

Wage Stagnation and Inequality: The Role of Taxes

Emmanuel Saez, UC Berkeley
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WHAT ROLE CAN TAXES PLAY?

1) Direct effects: Taxes and transfers mechanically affect the post-tax income distribution

2) Indirect effects: Taxes and transfers affect behavior and hence the pre-tax distribution

a) At the bottom, tax and transfer system can encourage/discourage work

b) At the top, taxes can play a role in regulating compensation practices

DIRECT EFFECTS OF TAXES AND TRANSFERS

US government (Fed+state) taxes about 30% of National Income to provide public goods and welfare state (education, health, retirement, and means-tested programs)

⇒ Taxes and transfers have a large direct effect on the distribution of economic resources

We can assess in a comprehensive way the role of taxes and transfers in mitigating income stagnation at the bottom using Piketty, Saez, and Zucman (2016) Distributional National Accounts (DINA)

Distributional National Accounts (DINA)

Goal is to create measures on pre-tax and post-tax income measures consistent with National Income from National Accounts

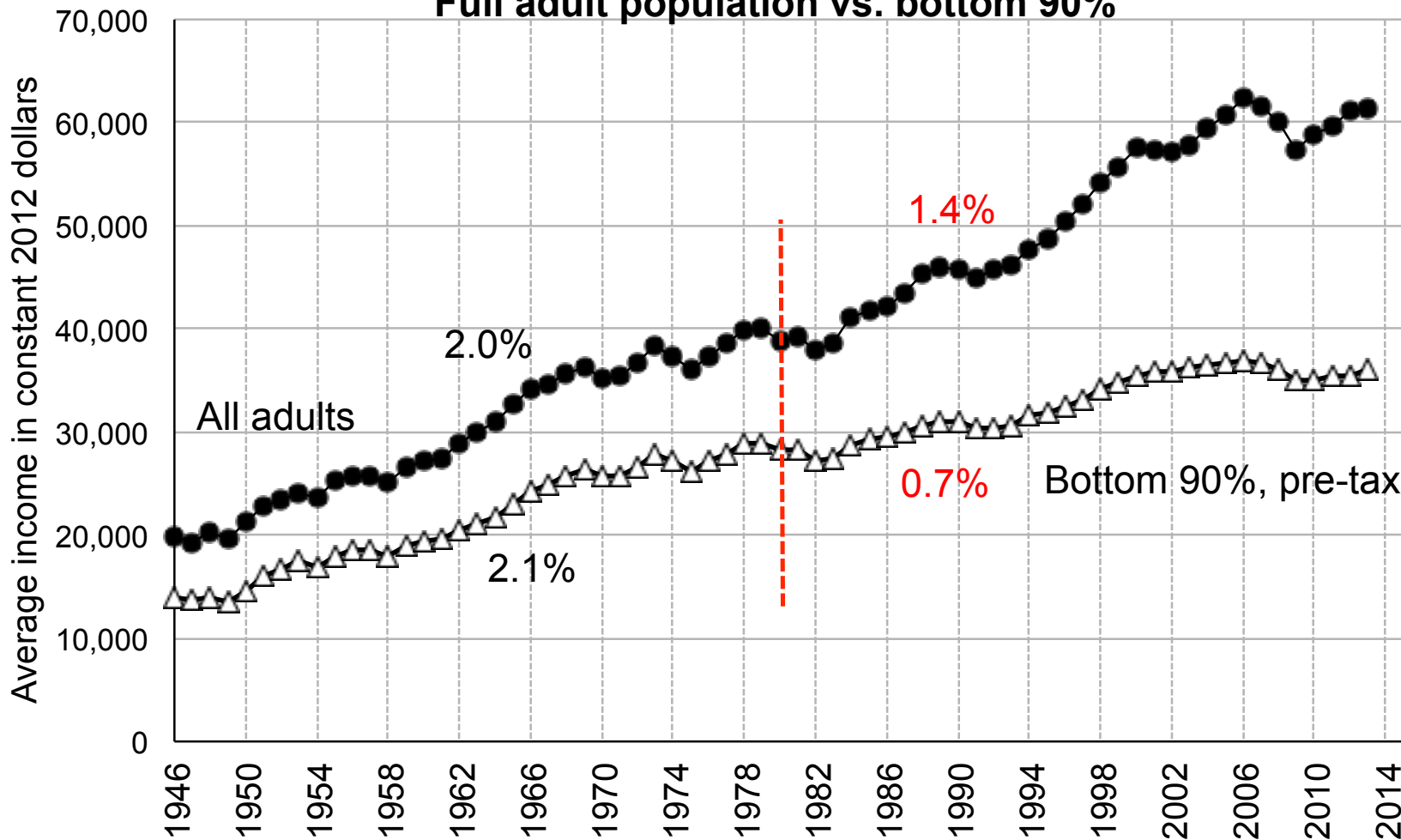
Puts together growth and inequality analysis in a coherent framework

Provides a comprehensive view of the redistributive effects of government taxes and transfers [including all taxes Federal and local, all transfers, and all forms of public good spending]

Preliminary estimates for the US in Piketty, Saez, and Zucman (2016)

Unit is individual adults (aged 20+). Incomes within married couples are split 50/50. Pre-tax income includes public+private pensions.

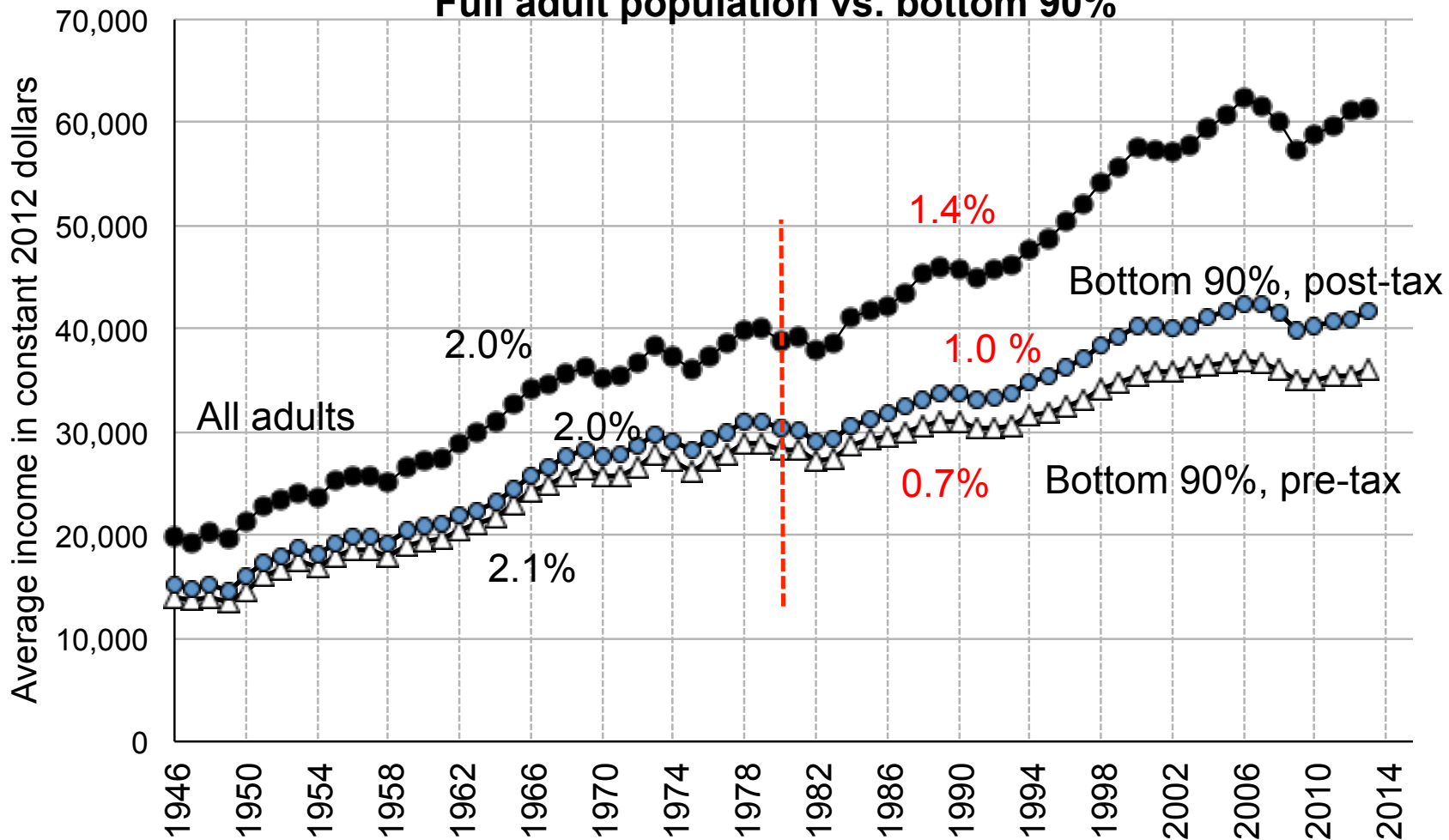
Real average national income: Full adult population vs. bottom 90%



Pre-tax income and post-tax income match total national income and are divided equally among spouses.

Source: Piketty-Saez-Zucman: Distributional National Accounts (2016, in progress)

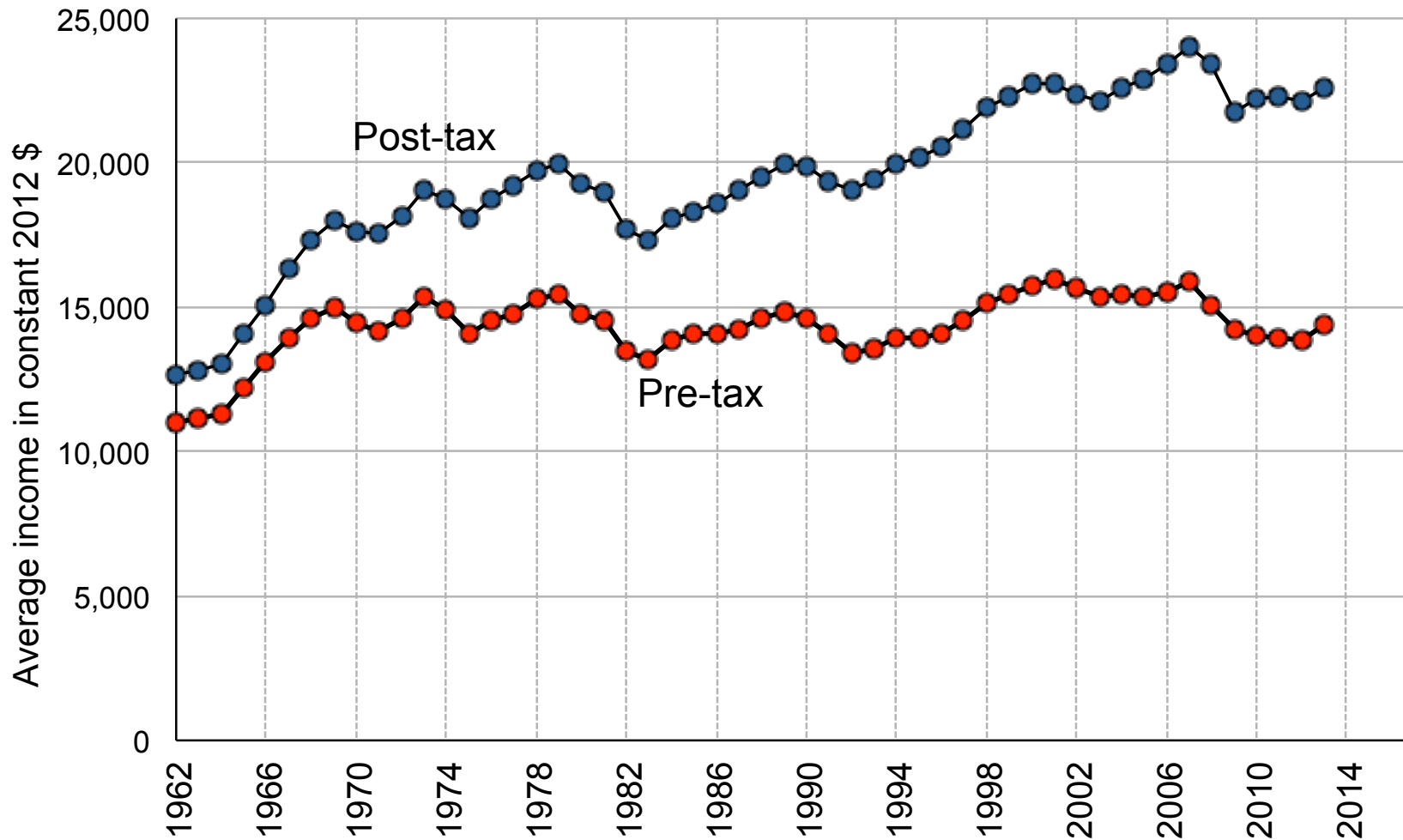
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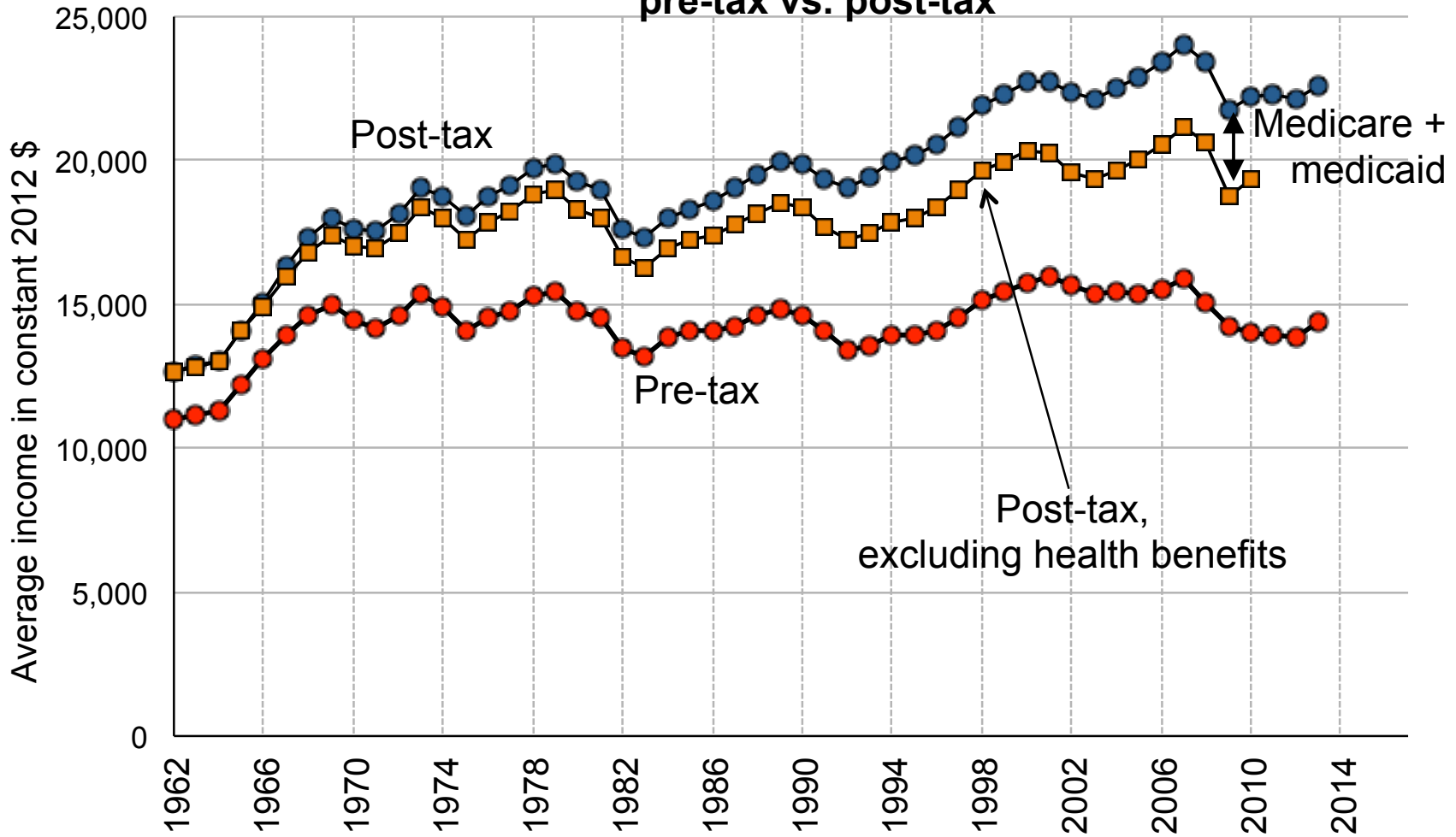
Real income of bottom 50%: pre-tax vs. post-tax



Real values are obtained by using the national income deflator and expressed in 2012. Income is divided equally among spouses. Post-tax is income net of all taxes and adding all transfers and government spending

Source: Piketty-Saez-Zucman: Distributional National Accounts (2016, in progress)

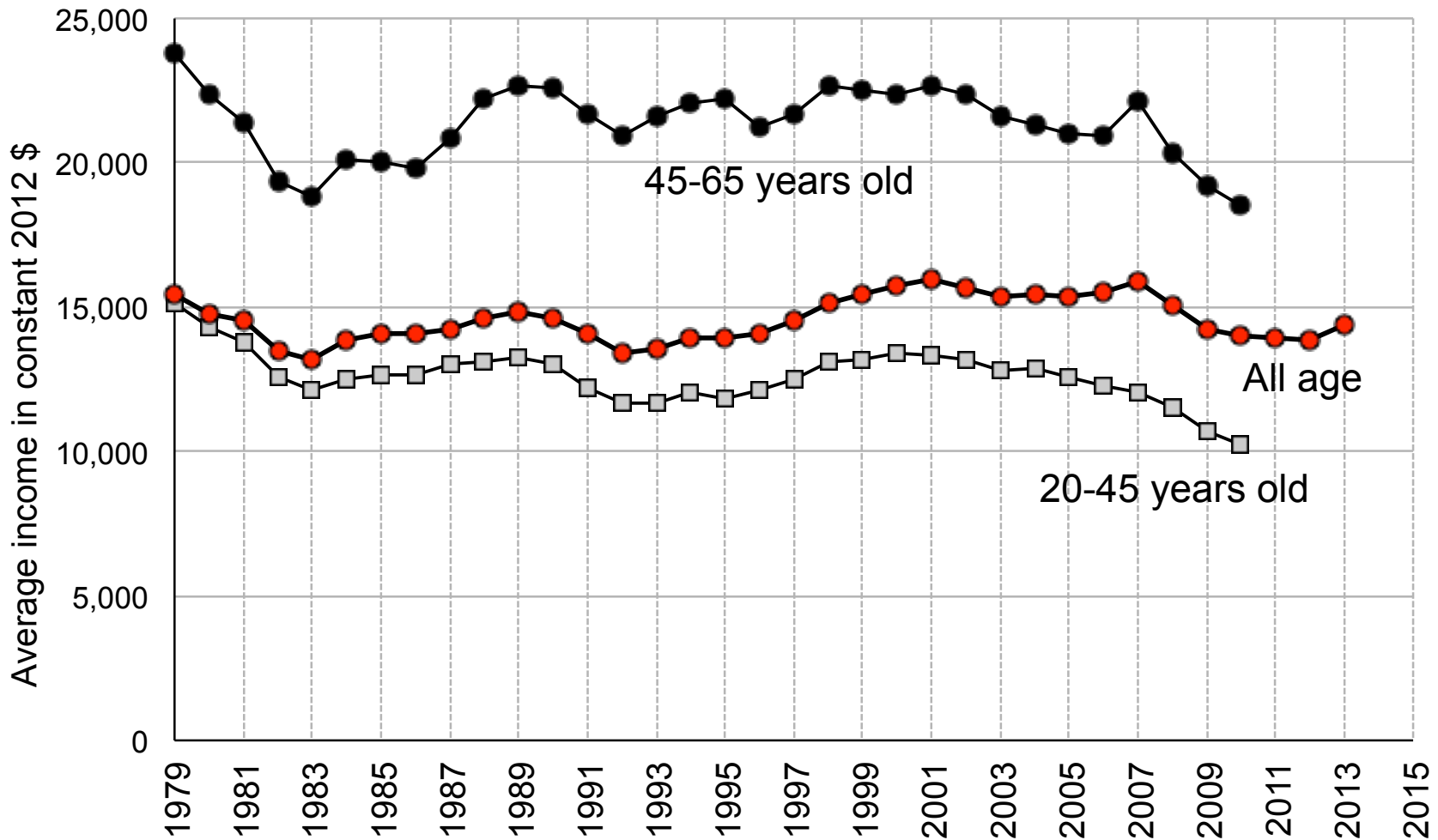
Real income of bottom 50% equal-split: pre-tax vs. post-tax



Real values are obtained by using the national income deflator and expressed in 2012.

Source: Piketty-Saez-Zucman: Distributional National Accounts (2016, in progress)

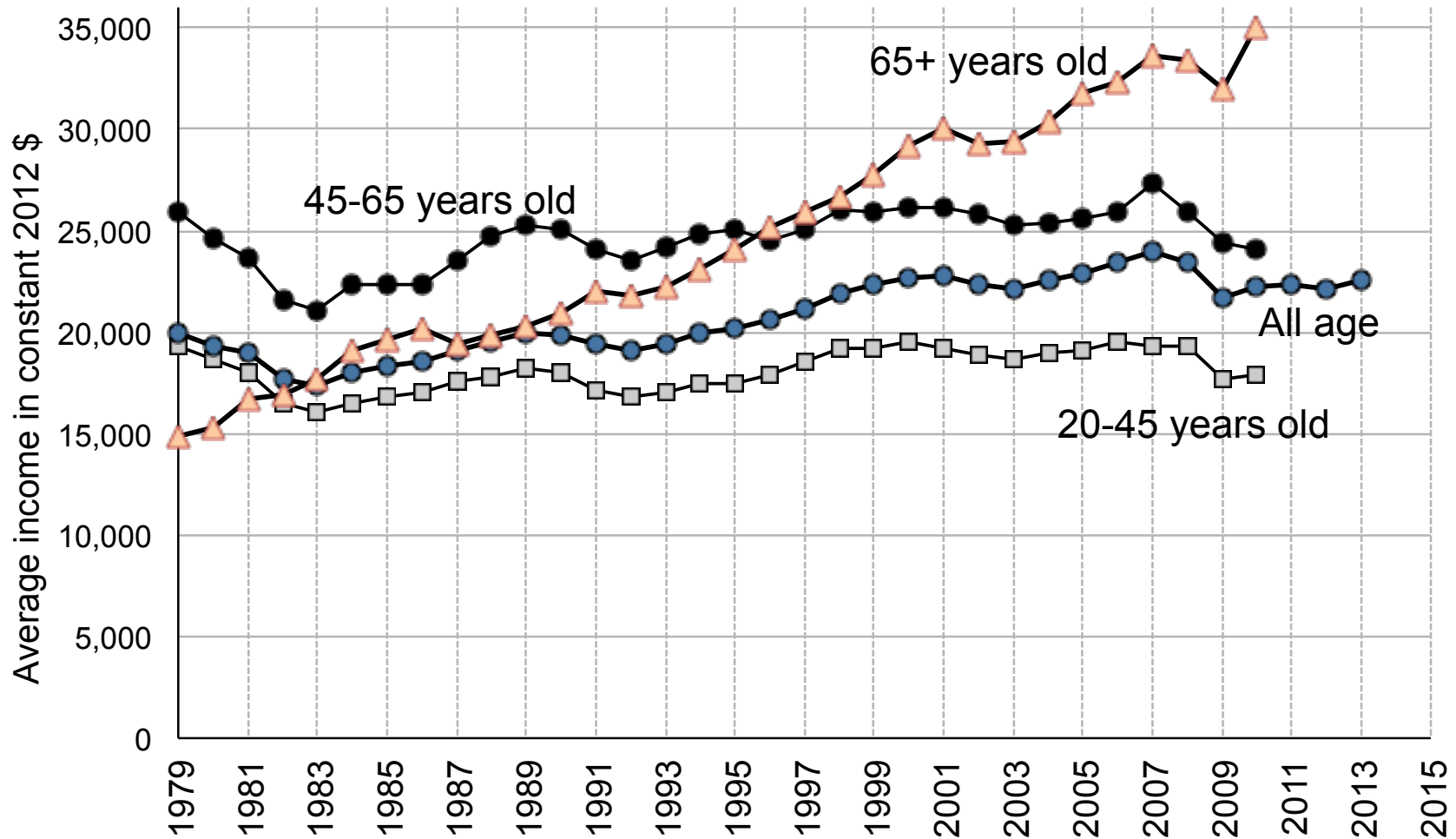
Real pre-tax income of bottom 50%, by age group



Real values are obtained by using the national income deflator and expressed in 2012. Income is divided equally among spouses.

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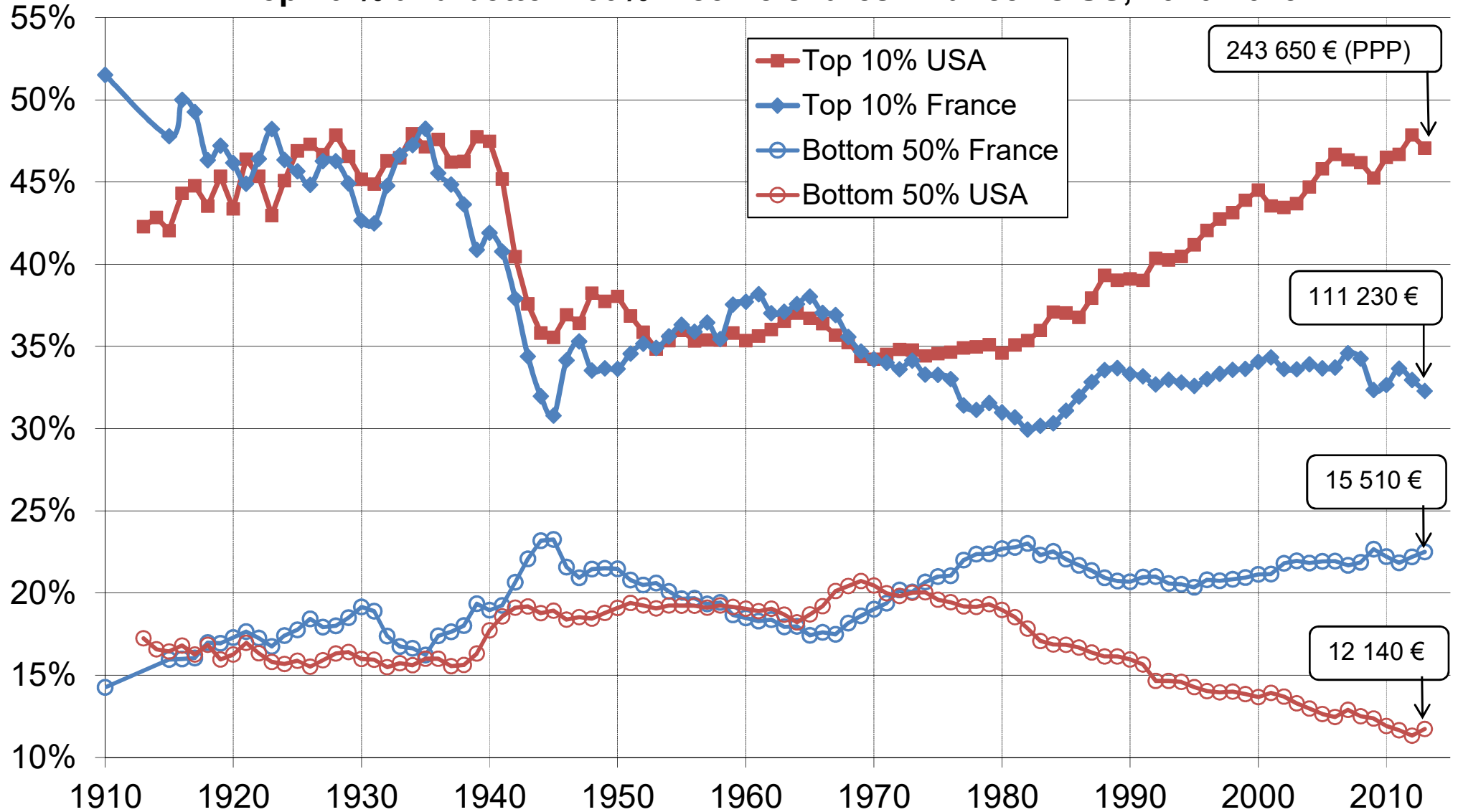
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Top 10 % and bottom 50% income shares: France vs US, 1910-2013



Distribution of pretax national income (before all taxes and transfers, except pensions and unempl. insurance) among adults. Equal-split-adults series (income of married couples divided by two).

Direct effects: bottom line

Pre-tax incomes of bottom 50% adults have stagnated since late 1960s

Post-tax incomes of bottom 50% adults have increased only modestly since late 1960s

Taxes and transfers have only modestly mitigated income stagnation at the bottom

Situation is even worse for working age adults

National income per adult in France is 25% smaller than in the US but bottom 50% average income is 30% higher in France [on a pre-tax basis]

Taxes/Transfers and Work Behavior

Profile of taxes and transfers can affect labor supply and hence earnings

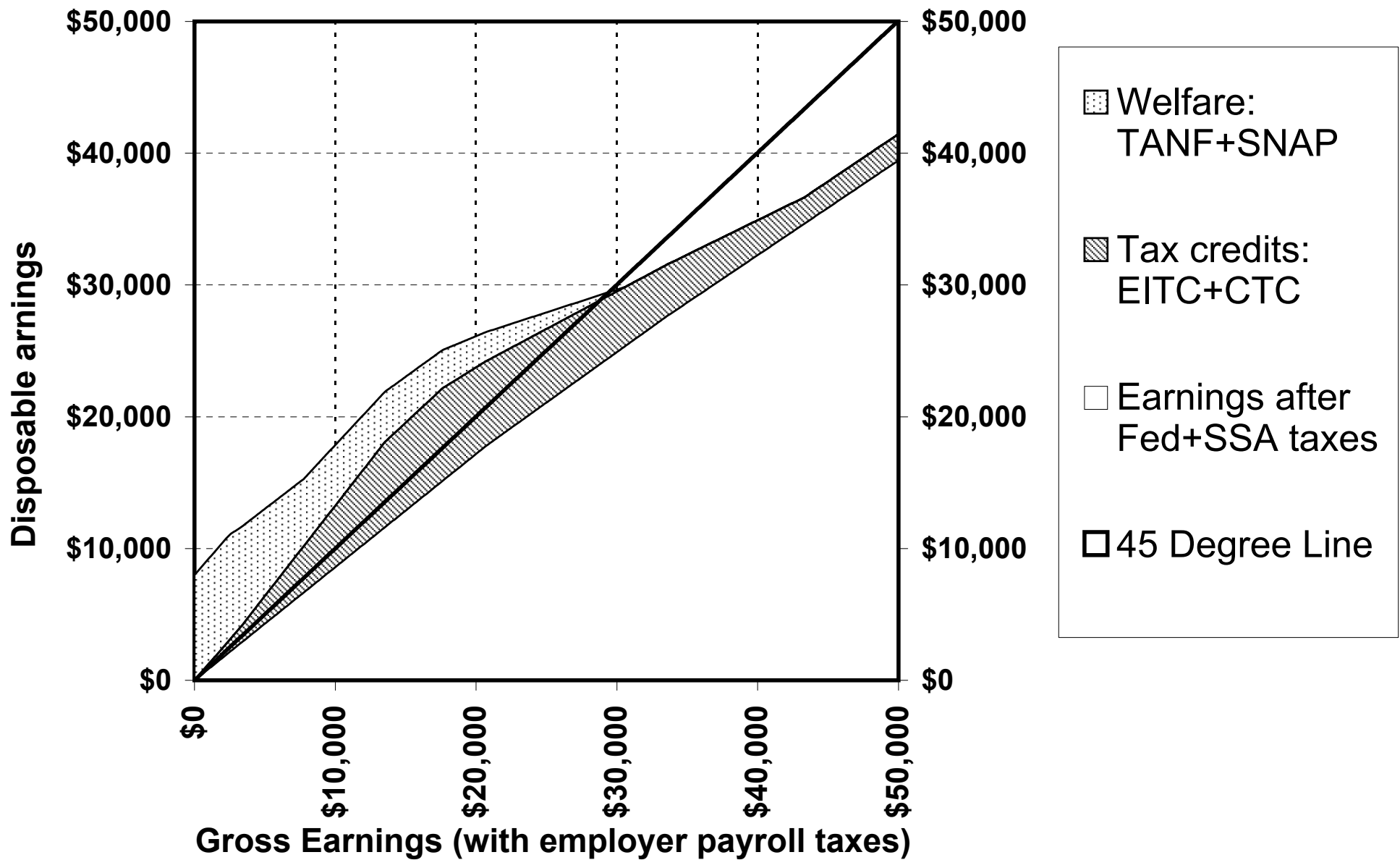
Means-tested transfers in the US are fairly modest (relative to European countries) and provide strong work incentives especially for families with children

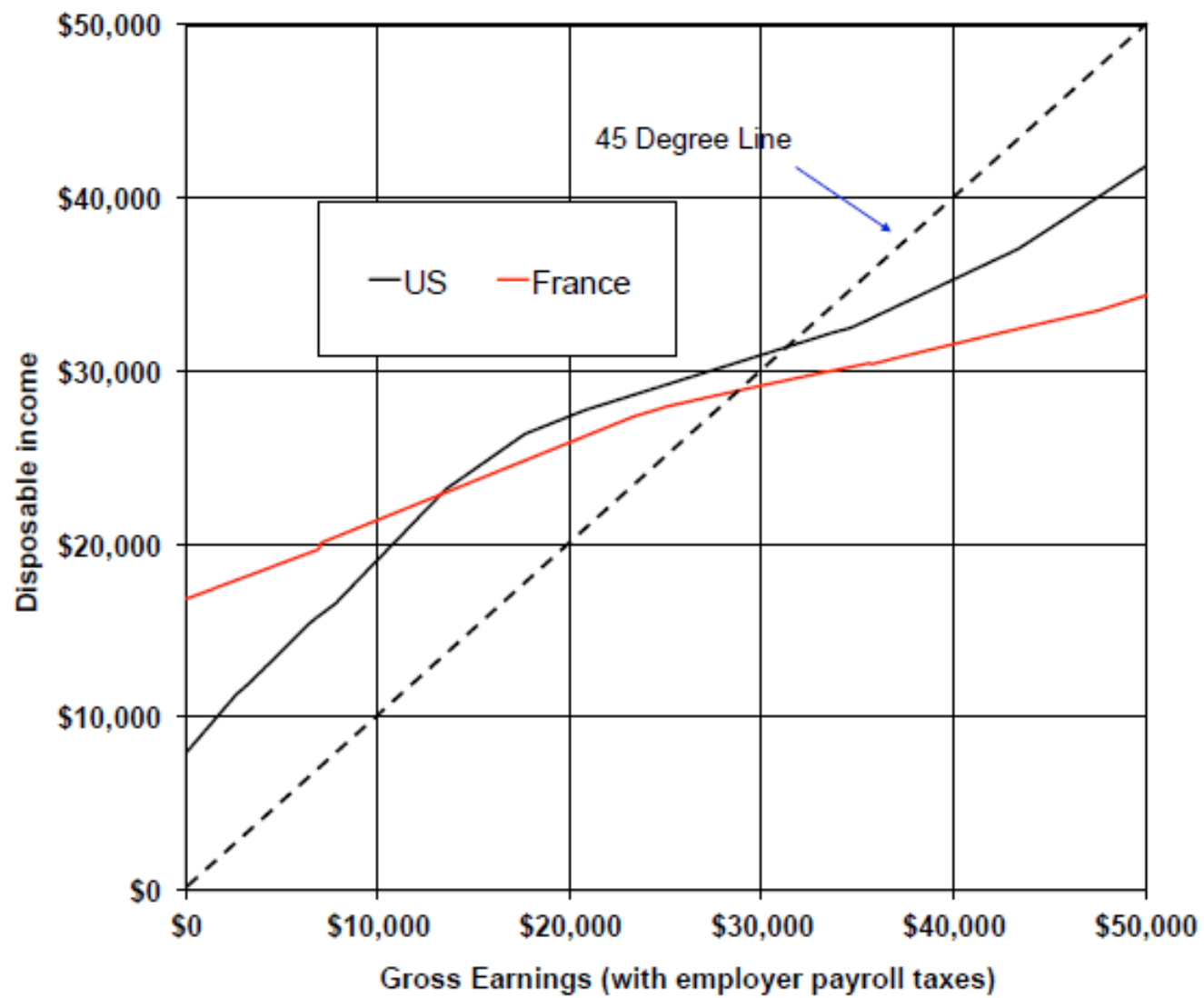
Evidence that EITC increases labor force participation among single mothers

US lacks pre-K universal childcare which is most valuable to working mothers

Pre-K childcare is like an in-kind EITC, which might explain why mothers LFP is so high in Scandinavian countries in spite of high implicit tax rates on work [Kleven JEP 2014]

US Tax/Transfer System, single parent with 2 children, 2009





Source: Piketty, Thomas, and Emmanuel Saez (2012)

Can Taxes/Transfers Explain Wage Stagnation?

Conservatives view: growth in transfers discourages work but:

(a) Most of the growth in US transfers comes from Social Security retirement and disability, Medicare, and Medicaid [vast majority goes to elderly]

(b) Transfers to able bodied working age adults are modest (relative to other countries) and have become more conditional on work since 1990s (EITC)

(c) Evidence from Case and Deaton (2015) and Chetty et al. (2016) suggests that health for US low income earners is deteriorating [particularly whites]

Payroll Taxes and Wages

Classic assumption: incidence falls on wages in the long-run (so equivalent to income taxes and transfers)

Short-run: incidence is sticky due to wage rigidities

⇒ Employer payroll taxes can affect the pre-tax distribution of labor income

Employers seem to respond along the hiring margin

Employer payroll tax could be a useful tool to fight unemployment especially in countries with minimum wage

US could cut employer payroll tax up to Federal min wage [to mitigate adverse effects of a higher minimum wage]

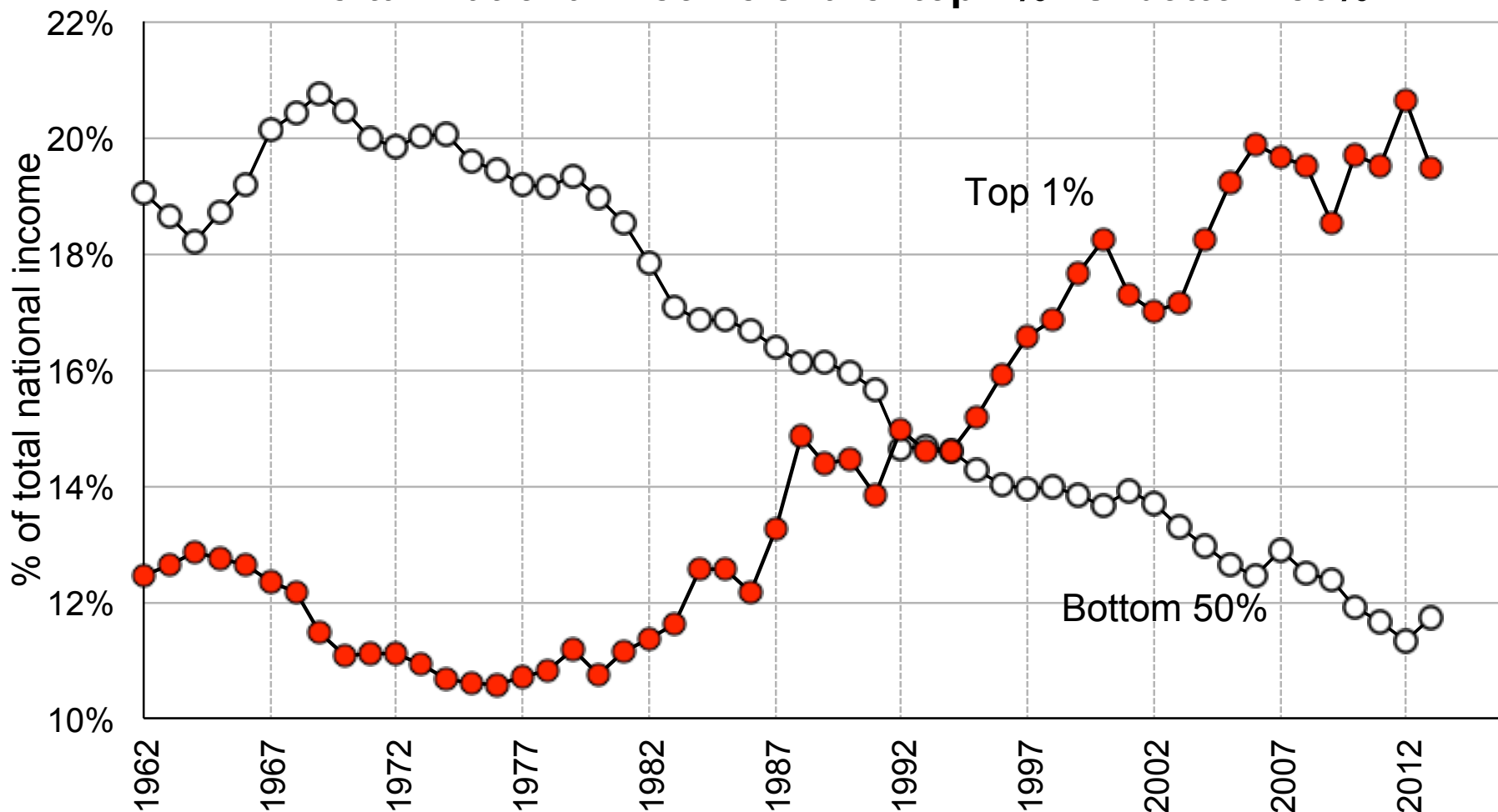
Taxes and Top Incomes

Flip side of bottom 50% pre-tax income stagnation is the surge in top 1% incomes

Strong evidence that level of top incomes depends on institutions and policies [Atkinson, Piketty, Saez JEL '10]:

- 1) All advanced economies had very high levels of income concentration one century ago
- 2) Income concentration fell following specific historical events in each country: Depressions and Wars [and the permanent policy changes they triggered]
- 3) Surge back in top income shares happened in some but not all countries and coincides with sharp policy changes [Reagan and Thatcher revolutions in the US and UK]

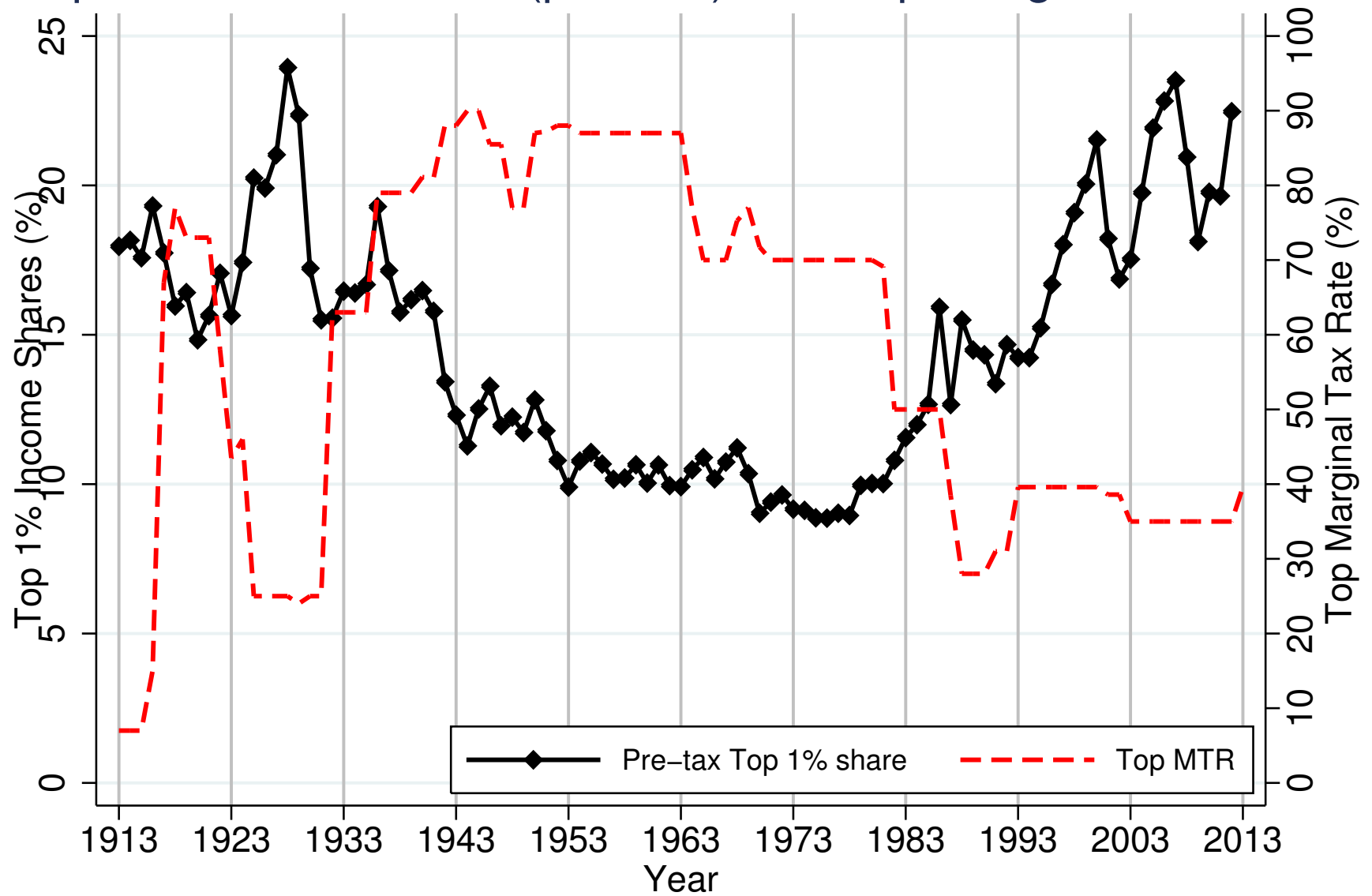
Pre-tax national income share: top 1% vs. bottom 50%

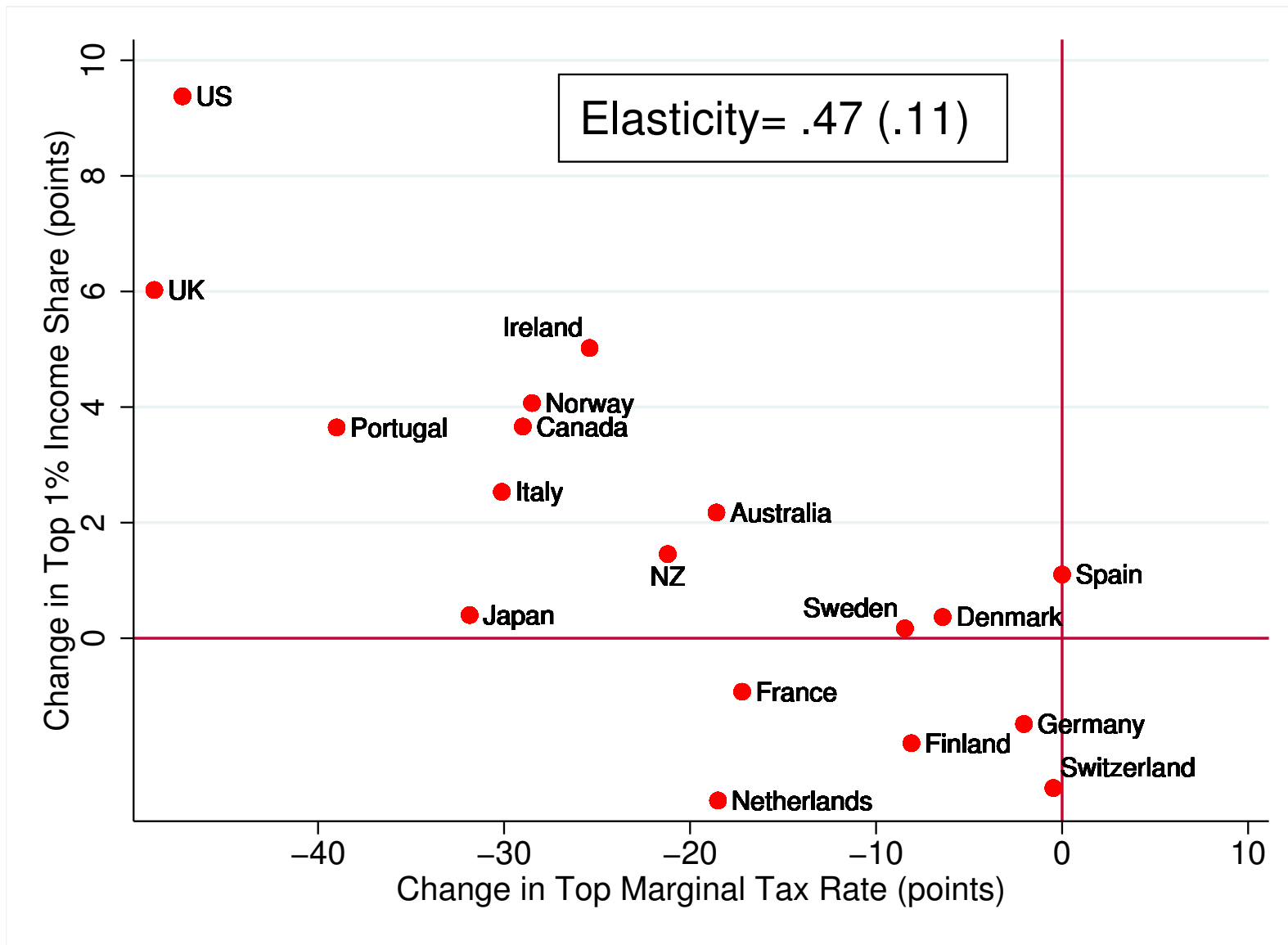


Source: Piketty, Saez, Zucman (2016). Pre-tax income is divided equally among spouses and matches national income.

Source: Piketty-Saez-Zucman: Distributional National Accounts (2016, in progress)

Top 1% Income Share (pre-tax) and Top Marginal Tax Rate





Change in top tax rates and top 1% pre-tax income shares from 1960-4 to 2005-9

ECONOMIC EFFECTS OF TAXING THE TOP 1%

Strong empirical evidence that **pre-tax** top incomes are affected by top tax rates

3 potential scenarios with very different policy consequences

1) Supply-Side: Top earners work less and earn less when top tax rate increases \Rightarrow Top tax rates should not be too high

2) Tax Avoidance/Evasion: Top earners avoid/evade more when top tax rate increases

\Rightarrow a) Eliminate loopholes, b) Then increase top tax rates

3) Rent-seeking: Top earners extract more pay (at the expense of the 99%) when top tax rates are low \Rightarrow High top tax rates are desirable

Real changes vs. tax Avoidance?

Test using charitable giving behavior of top income earners

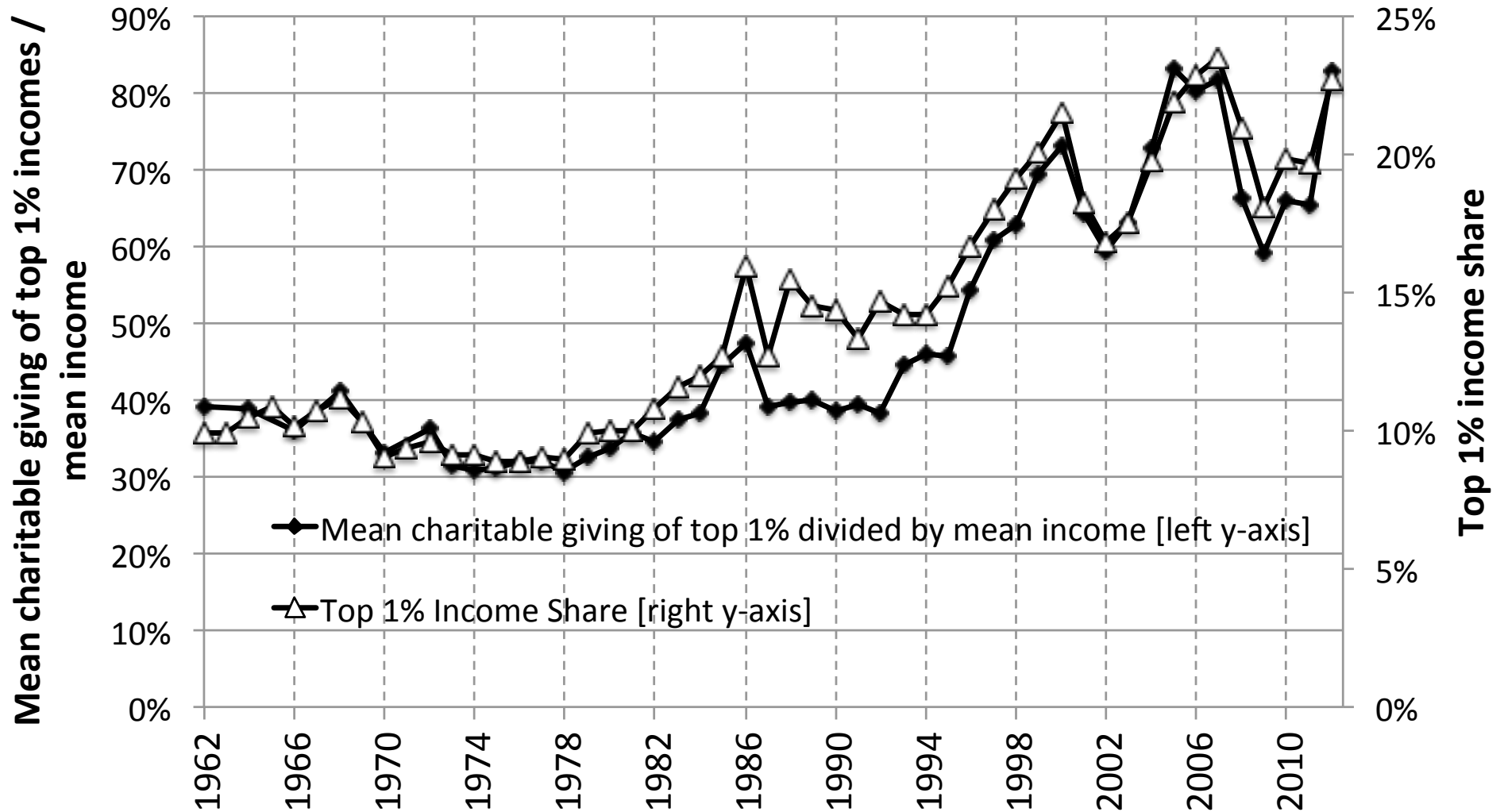
Because charitable is tax deductible, incentives to give are stronger when tax rates are higher

Under the tax avoidance scenario, reported incomes and reported charitable giving should move in opposite directions

Empirically, charitable giving of top income earners has grown in close tandem with top incomes

⇒ Incomes at the top have grown for real

Charitable Giving of Top 1% Incomes, 1962-2012



Source: The figure depicts average charitable giving of top 1% incomes (normalized by average income per family) on the left y-axis. For comparison, the figure reports the top 1% income share (on the right y-axis).

Supply-Side or Rent-seeking

Under supply-side scenario, growth in top 1% incomes due to more economic activity and hence more growth

Under rent-seeking scenario, growth in top 1% incomes comes at the expense of bottom 99%

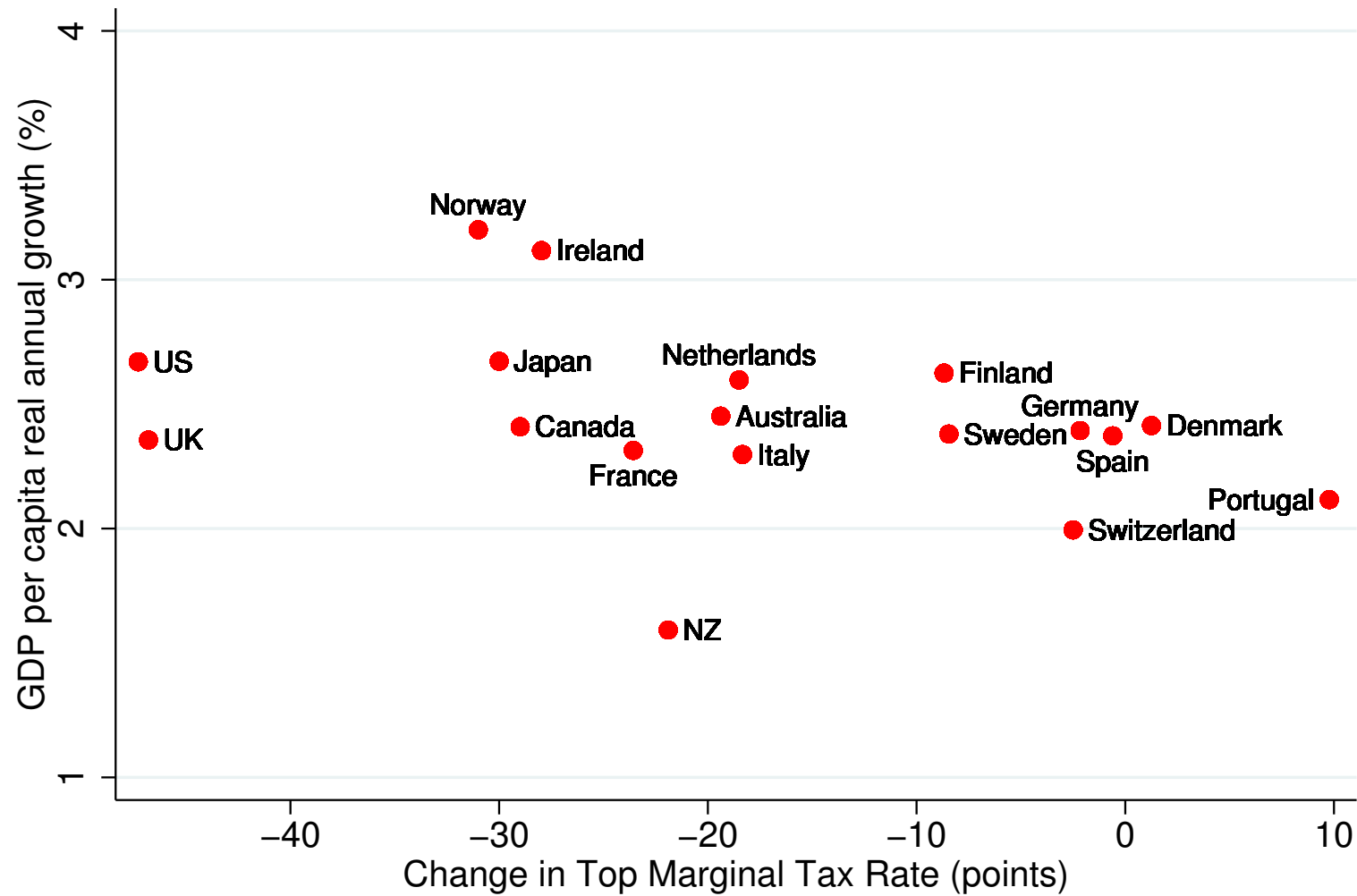
International macro evidence: Hard to find an effect of top rate cuts on economic growth

US Evidence: Top 1% incomes grow slowly from 1933 to 1975 and fast afterwards. Bottom 99% incomes grow fast from 1933 to 1975 and slowly afterwards

Surge in top US incomes driven by executive pay and surge in finance (securitization, private equity, hedge funds)

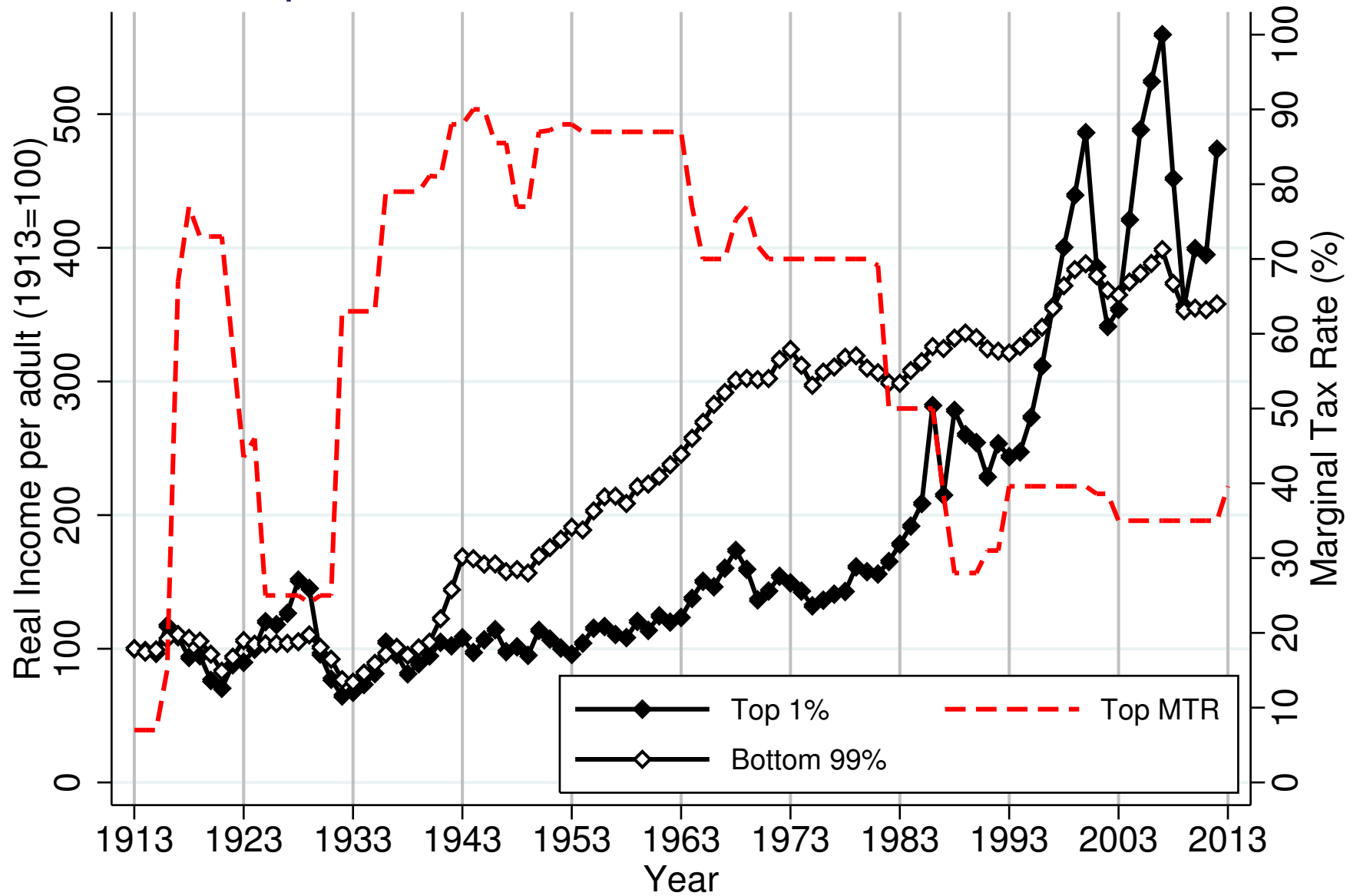
⇒ Consistent with rent-seeking effects

B. Growth (adjusted for initial 1960 GDP)



Change in Top Tax Rate and GDP per capita growth since 1960

Top 1% and Bottom 99% Income Growth



CONCLUSIONS

- 1) Taxes and transfers have a large direct redistributive effect but increase in transfers at the bottom has not mitigated pre-tax income stagnation much
- 2) Transfers at the bottom in the US are not very generous and have become more work related \Rightarrow cannot explain low earnings stagnation.
- 3) High top tax rates can reduce the **pre-tax** income gap without visible effect on economic growth

MAIN REFERENCES

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