POLICY SPOTLIGHT

Wealth Taxes: Theoretical Promises vs. Real-World Performance

VERONIQUE DE RUGY AND JACK SALMON | FEBRUARY 2020

In the run-up to this year's presidential election, the wealth tax has become central to the debate over income inequality. Indeed, some candidates are not only debating the merits of a progressive wealth tax, but also drawing up plans to implement one if elected. This is despite the fact that a number of European countries have already tried wealth taxes and in most cases abandoned them. Their experience suggests that a US wealth tax (a) would deliver fewer benefits than anticipated and (b) might actually make economic conditions worse for most Americans.

A CLOSER LOOK AT THE WEALTH OF THE TOP 1 PERCENT

How wealthy are they? Advocates of a wealth tax claim that the top 1 percent of US income earners hold as much as 42 percent of the nation's total wealth.[1] This percentage has been disputed, with other estimates putting it closer to one-third.[2]

How do they use their wealth? The wealthy do not hoard their wealth and spend only a small percentage of it on luxury consumption.[3] They use much of it to invest in companies, fund R&D that contributes to the creation of better consumer goods and services, or provide capital for innovators to grow their businesses. In these ways, the wealthiest are creating new products, raising workers' wages, and driving down consumer prices.

How much would a wealth tax raise? It has been claimed that a tax on wealth above $50 million could raise $212 billion (1 percent of GDP in 2019).[4] This estimate was made assuming a tax avoidance and evasion rate of 15 percent.

HOW REALISTIC IS THE PROJECTED $212 BILLION?

$212 billion would represent about 6 percent of total US government revenue. Compare this to three European countries:

- Switzerland raises 3.3 percent of its revenues from a wealth tax
- Luxembourg raises 1.6 percent
- Norway raises 1.1 percent

Replicated in the United States, these percentages would represent tax revenues of $40–120 billion.

LESSONS LEARNED FROM OTHER COUNTRIES

Fifteen European countries have implemented a wealth tax, but only three still have one. Their experience is out of sync with the $212 billion estimate of potential revenues from a proposed US wealth tax.

Sweden: When abolished in 2016, Sweden's wealth tax was generating a small amount of revenue (0.16 percent of GDP), with levels of tax avoidance and evasion significantly higher than 15 percent.[5] Abolishing the tax was an attempt to boost low levels of investment, encourage entrepreneurial activity, and increase employment.

France: From the inception of France's wealth tax in 1988 until its end in 2006, about €200 billion was lost in capital flight every year.[6] It is estimated that the tax reduced GDP growth by 0.2 percent per annum while shifting the tax burden from wealthy taxpayers leaving France onto other taxpayers.[7]

Germany: The country eliminated its failing wealth tax in 1996. One study estimates that reintroducing it would decrease annual GDP growth by 0.33 percentage points, production by 5 percent, and investment by 10 percent.[8]

United Kingdom: The United Kingdom considered a wealth tax in the 1970s but decided against it. One reason was the cost of compliance and administration that comes with regularly compiled valuations of wealth. According to the country's chancellor of the exchequer, "I found it impossible to draft [a tax] which would yield enough revenue to be worth the political hassle."[9]

KEY TAKEAWAYS

Proponents have exaggerated the benefits that would result from a US wealth tax. The experience of countries that have implemented wealth taxes indicates the following:

- Wealth taxes contribute to a *lower capital stock*, promoting the flight of capital out of a country and discouraging foreign investors from coming in.
- The *high administrative costs* of regular valuations can reduce net revenue, so wealth taxes rarely yield more than 0.2 percent of GDP.[10]
- A wealth tax often results in *reduced economic growth* and lower wages, which further depress tax revenues while detracting from the welfare of many households.

NOTES

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3. William D. Nordhaus, "Schumpeterian Profits in the American Economy: Theory and Measurement" (NBER Working Paper No. 10433, National Bureau of Economic Research, Cambridge, MA, April 2004).
4. Emmanuel Saez and Gabriel Zucman, letter to Senator Elizabeth Warren, January 18, 2019, https://elizabethwarren.com/wp-content/uploads/2019/01/saez-zucman-wealthtax-warren-v5-web.pdf.
5. Gunnar Du Rietz and Magnus Henrekson, "Swedish Wealth Taxation (1911–2007)," in *Swedish Taxation: Developments since 1862*, ed. Magnus Henrekson and Mikael Stenkula (New York: Palgrave Macmillan, 2015), 267–302.
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8. Clemens Fuest et al., "The Economic Effects of a Wealth Tax in Germany" (ifo DICE Report 16, No. 2, ifo Institute, Munich, 2018), 22–26.
9. Robin Broadway, Emma Chamberlain, and Carl Emmerson, "Taxation of Wealth and Wealth Transfers," in *Dimensions of Tax Design: The Mirrlees Review*, ed. Stuart Adam et al. (Oxford: Oxford University Press), 781–87.
10. Organisation for Economic Co-operation and Development, "Revenue Statistics - OECD Countries: Comparative Tables" (dataset), accessed November 14, 2019, https://stats.oecd.org/Index.aspx?DataSetCode=REV.

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