but despite that his net worth is increasing. "*Bill Gate's stopped working for a living. He sold most of his stake in Microsoft. And he's poured $28 billion so far into the family foundation. Despite all that, Gates's pile keeps getting higher. His wealth as of April 8 totalled $79 billion. That's up $16 billion in just the past two years. Gates is just the most extreme example of the polarisation of wealth in the US. The top hundredth of 1% of US taxpayers — that's 16,000 people — have a combined net worth of $6 trillion. That's as*

[1] Auerbach, Alan J., and Kevin Hassett. "Capital Taxation in the Twenty-First Century." *The American Economic Review*, vol. 105, no. 5, 2015, pp. 38–42., www.jstor.org/stable/43821847.

much as the bottom two thirds of the population. Meanwhile, a quarter of American families say they have no money in a checking or savings account to cover an emergency, according to Bankrate.com[2]*".*

As it is clear from case study, that global wealth tax is directed towards solving the problems of income inequality, concentration of wealth in hands of few and the threat to democracy. These all problems are interlinked. Piketty by proposing Global Tax tries to resolve these problems and lessen the amplitude of them. Further, the problem he tries to elaborate upon is, how the concentration of wealth keeps on increasing. He describes this problem as a problem of r>g i.e. rate of return of capital greater than rate of growth. Global tax according to Piketty, will help g in exogenous growth, and reduce r.

This ides of Global Wealth Tax by Piketty, has been described as a utopian idea by himself. Despite being a utopian idea and not ready to be implemented at present, it has advantages which keeps it in the loop and doesn't discard it outright. To begin with the advantages that this type of tax provides is, firstly, the analysis sketched by Piketty (if one accepts it fully) shows the flaws of an inheritance-based system that favors those who do not need to work for their sustenance. This can be modified by a tax on capital. Secondly, taxes on capital, whether in the form of taxes on land or inheritance, have a long history— probably the longest of all taxes, precisely because some forms of capital were difficult to hide. Extending this to include all forms of capital seems logically consistent[3]. Thirdly, technical requirements for such a tax (which, in a rudimentary form exists in most advanced economies) are not overwhelming. Housing is already taxed; the market value of different financial instruments is easily ascertainable and the identities of owners known[4]. In contrast to advantages that are posed by the global tax, there are many hurdles that need to be tackled for its implementation. The biggest hurdle being the international cooperation. The global tax imposes tax on the global wealth of an individual, but the problem is where that tax will go. Whether to the resident country, source country or divided according to ratios of wealth. Building upon this question is the problem of full transparency. Transparency and full disclosure of credentials about the individuals is the inherent premises on which the global tax works. If, the global tax needs to work in its entirety then transparency is inherent. Adding on to the problem of transparency is the issue of Tax Havens and OFC's. These countries are not readily willing to share the credentials of the people who invest in these countries to avoid the tax liabilities in the other states. This contrasting picture clearly depicts the bipartisan approaches to Piketty Tax.

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[2] https://www.taxmann.com/filecontent.aspx?Page=|NEWS&isxml=N&id=222330000000002840&search=Piketty+tax&tophead=true, Last Accessed on 2/11/2019

[3] Milanovic, Branko. "The Return of 'Patrimonial Capitalism': A Review of Thomas Piketty's 'Capital in the Twenty-First Century.'" *Journal of Economic Literature*, vol. 52, no. 2, 2014, pp. 519–534. *JSTOR*, www.jstor.org/stable/24433816.

[4] ibid

II. Discontents

Problem with the data and figures

The main measure that Capital uses for inequality is the share of income (or wealth) that goes to the top portion (10, 1 or 0.1 per cent). Capital argues that this measure of inequality has significantly increased in recent decades as depicted by the U shaped curve of Piketty. While Capital measures inequality through the shares of incomes going to the rich, there are many other measures, including the Gini coefficient that showed different results. Piketty discards these indexes as misleading because they try to 'summarize a multidimensional reality with a unidimensional index'. However, Piketty is not consistent - Capital also sometimes summarizes inequality with a single figure. In addition, Capital's use of income shares means that some of Piketty's arguments are difficult to reconcile with other studies like that of, inequality growth between 1988 and 2008 by Gini coefficient that produced very different results. Further, the data that Piketty has relied upon, is based upon tax data surveys which Piketty himself has criticized for not being depicting top incomes correctly as they have existed for a short time.

Omission of impact of welfare state

Further, the data from tax returns used in Capital is based on market incomes and leaves out the effect of income support and welfare programs such as health and education. Capital does spend some time analyzing the growth in the welfare state (in Part 4), but it completely leaves out the impact of this in the data on inequality in the first three parts of the book and therefore omits the main force that has offset inequality in market incomes. As an illustration of the impact of this omission, when welfare income is included, the (disposable) income of the bottom 90 per cent in the US rose nearly $12,000 between 1979 and 2012, whereas Piketty's data has this income dropping by $3,000 (Winship 2014). Similar arguments are in Burkhauser and Larrimore (2014) and Milanovic (2013). Interestingly, Burkhauser and Larrimore suggest that the growth of the welfare state may have increased the inequality of incomes excluding welfare, presumably because welfare reduces the incentives to work for those on low incomes. If this is true, then this further emphasizes the problems caused by leaving out welfare payments from analysis of inequality[5].

Wrong computation of capital gains

Piketty's tax return data include capital gains as income in the year in which assets are sold. But a better measure of income includes capital gains when they accrue rather than when they are realized. Armour, Burkhauser and Larrimore (2013: 25) used accrued capital gains rather than realized taxable gains and find:

[5] Potter, Michael. "Capital in the Twenty-First Century: A Critique of Thomas Piketty's Political Economy." *Agenda: A Journal of Policy Analysis and Reform*, vol. 21, no. 1, 2014, pp. 91–113. *JSTOR*, www.jstor.org/stable/43610637

'The top quintile of the income distribution had the slowest income growth from 1989 through 2007, while the bottom quintile had the fastest[6].

Incorrect analyses of executive talent

Piketty in his book capital, raises another concern for increasing inequality, which was based upon the rise in executive salaries in the US. According to Piketty, high executive compensation in the United States today has little to do with managers' productivity and almost everything to do with the cozy relationship between managers and corporate boards. Managers and board members are clubby friends scratching each other's well-massaged backs and setting each other's exorbitant salaries. Piketty specifically blames (what he assumes to be) excessively high and wasteful executive pay on lax American "social norms" that cause people to tolerate very high executive salaries, combined with cuts in top income-tax rates. Piketty reasons that because tax cuts mean that executives keep more of what they are paid; tax cuts give managers stronger incentives to lobby corporate boards harder for higher pay. This argument is ironically one of the few instances in which Piketty recognizes that cutting taxes causes people to work harder to raise their incomes! Mysteriously, Piketty never asks the obvious question: Why do shareholders continue to invest in corporations that so wastefully spend their funds? Here is an even deeper mystery: If current patterns of executive compensation serve no purpose other than to enrich unproductive corporate oligarchs, what explains the high and rising market value of the capital that Piketty believes to be the main driver of increasing wealth inequality? How can it be that the value of capital invested in corporations continues to grow if boards of directors are consistently inattentive to the productivity of their management teams? Piketty does not ask these questions because, for him, wealth perpetuates itself. Wealth grows automatically, for the most part independently of human creativity, risk taking, effort, and entrepreneurial gumption. In reality, of course, wealth does not grow automatically. It must be carefully, skillfully, and continually nurtured. Therefore, if Piketty's peculiar theory of executive compensation were an accurate description of today's reality, corporations' market values would at best have stagnated over the past few decades and capitalist plutocrats would not have reaped the ever-greater wealth that Piketty takes such pains to show that they in fact have reaped. These plutocrats (as well as the masses) would today be far less prosperous than in fact they are. Yet, in fact, over these years the market values of corporations generally did grow quite impressively. Piketty appears to be untroubled by this inconsistency between his theory of executive compensation and the reality of the great growth in corporations' market values over the past few decades[7].

[6] ibid

[7] Boudreaux, Donald J. "Thomas Piketty's Flawed Analyses of Public Debt and Executive Compensation." *The Independent Review*, vol. 20, no. 2, 2015, pp. 285–289. *JSTOR*, www.jstor.org/stable/24562069

Flawed assumption about public debt

Another flaw that lies in Piketty's arguments is that, he wrongfully assumes that the debt financing by the government has increased the wealth of the top income whereas the tax would have extracted the same amount and reduced the wealth. The top incomes become the bond holder of the government by the issue of debt financing. These bond holders' real resources in hands decreases as the present time. The point at which the bond holders start to be repaid is the point where their real wealth is supposed to be increased. But the point which is ignored by Piketty is that the government would be able to pay its bond holders by extracting more taxes out of the top income. Therefore, to repay the bond holders the tax rated will be increased and taxed more heavily which will lead to more extraction of top incomes wealth and not accumulation of top incomes wealth[8].

III. Conclusion

Global wealth tax as a solution proposed by Piketty to the growing inequality is difficult to be implemented. Though it has many advantages which cannot be ignored but at the same time flaws in the theory of Piketty cannot be unnoticed. Global wealth tax is a utopian idea which clearly depicts its illusion from the reality. Therefore, global wealth tax as a concept needs to be refined and based on better reasoning and premises to make it more readily acceptable to whole world at large.

[8] ibid