

Global Inequality & Growth:

The United States in an international perspective

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Last lecture: two diverging tendencies in global inequality

- Since 1980 – Global inequality has remained fairly constant, but hides large movements:
 - Within country inequality has increased dramatically
 - Between country inequality has fallen dramatically
- Since the 19th century global inequality has increased in particular due to the industrial revolution
 - Location is now more important than class within countries
 - ... but the future may look like the past

Last lecture: within country inequality on the rise globally – but at very different paces

- After historical decline in most parts of the world from 1920s to 1970s, income inequality is on the rise in nearly all countries.
- But variety of national pathways, highlighting key role of political and institutional factors
- Among rich countries, Anglo-Saxon countries have experienced a sharp rise in inequality since the 1980s.

This lecture: the US vs EU



Trends since 1980's



The role of capital vs. labor income at the top



The role of redistribution

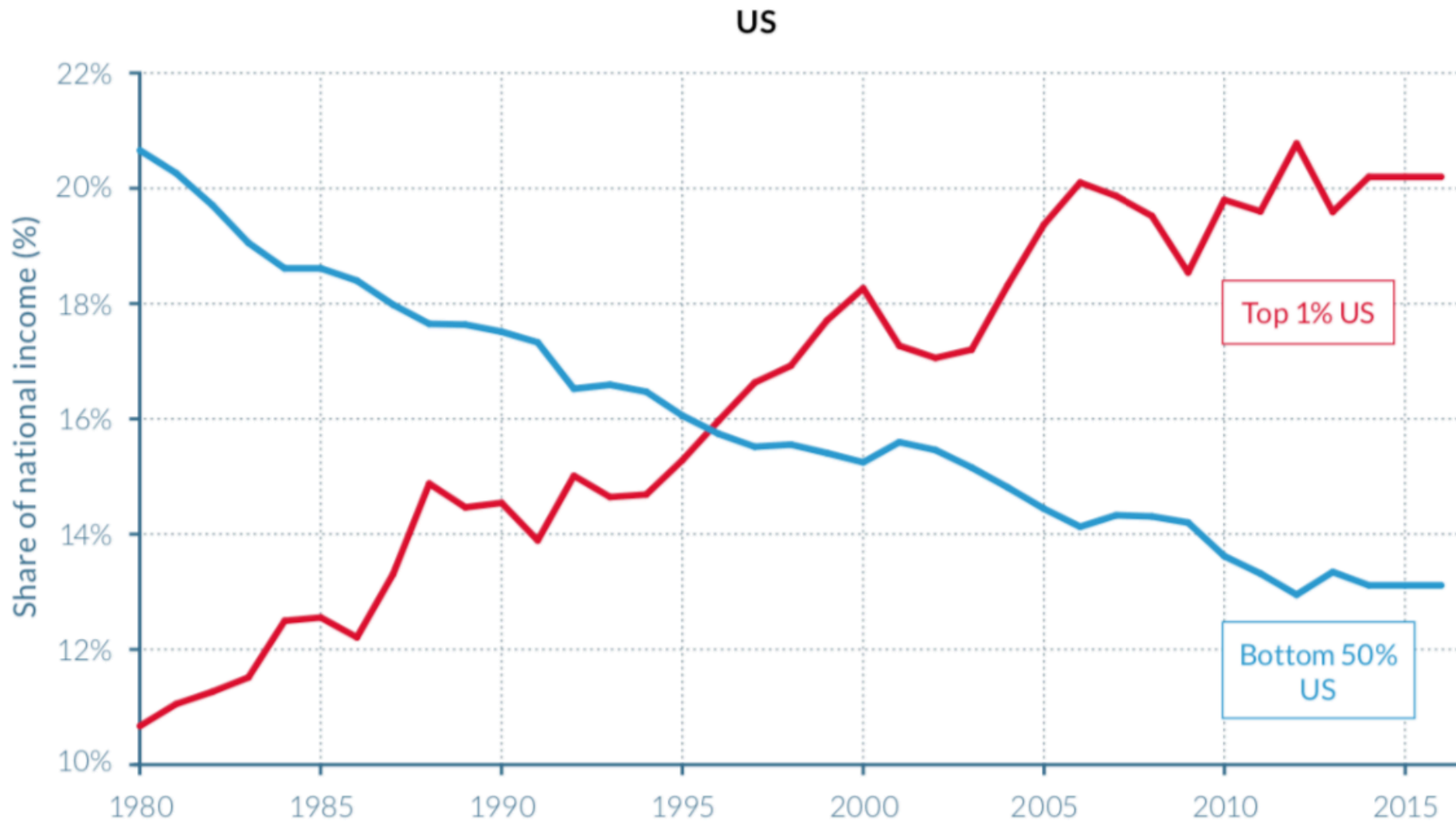


Link between pre-tax and post-tax income

What happened since 1980?

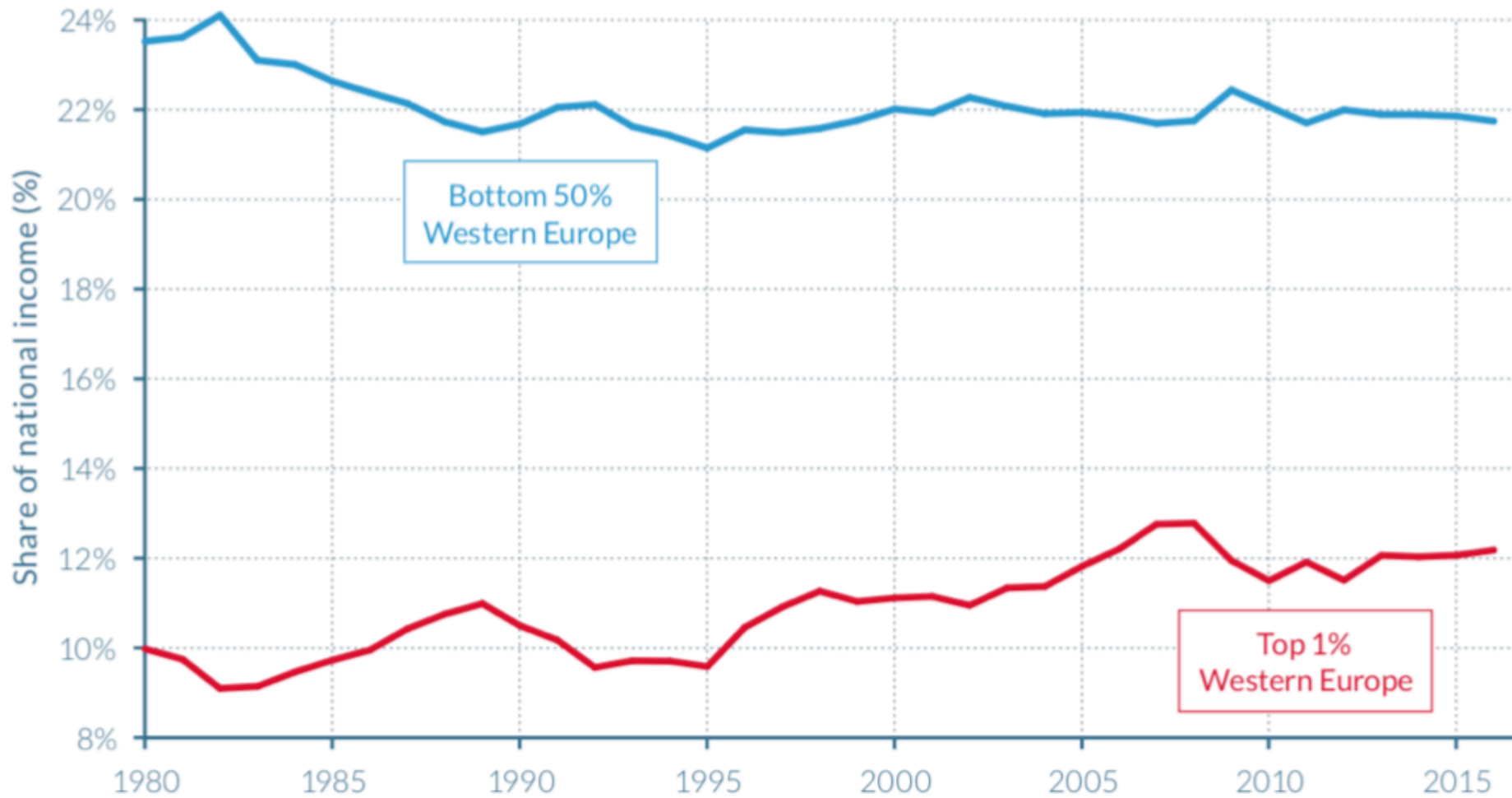


Top 1% vs. Bottom 50% national income shares in the US and Western Europe, 1980-2016



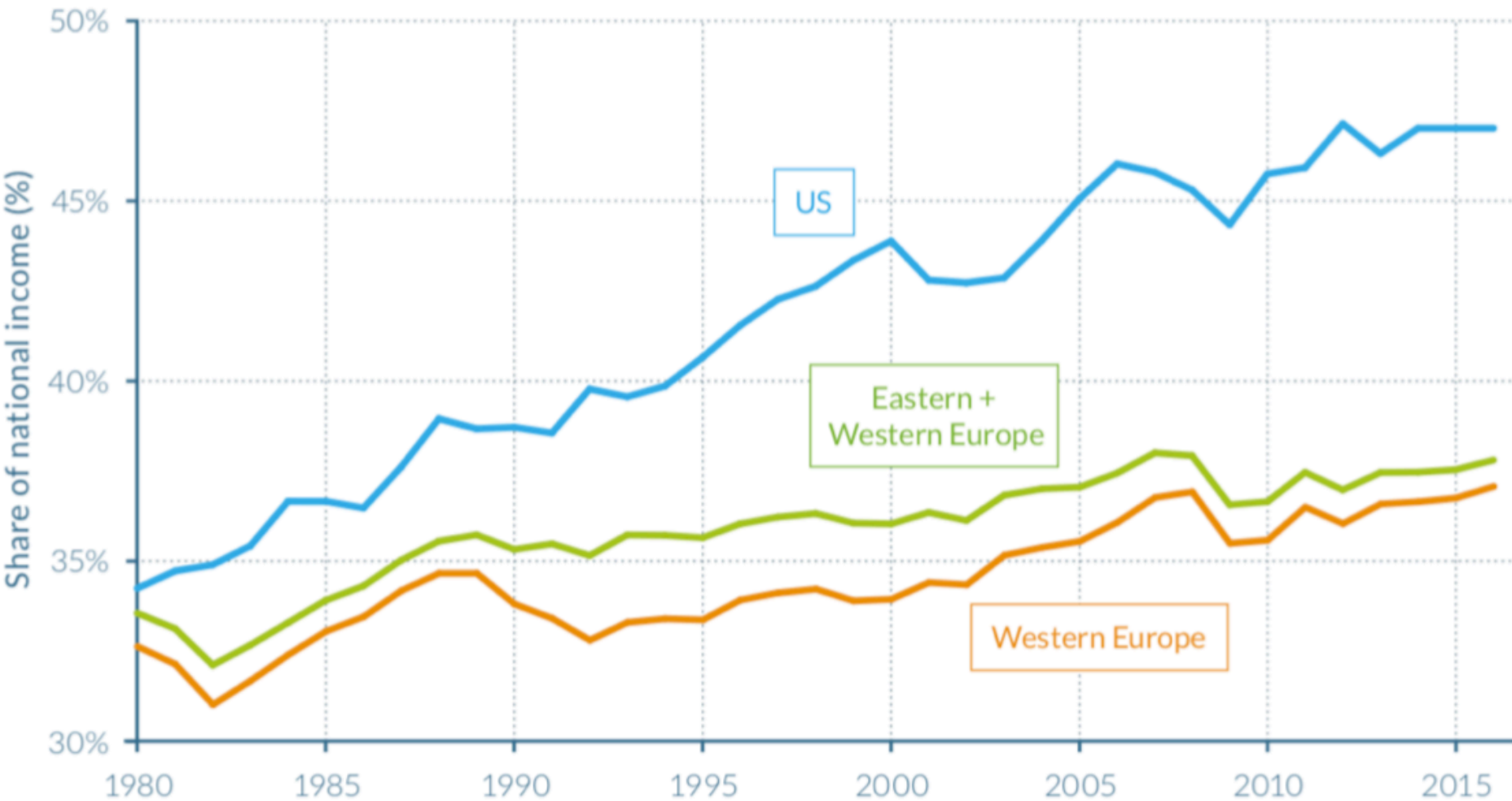
Source: WID.world (2017). See [wir2018.wid.world](#) for data series and notes.

Western Europe



Source: WID.world (2017). See [wir2018.wid.world](#) for data series and notes.

Top 10% national income share in Europe and the US, 1980-2016

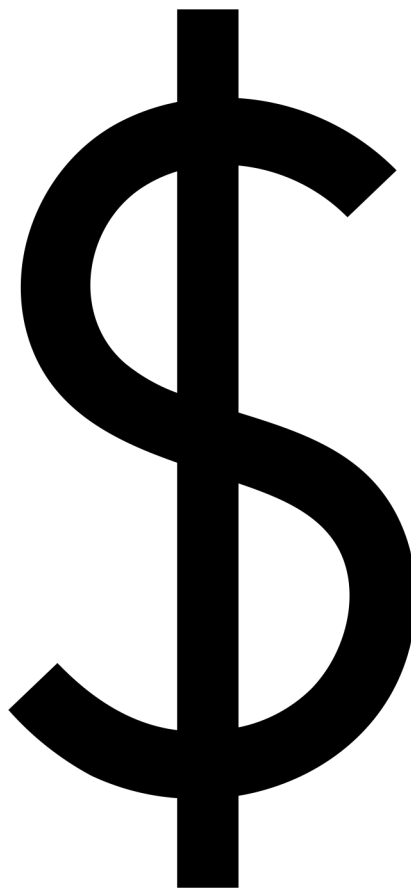


Source: WID.world (2017). See [wir2018.wid.world](#) for data series and notes.

The US vs the EU

- Inequality has increased more in the US than other developed countries
- Technology, globalization cannot explain this pattern
- **Domestic policies matter**

The role of capital income vs labor income



The role of capital income vs labor income

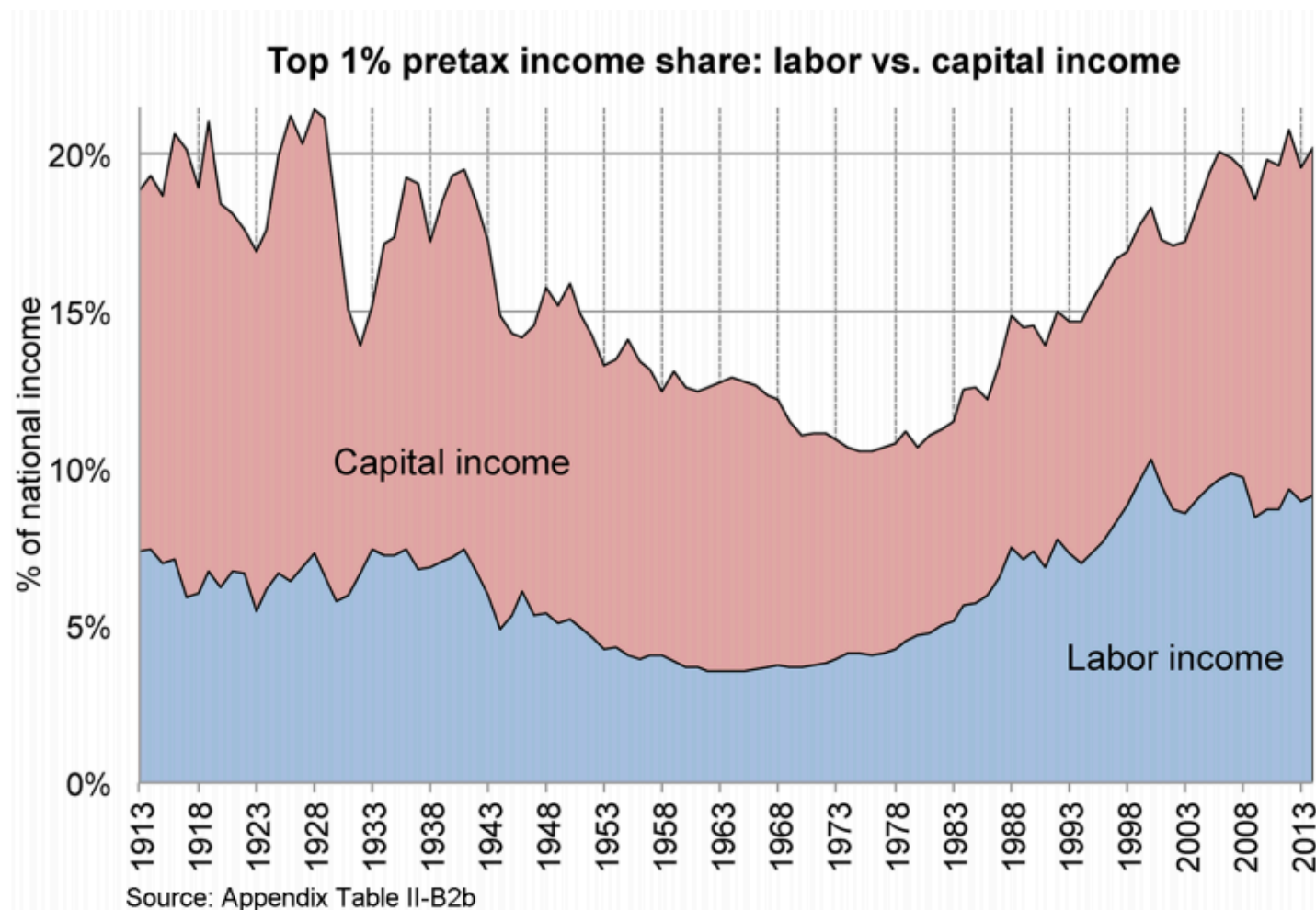
Several ways in which overall income inequality can be high:

- “Rentier society”: high ineq. of wealth, inherited = Europe in 1913
- “Robber baron”: high ineq. of wealth, self-made = US in 1913
- “Supermanagers”: high inequality of labor income = US in 1990s
- Combination of the above = the US in 2020 – 2030?

The US is a story of rising labor and income inequality

- Role of capital vs. labor in dynamics of US top income shares:
- Huge increase in income concentration at the top since 1980s
- Mostly due to labor income inequality up to 2000s
- Since then, mostly due to capital inequality

The role of capital income: case of US



What do governments do?

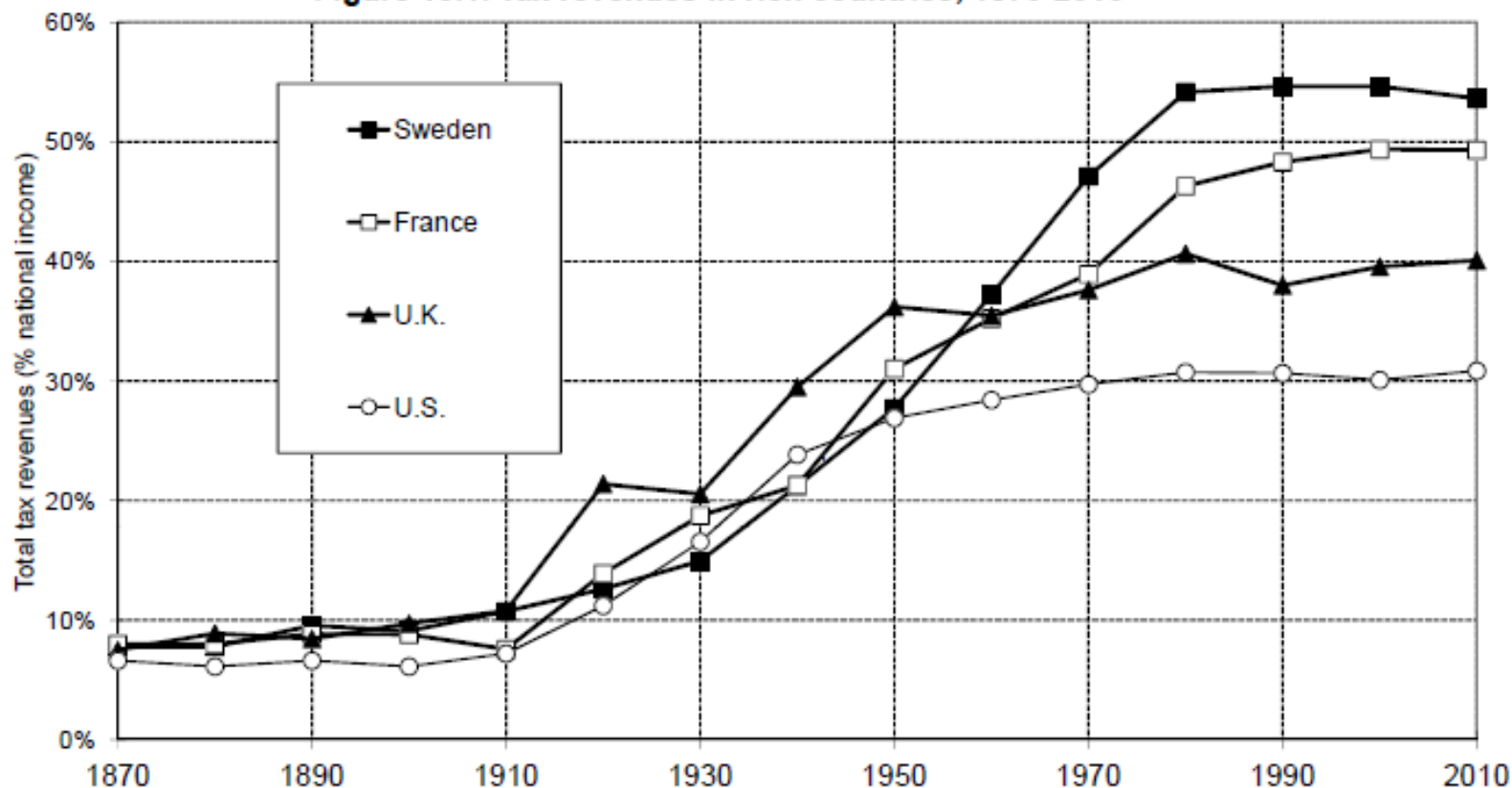


Pre-tax vs. post-tax inequality ?

- Governments tax and redistribute a big fraction of national income
- US: 1/3 of national income
- Europe: 40-50% of national income
- Developing countries: typically 5-20% of national income

The role of government

Figure 13.1. Tax revenues in rich countries, 1870-2010



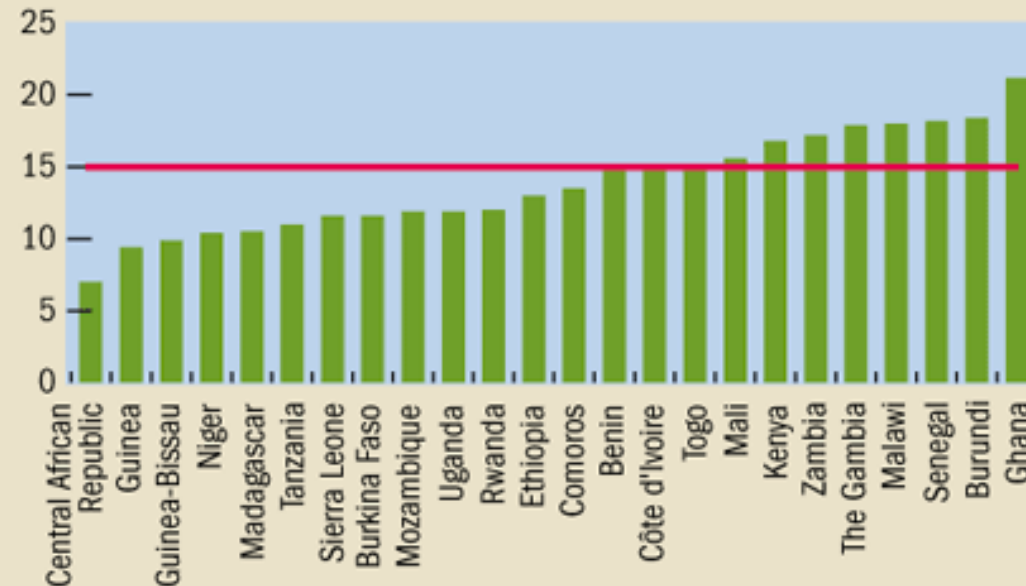
Total tax revenues were less than 10% of national income in rich countries until 1900-1910; they represent between 30% and 55% of national income in 2000-2010. Sources and series: see piketty.pse.ens.fr/capital21c.

Chart 4

Raising the bar

Many oil-importing countries in Africa have a strikingly low tax-to-GDP ratio, but a target of at least 15 percent is desirable.

(tax revenue, percent of GDP)

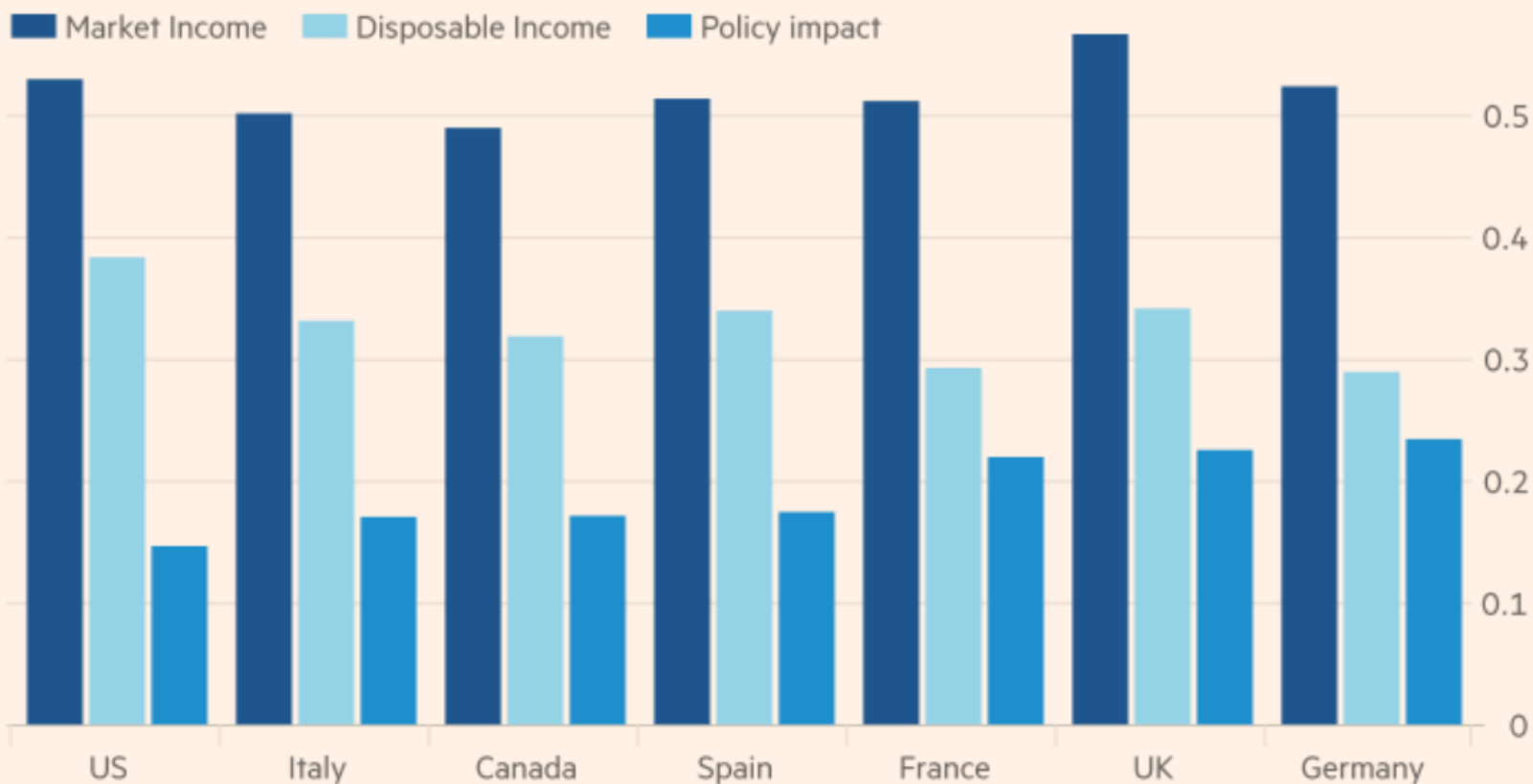


Source: IMF staff calculations.

Note: Data refer to simple averages in each country for 2004-05.

How policy affects outcomes

Income inequality before and after taxes and transfers (Gini coefficient, latest value)



Source: Luxembourg Income Study
© FT

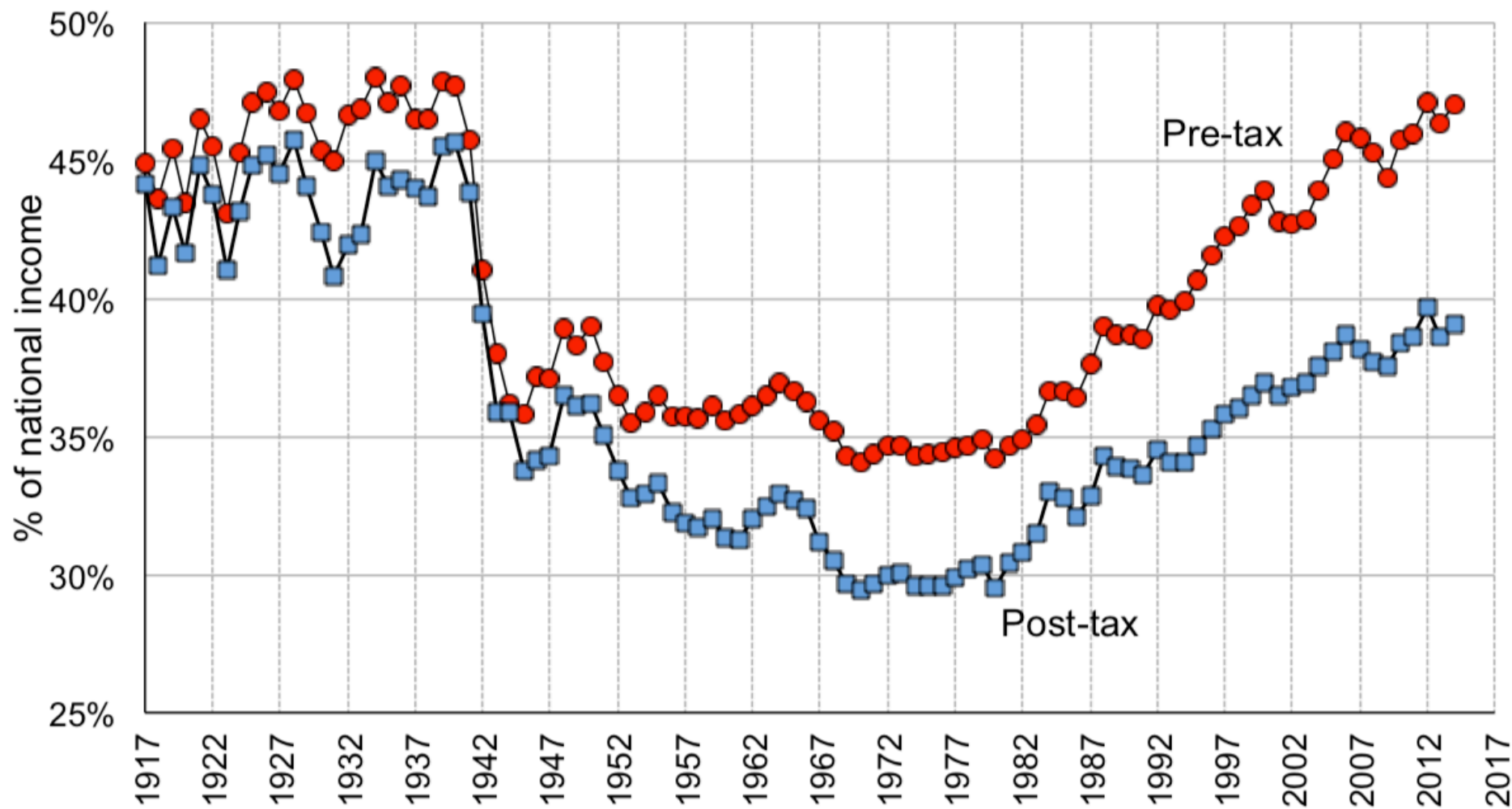
Post-tax vs Pre-tax income

- Denote z pre-tax income, $y = z - T(z) + B(z)$ post-tax income
- If inequality in y is less than inequality in $z \Leftrightarrow$ tax and transfer system is redistributive (or progressive)
- If inequality in y is more than inequality in $z \Leftrightarrow$ tax and transfer system is regressive
- US tax and transfer system is overall redistributive
 - But redistribution of limited size and has not offset rise in pre-tax inequality
 - Excluding health transfers, negligible net redistribution toward bottom 50%

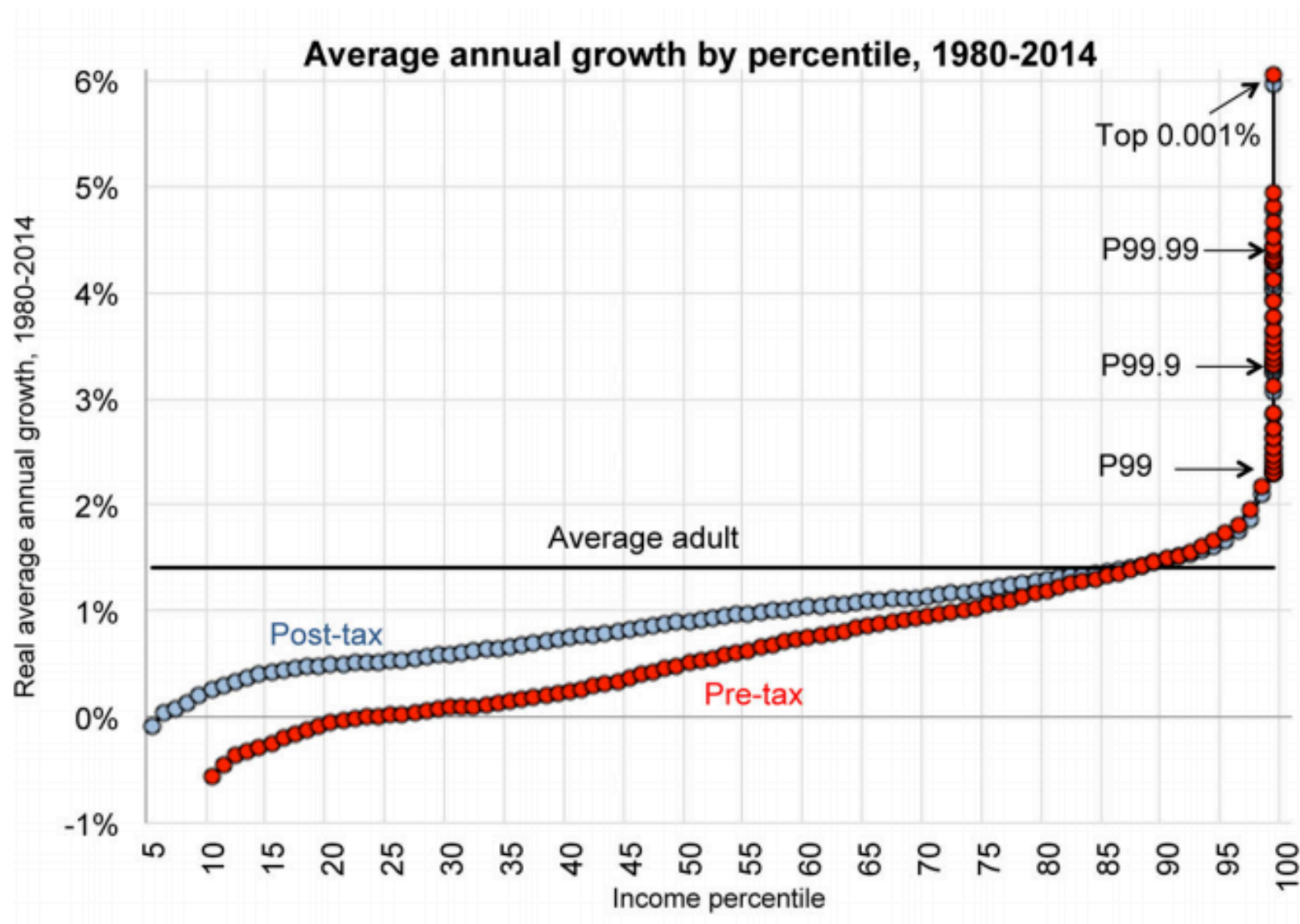
Surprising facts about the US transfer system

1. Transfer system directed at the middle class
2. Tax system is regressive at the top

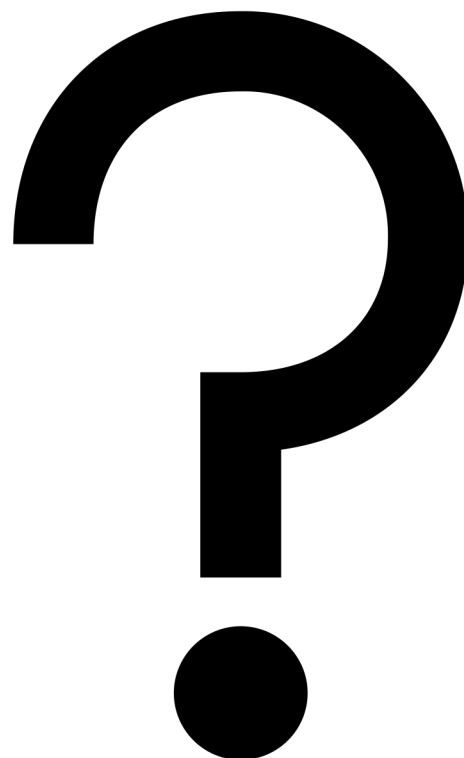
Top 10% national income share: pre-tax vs. post-tax



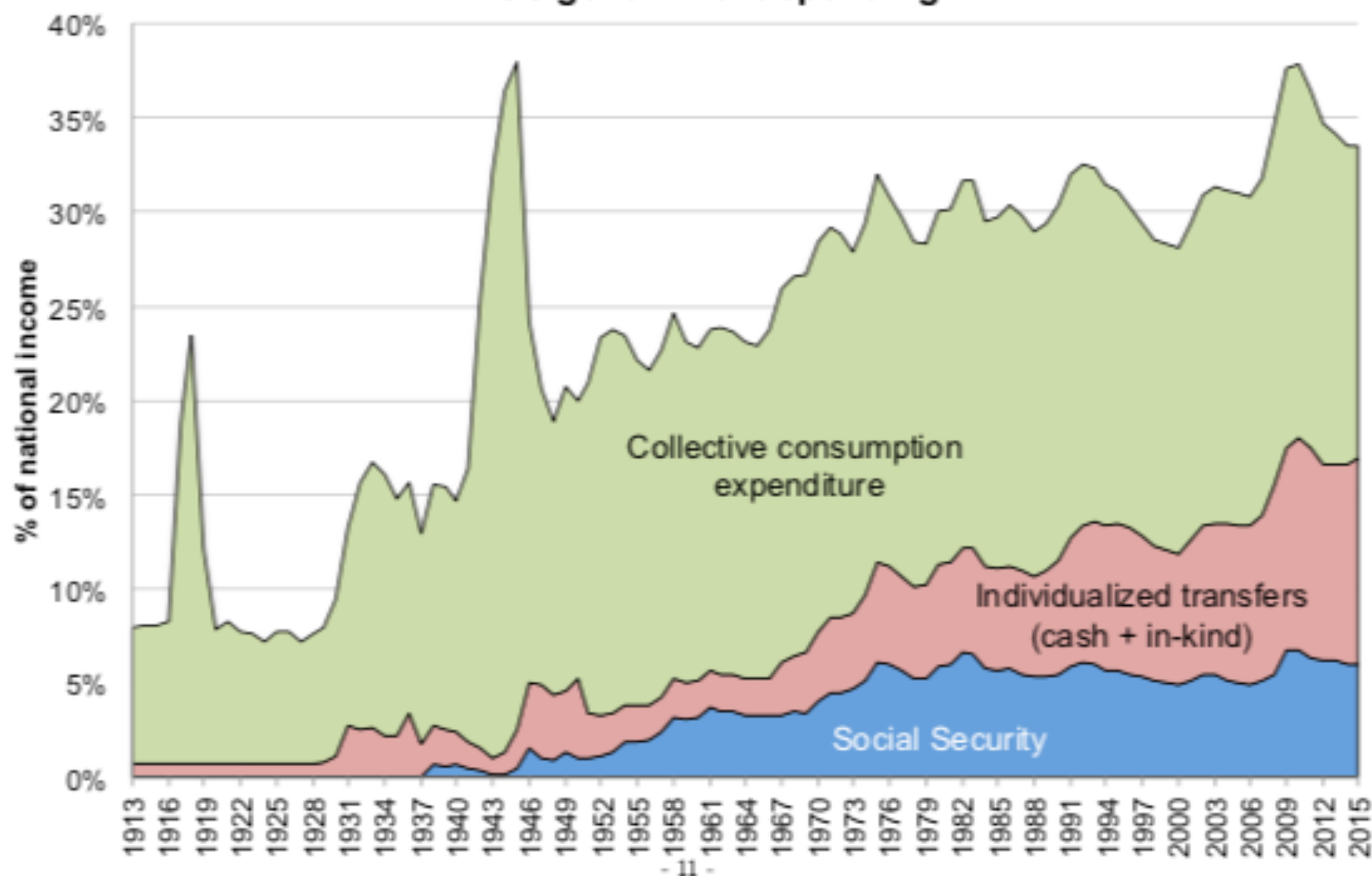
Source: Appendix Tables II-B1 and II-C1



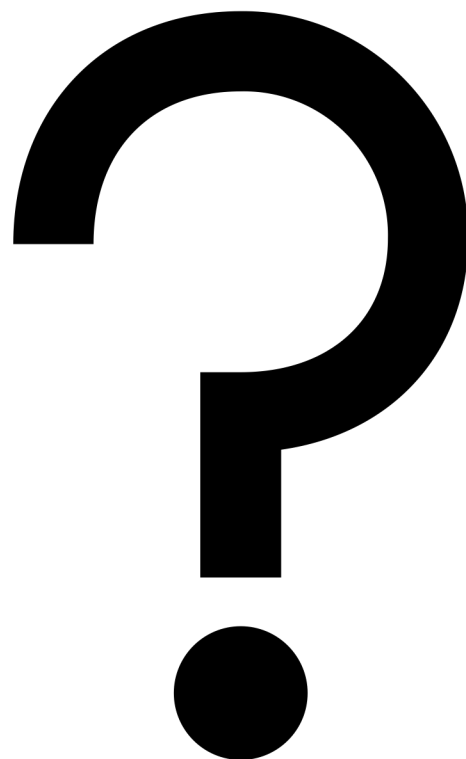
How does the US gov't spend its \$\$\$



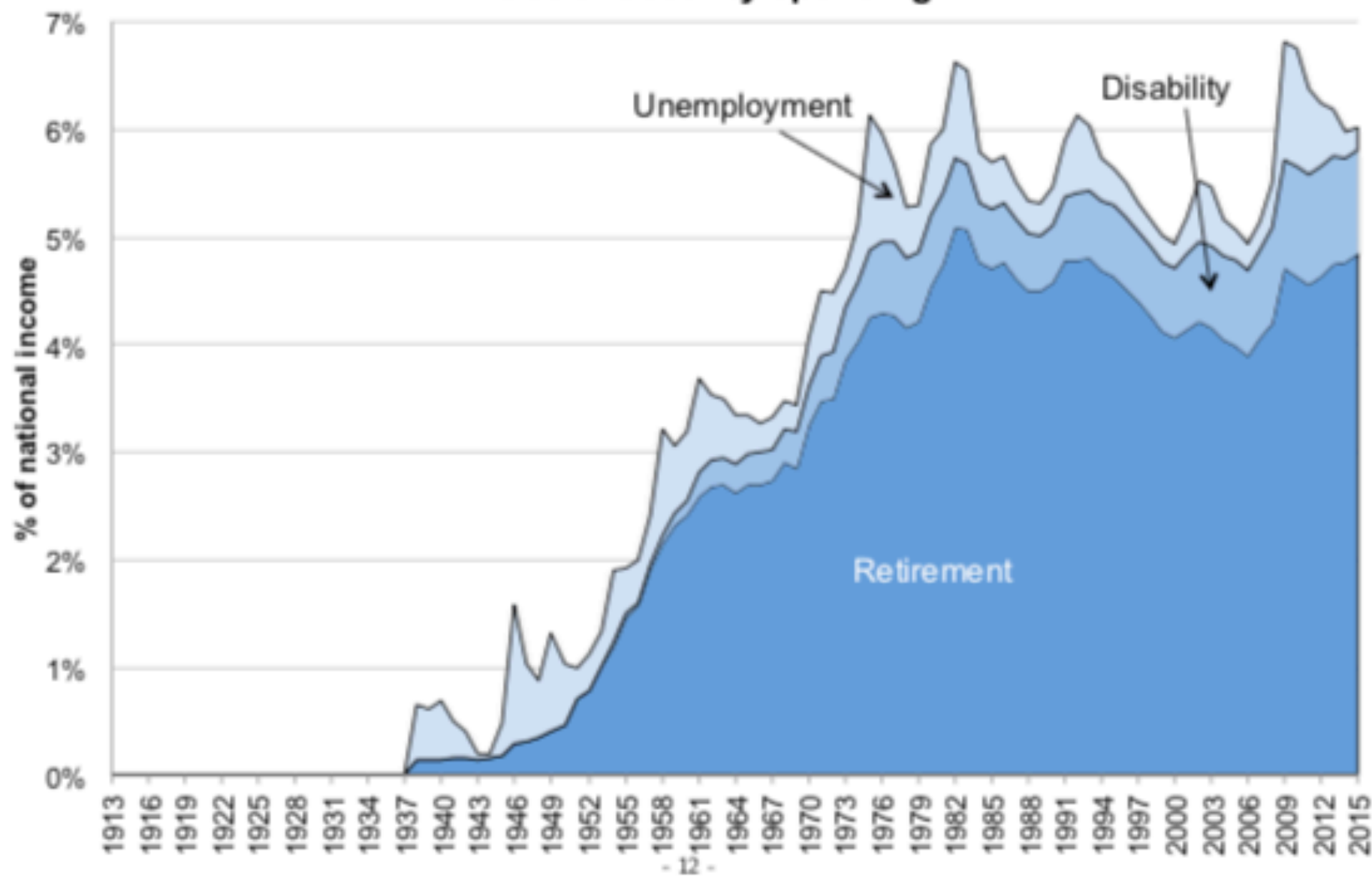
US government spending



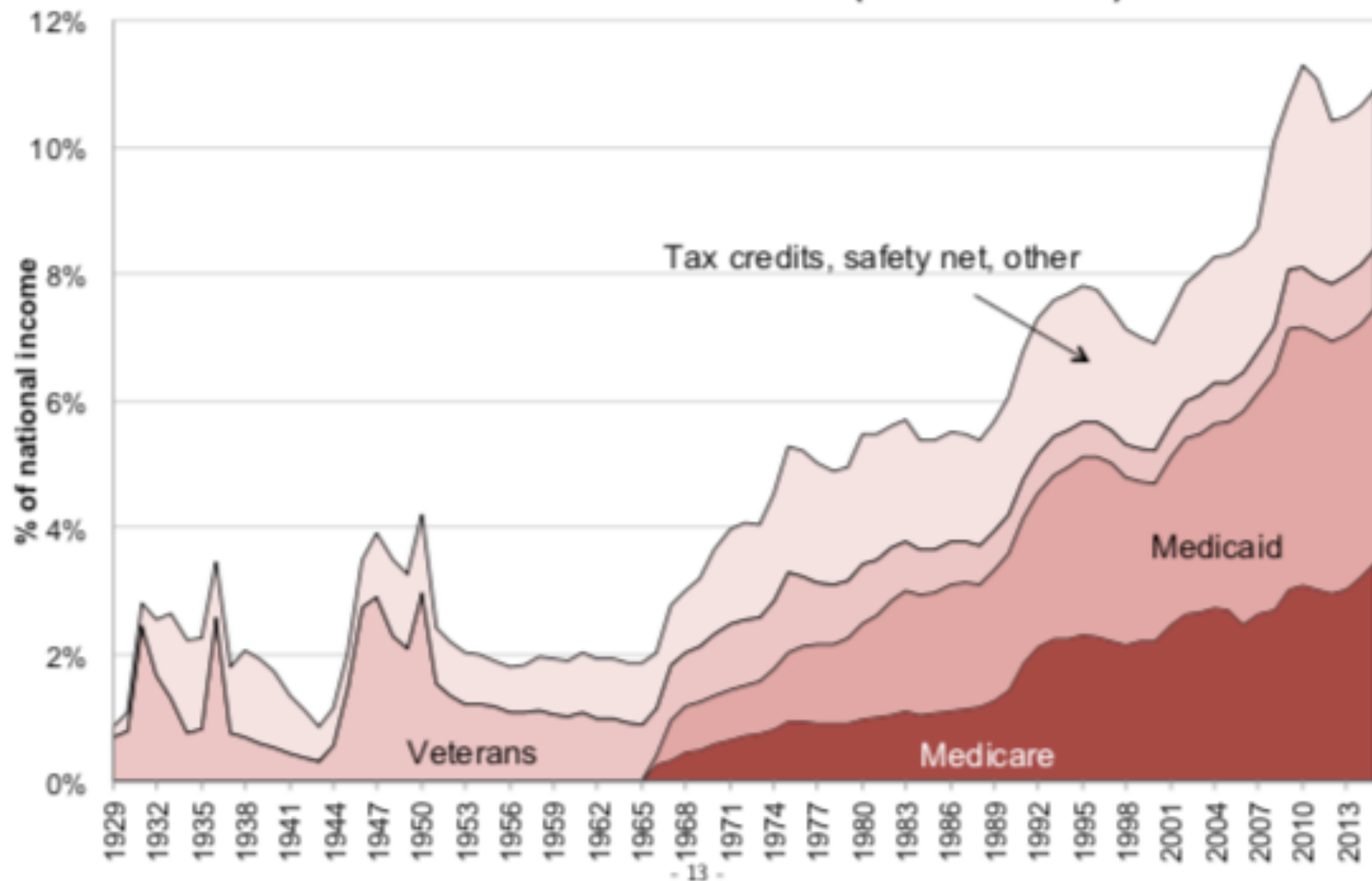
Who benefits from Social Security spending



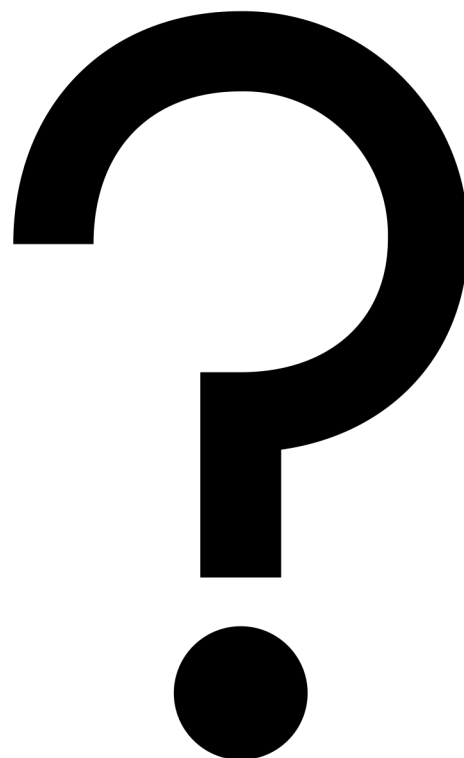
Social Security spending



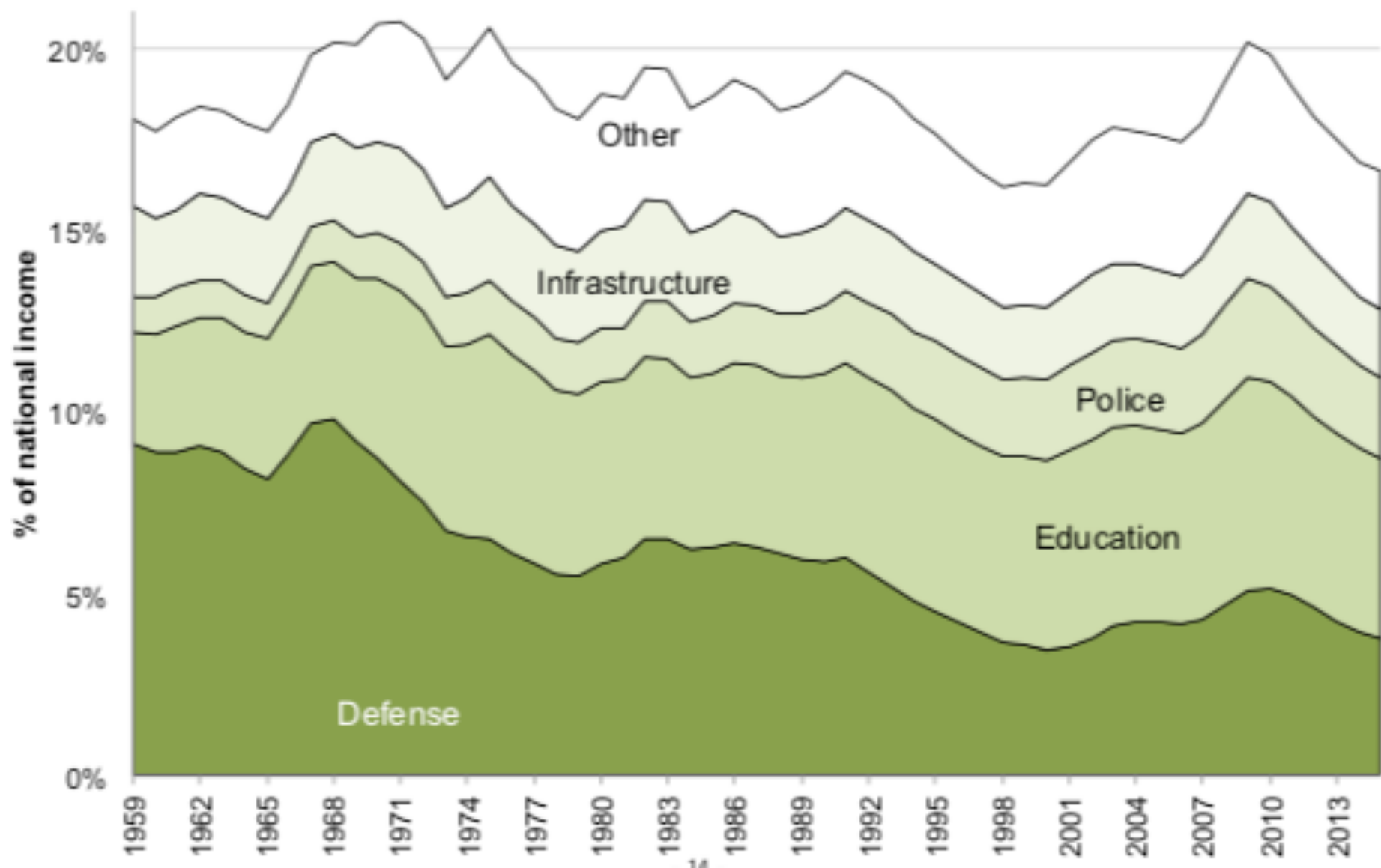
Individualized transfers (cash + in-kind)



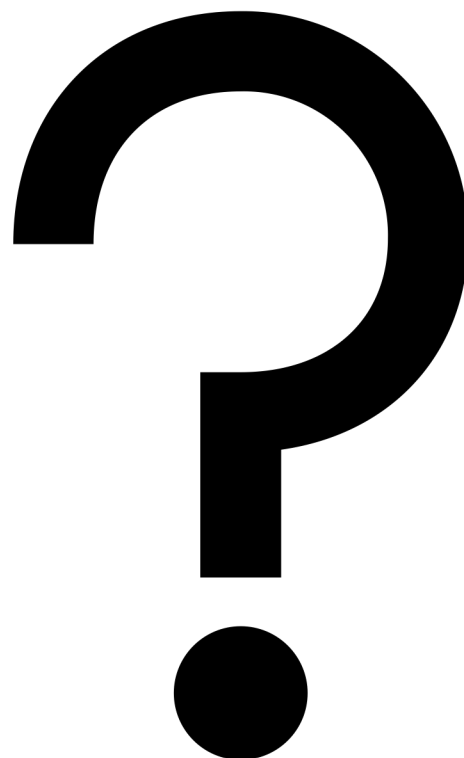
Who benefits from medicare and medicaid



US government collective consumption expenditure

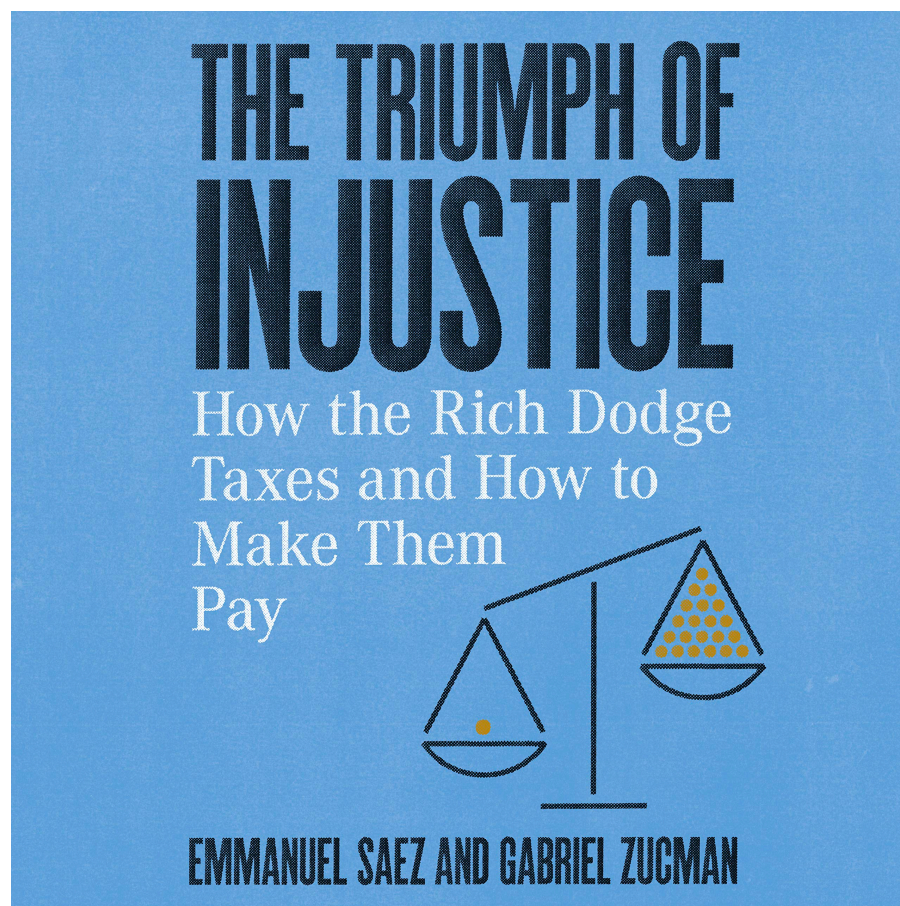


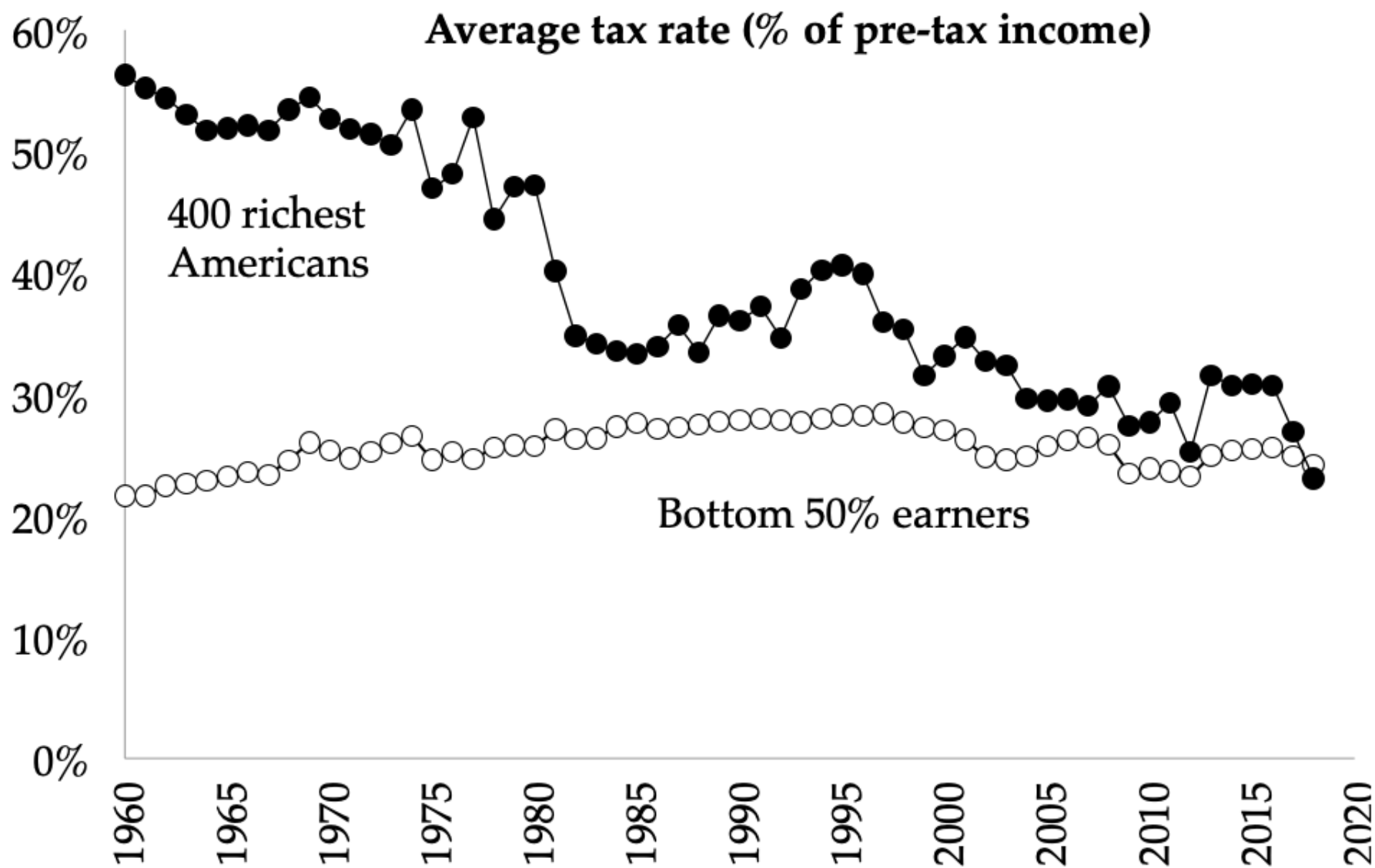
Who benefits from US collective consumption



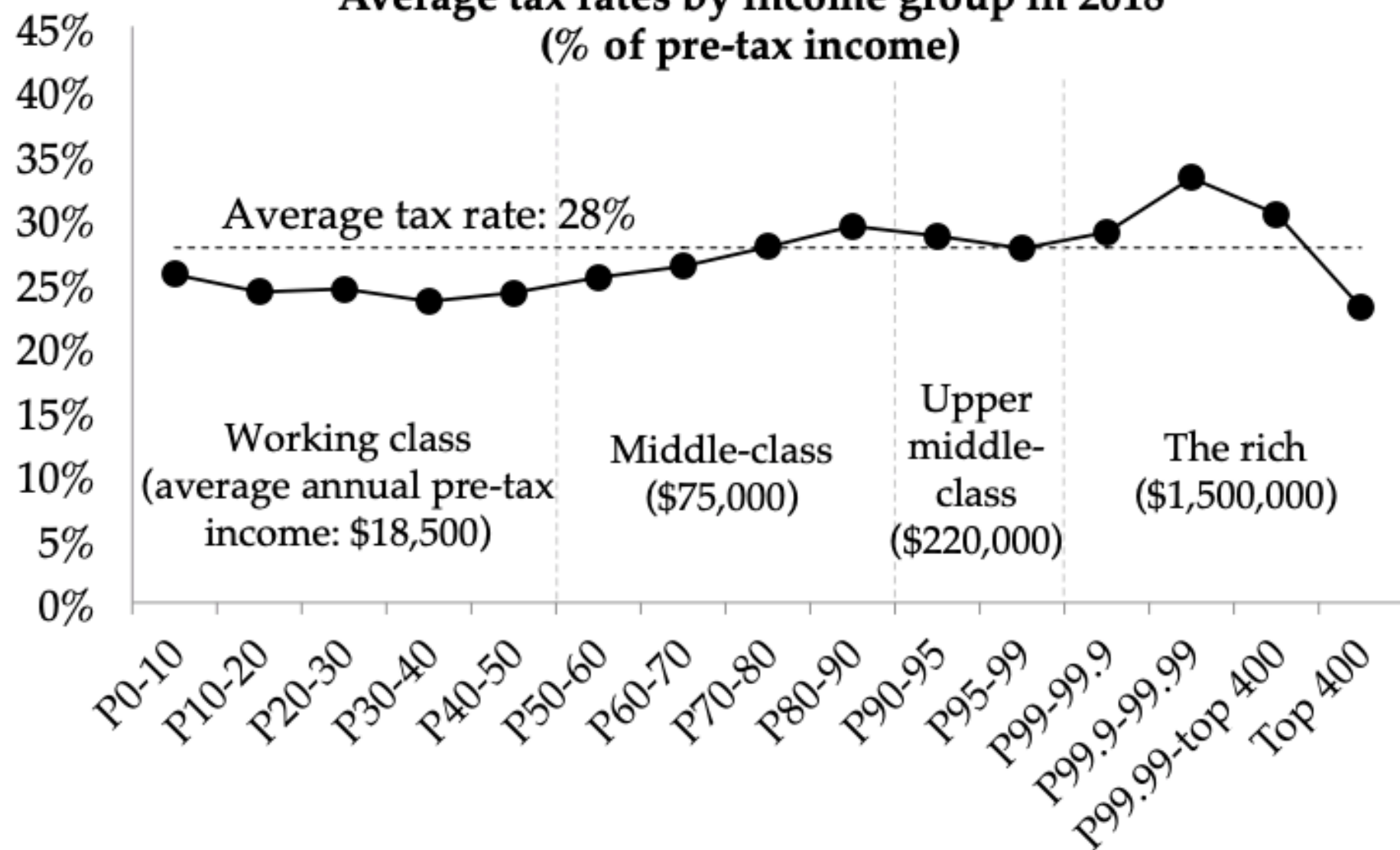
The Triumph of Injustice

- <https://matrix.berkeley.edu/research/qa-professor-gabriel-zucman>

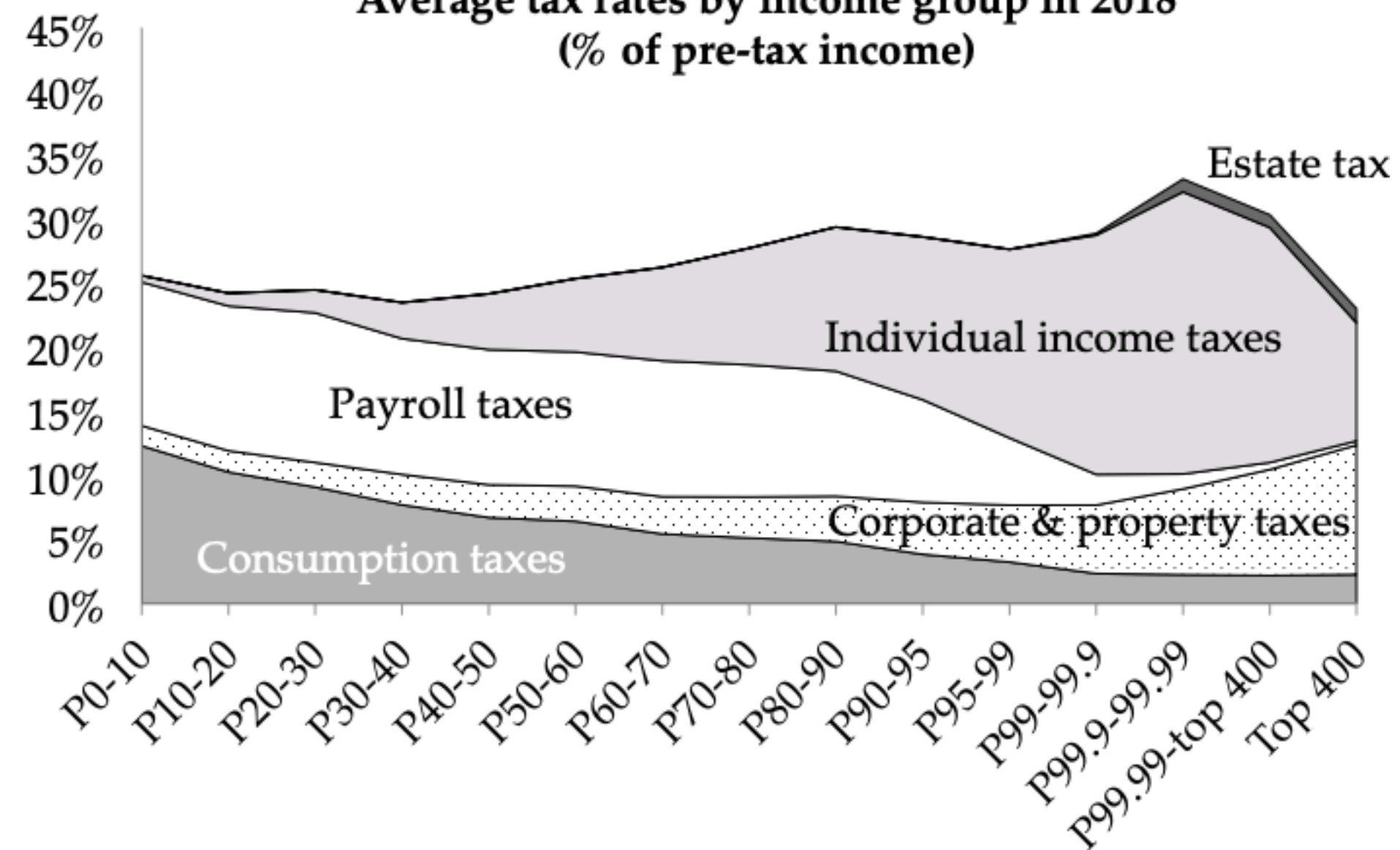




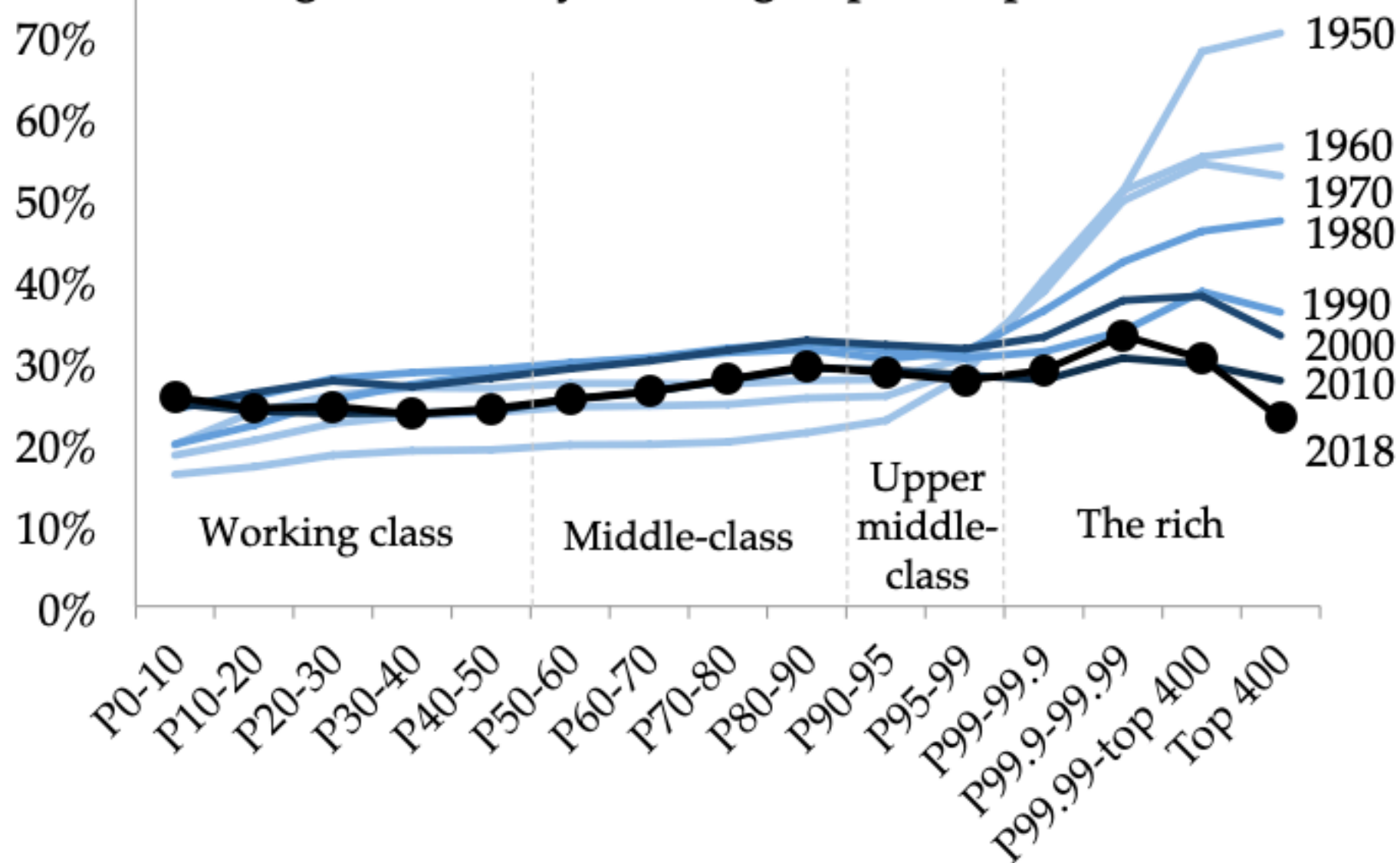
Average tax rates by income group in 2018 (% of pre-tax income)



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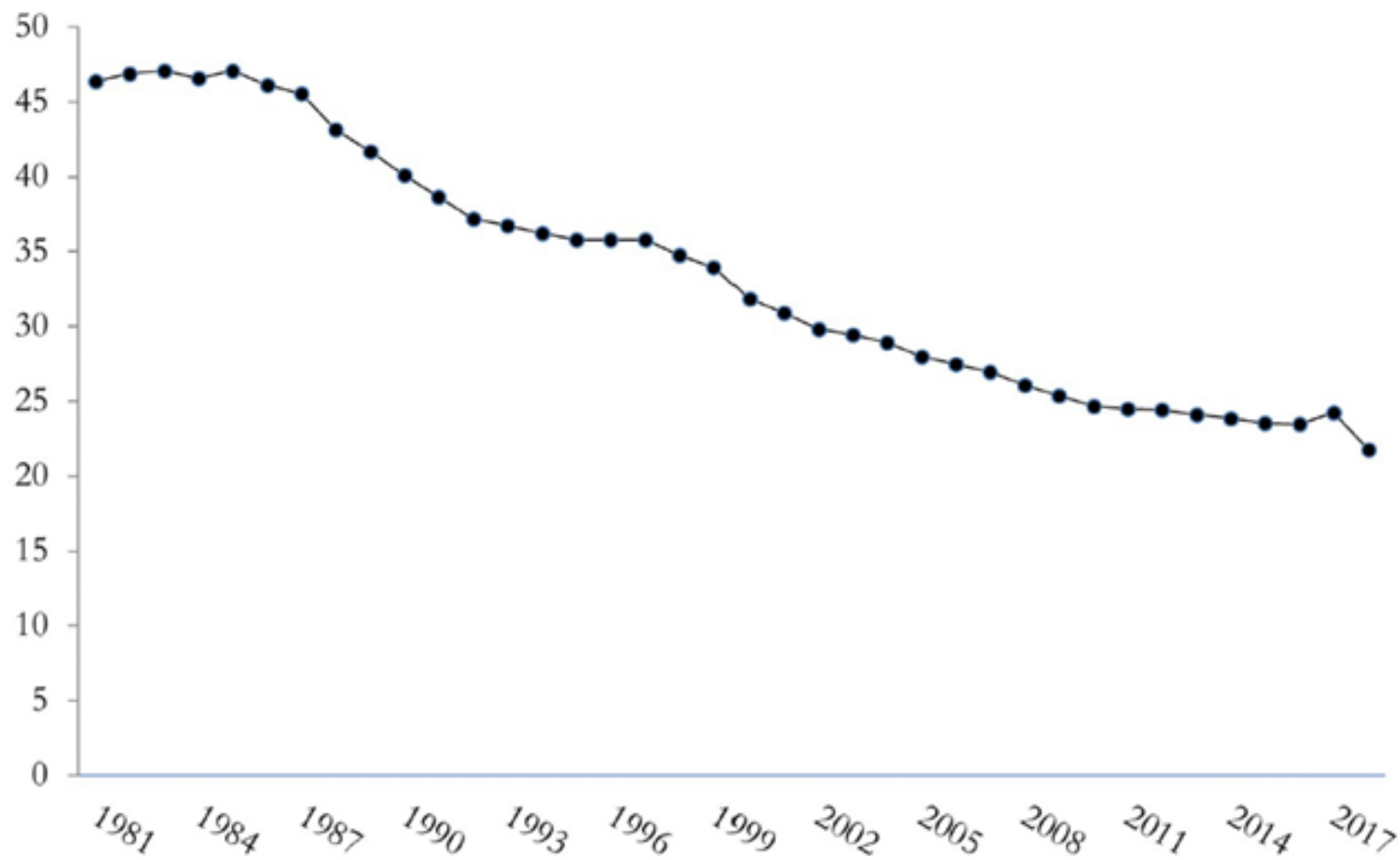
Three main drivers of declining tax progressivity:

1. Collapse in capital taxation, itself reflecting changes in politics and ideology
2. Choice to tolerate certain forms of evasion. Let avoidance fester → slash rates → repeat
 - 1980s: individual income tax → Reagan 1986
 - 2000s-2010s: corporate tax → Trump 2017
3. Globalization in its current form: tax havens; tax competition.
 - But nothing inherent in globalization prevents K taxation: other choices are possible

The collapse of the corporate tax

- Collapse in global corporate tax rate (halved since 1980s)
- Key problem: no progressive income taxation possible without high enough corporate tax rate
- If low corporate tax rate, the rich incorporate and retain earnings within their firm → save tax free
- As tax competition rages, gap between corp. vs. top indiv. tax rate rises → rich more likely to incorporate

World average corporate tax rate (%)



Average tax rate of the top 0.1% (% of pre-tax income)

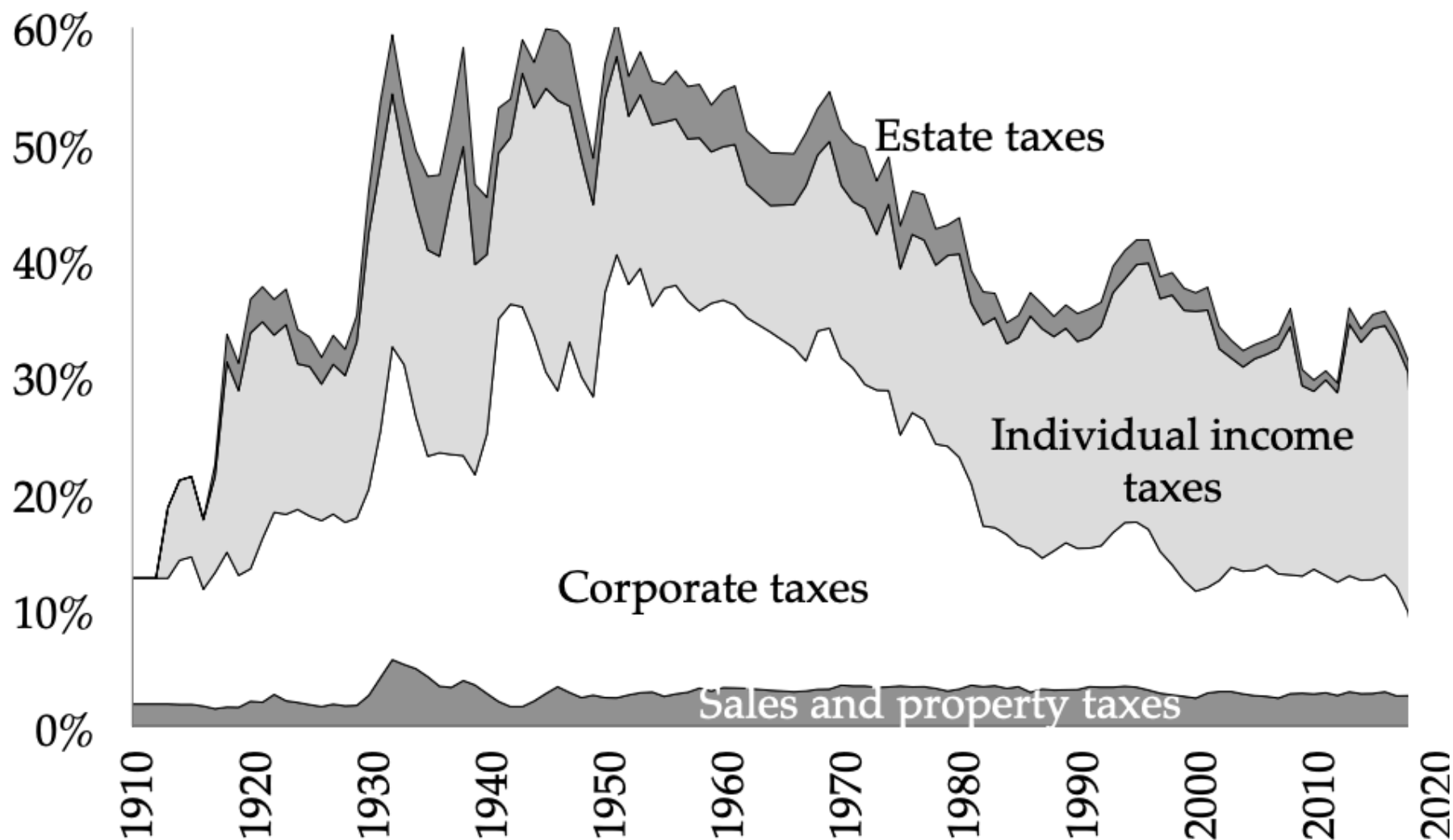
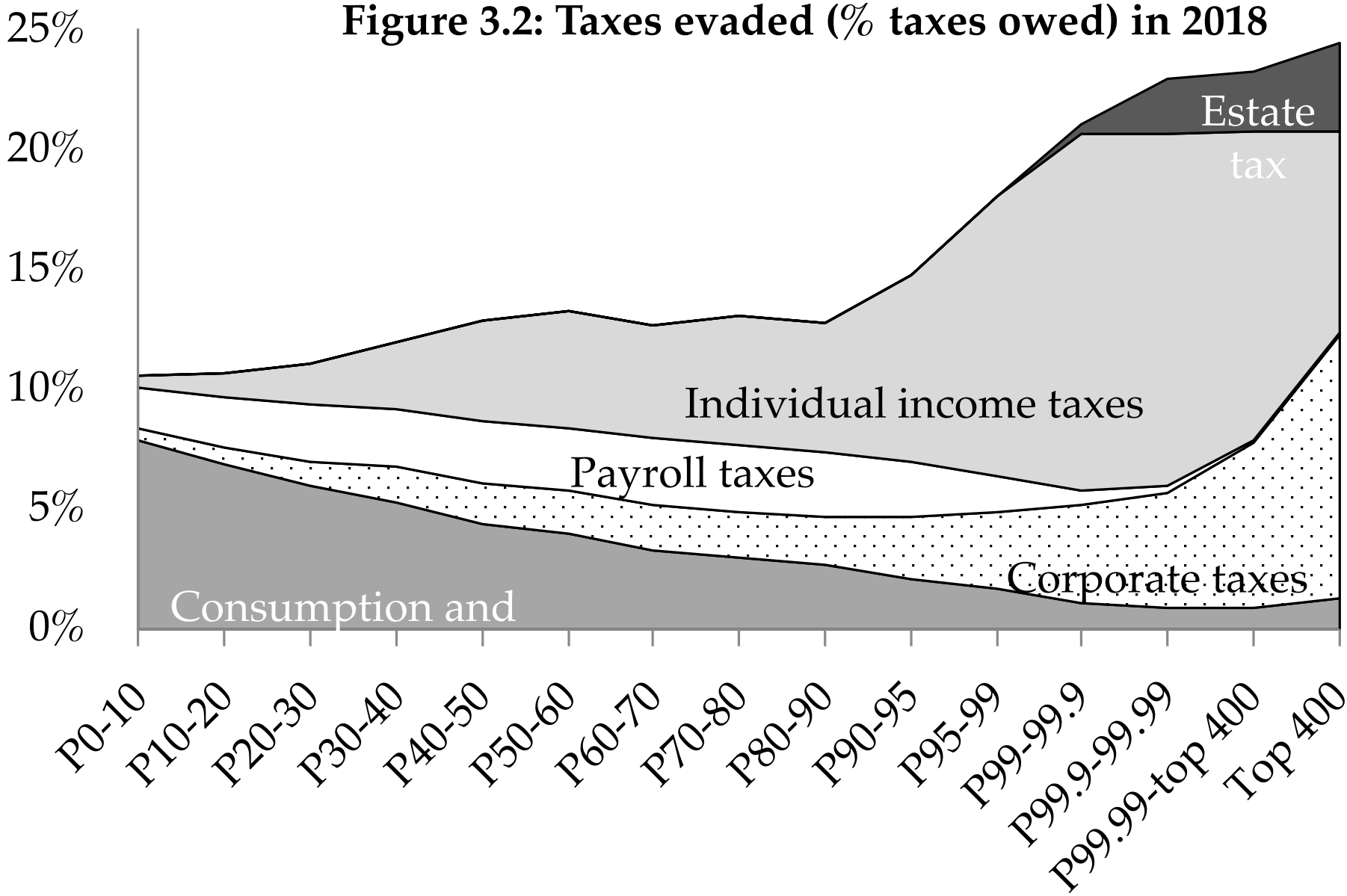
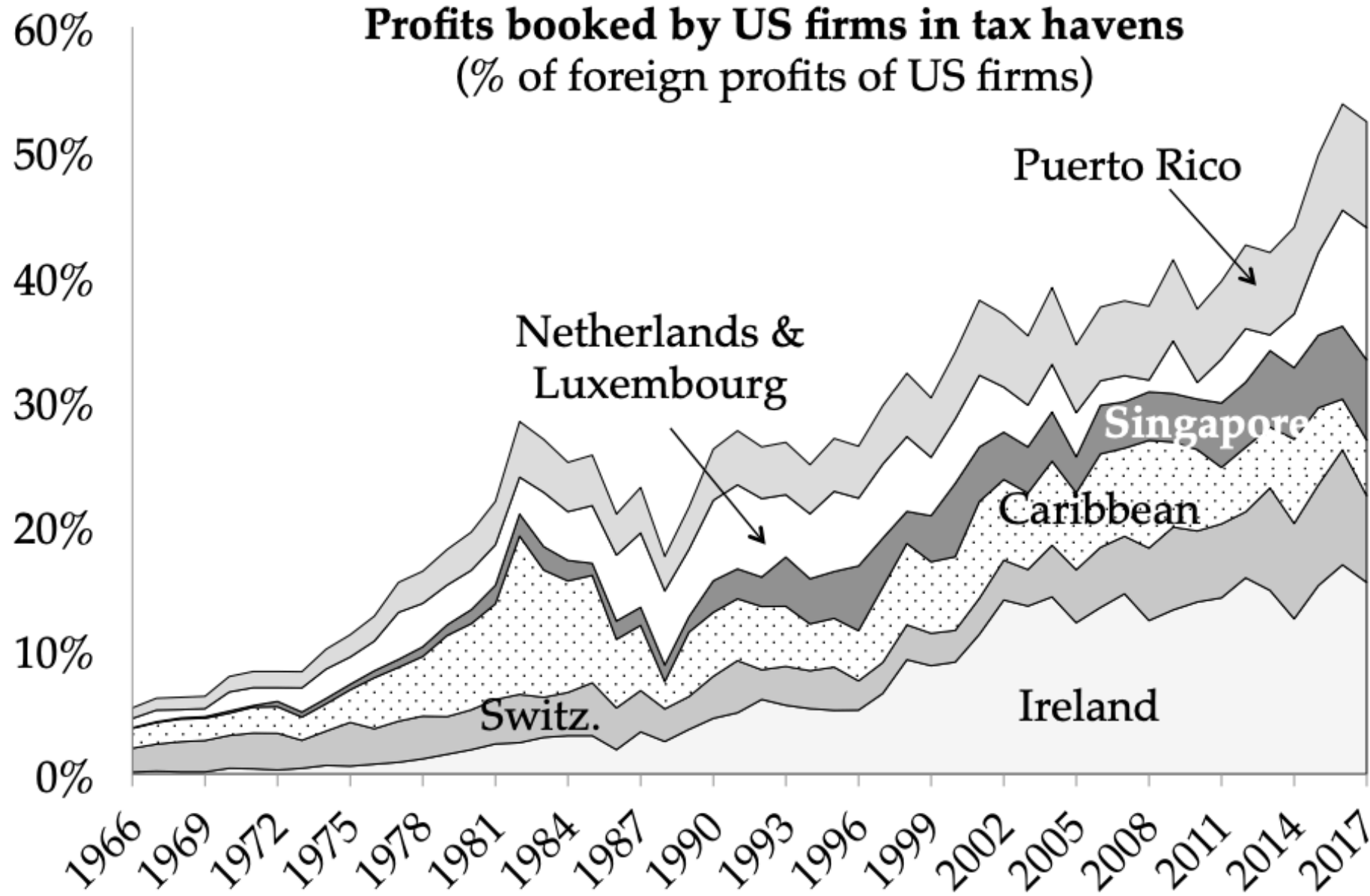


Figure 3.2: Taxes evaded (% taxes owed) in 2018



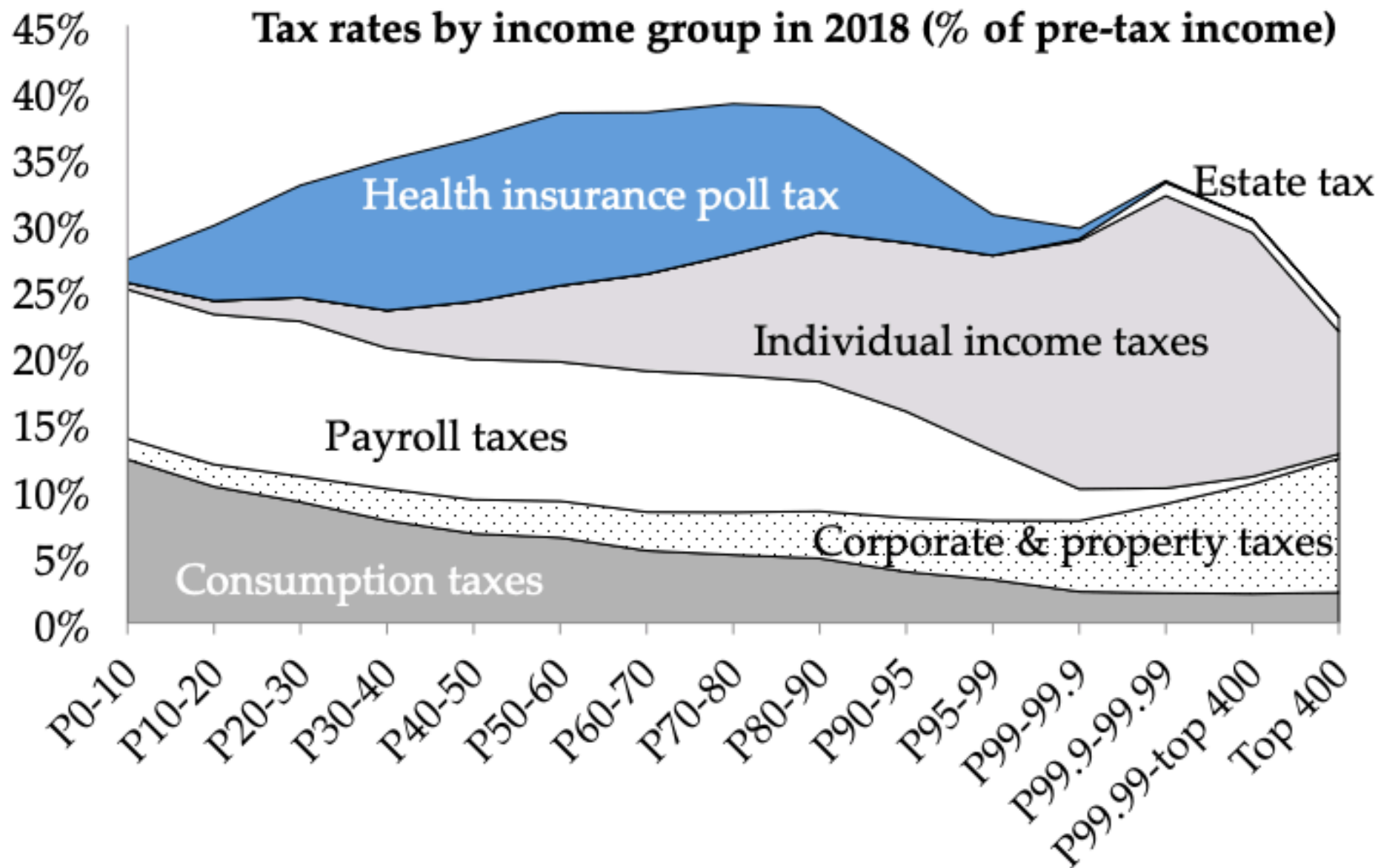
Profits booked by US firms in tax havens (% of foreign profits of US firms)



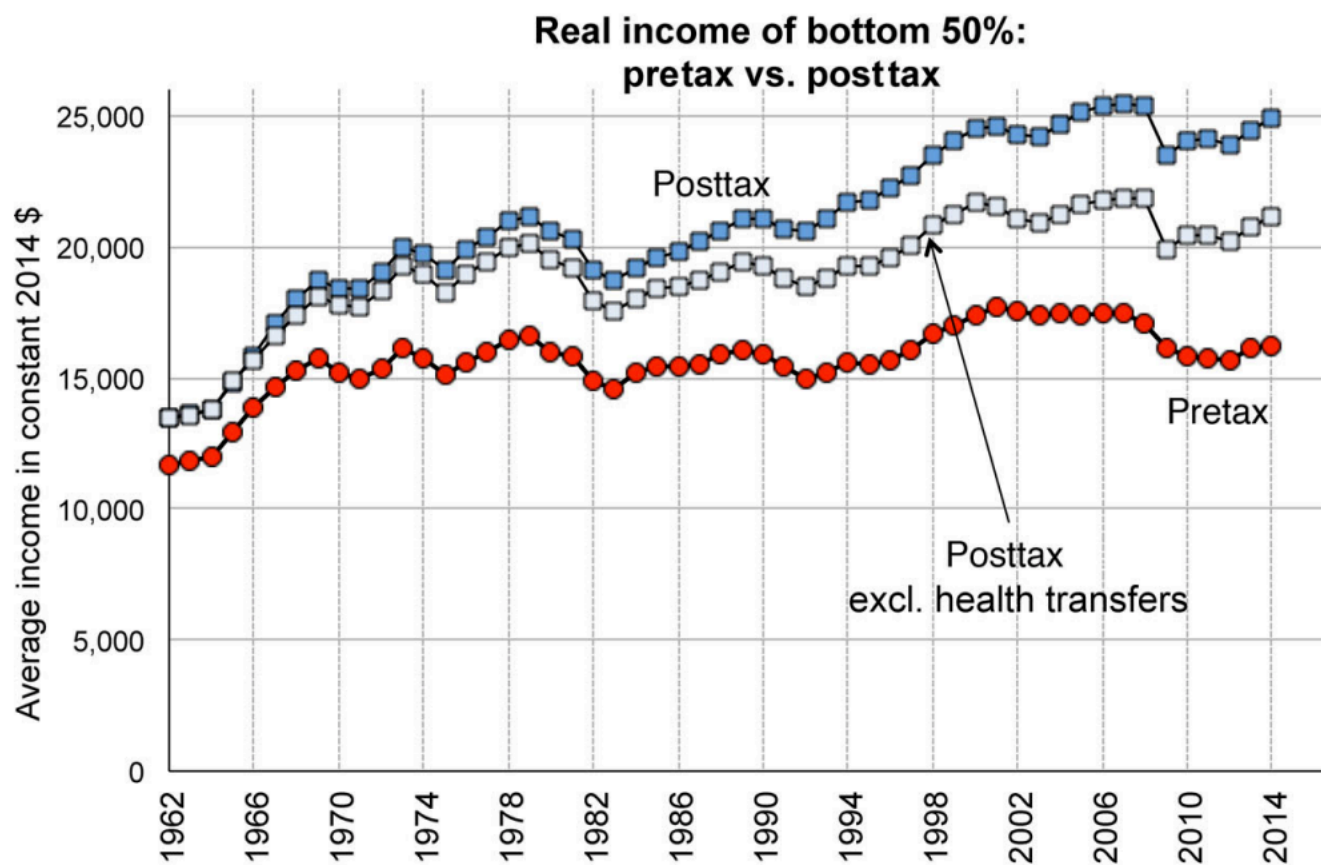
Is the US tax system actually far more regressive than it appears

- <https://www.youtube.com/watch?v=7Z2XRg3dy9k>

Tax rates by income group in 2018 (% of pre-tax income)



Post-tax income overated?



Source: Appendix Tables II-B7, II-C7 and II-C3c.

Is the US transfer system actually more regressive than it appears

- <https://www.youtube.com/watch?v=7Z2XRg3dy9k>

Kahoot! In the United States today, government intervention (total taxes + total transfers):

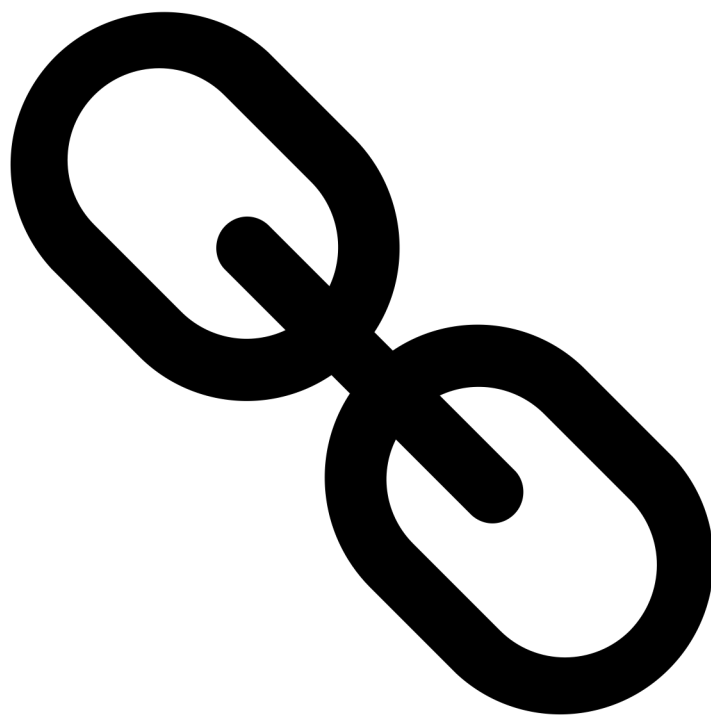
A — Does not affect the distribution of income

B — Exacerbates inequality

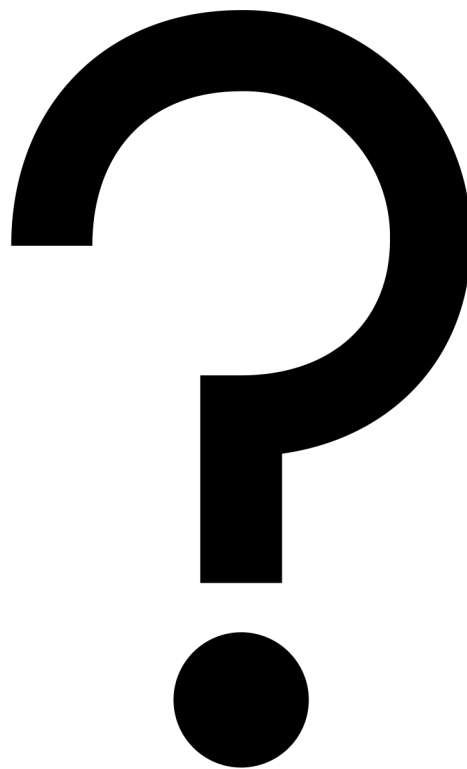
C — Reduces inequality

D — Has offset the rise of pre-tax inequality since the 1980s

The link between pre-tax and post-tax income

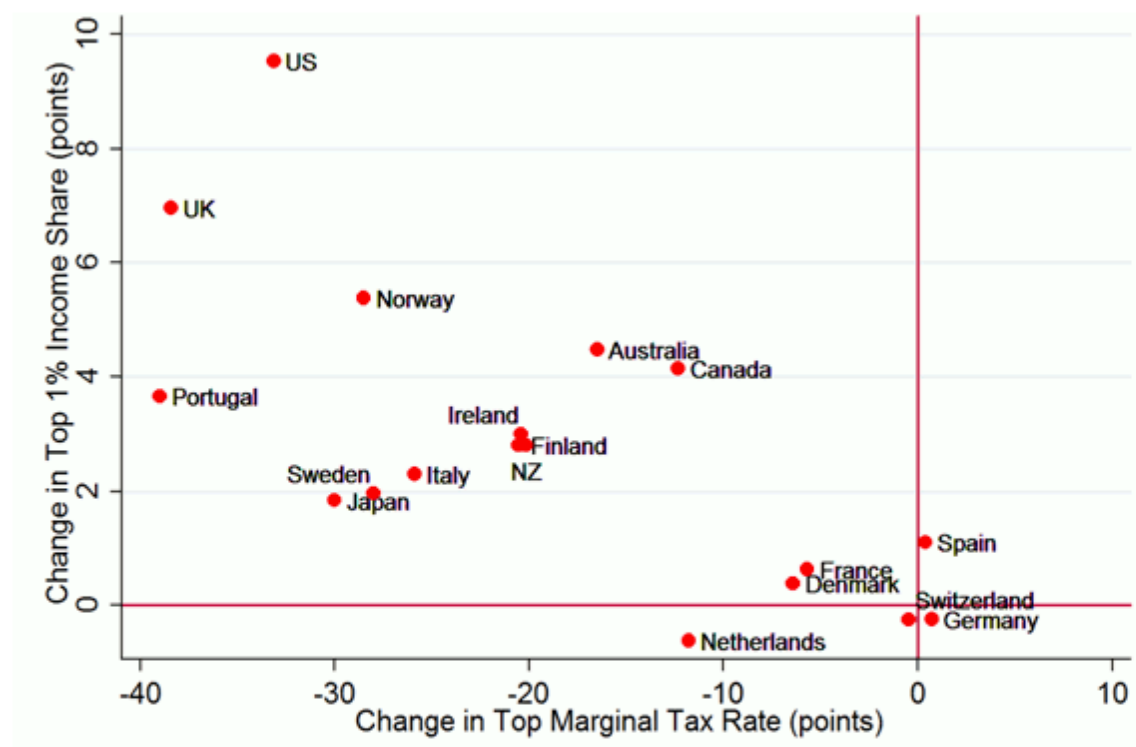


Ludvig: Why do you keep mentioning taxes as an explanation for rising pre-tax inequality!!



Link between pre-tax and post-tax

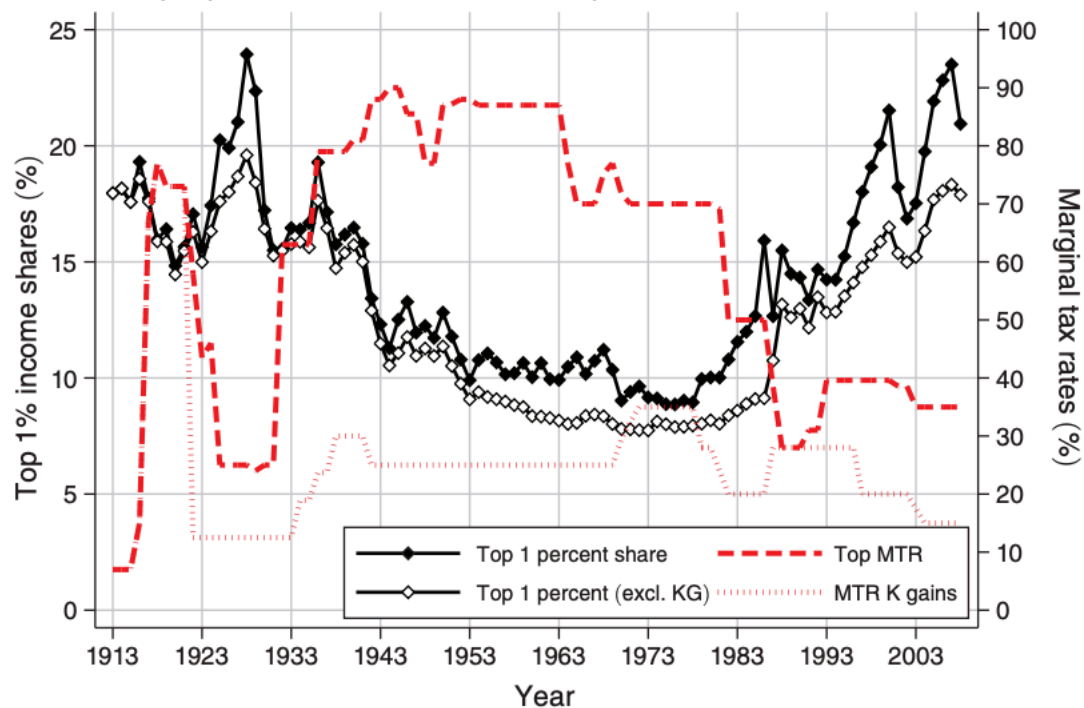
Figure 1. Changes in top 1% pre-tax income shares and top marginal tax rates since the 1970s



Note: The Figure depicts the change in top 1% pre-tax income shares against the change in top marginal income tax rates from 1975-9 to 2004-8 for 18 OECD countries (top tax rates include both central and local individual income tax rates, exact years vary slightly by countries depending on data availability in the World Top Income Database). *Source:* Piketty *et al* (2011), Figure 4A.

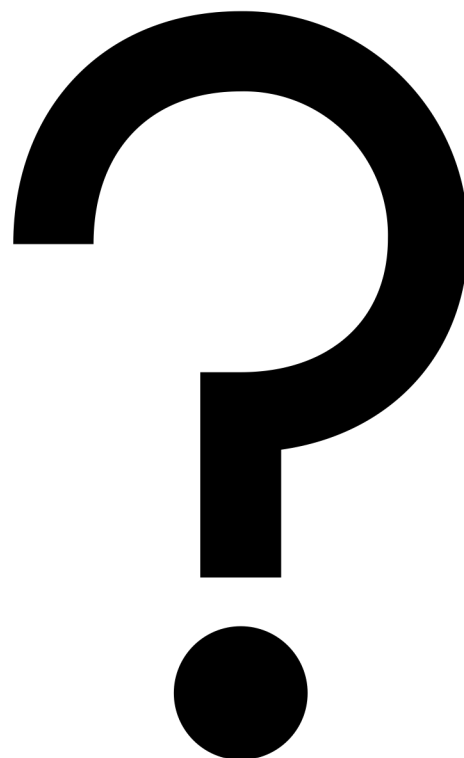
Link between pre-tax and post-tax

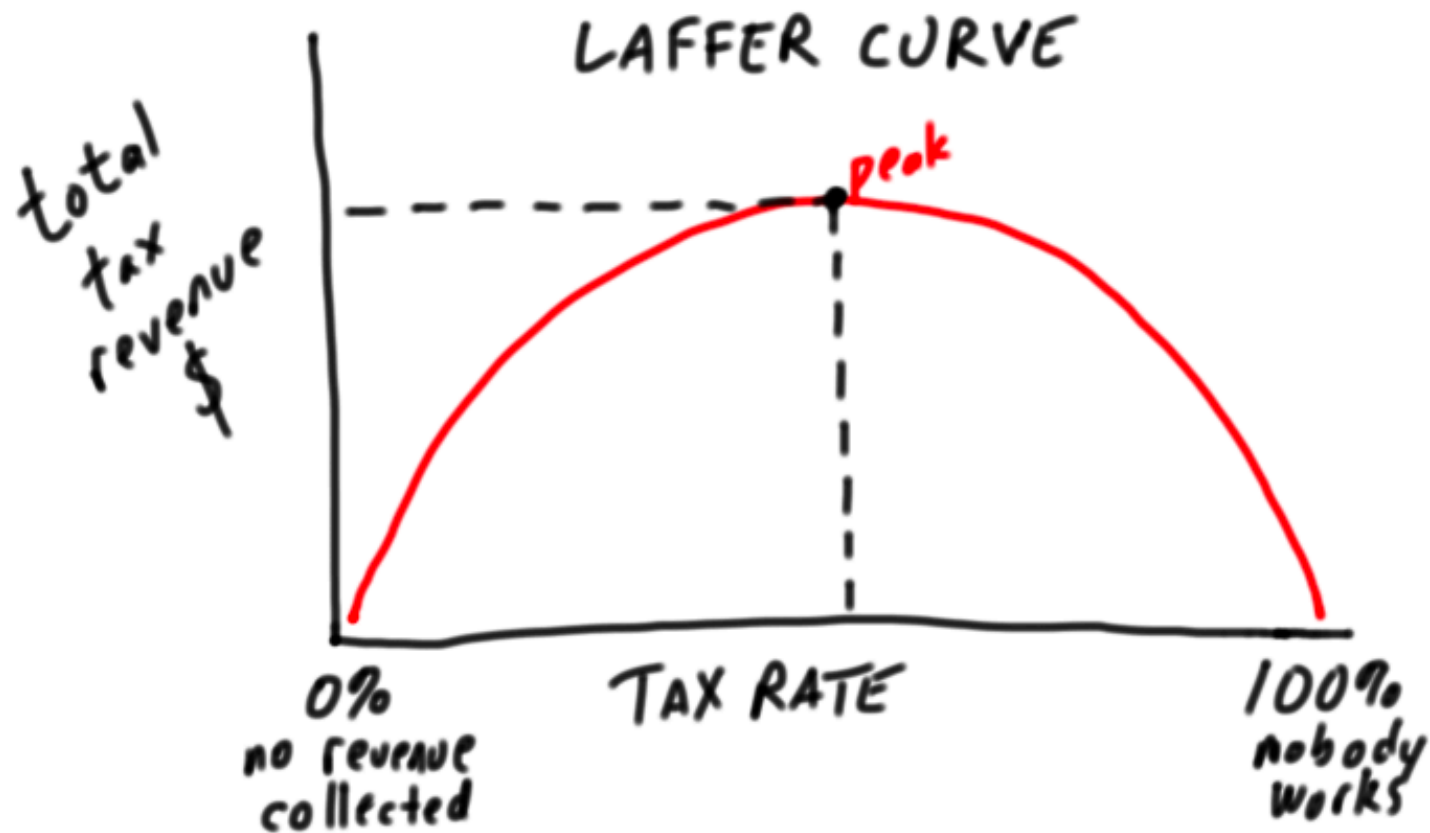
Panel A. Top 1 percent income shares and Top MTR



- <https://pubs.aeaweb.org/doi/pdfplus/10.1257/pol.6.1.230>

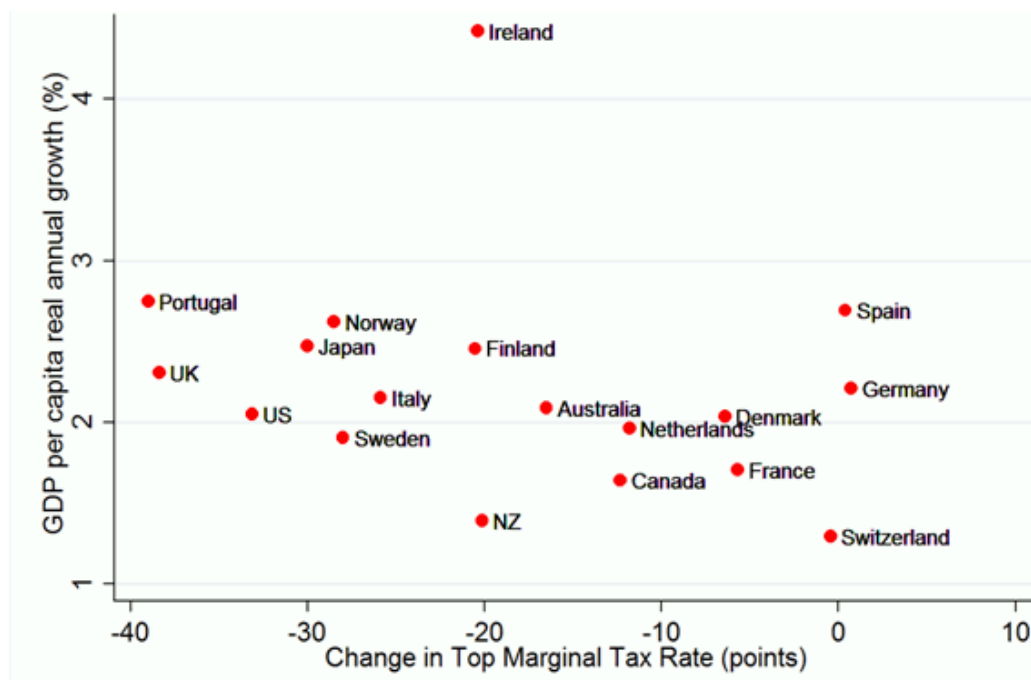
Why do taxes impact pre-tax income?





Why do taxes impact pre-tax income?

Figure 2. GDP-per-capita growth rates and top marginal tax rates since the 1970s



Note: The Figure depicts the average real GDP-per-capita annual growth rate from 1975-9 to 2004-8 against the change in top marginal tax rates from 1975-9 to 2004-(exact years are the same as Figure 1 and vary slightly by countries). The correlation is virtually zero and insignificant suggesting that cuts in top tax rates do not lead to higher economic growth. *Source:* Piketty *et al* (2011), Figure 4B.

A tale of three elasticities!

1. Labor supply
2. Tax avoidance
3. Compensation bargaining

<https://www.aeaweb.org/articles?id=10.1257/pol.6.1.230>

Beyond laffer

- <https://www.youtube.com/watch?v=K6Emg5WiQ5A>

Summary

- Rising labor income inequality explains bulk of rising income inequality in the US from 1970 to 2000s; now capital is key
- Bottom 50% shut off from growth in US since '80 (\neq Europe)
- Government spending has increased in US since the 1960s
- Overall, government redistribution has offset only a small fraction of the rise in pre-tax inequality
 - In particular when ignoring the increase in health care transfers resulting from increased medical prices

Summary

- The US tax system has gone from being the World's most progressive to regressive – tax avoidance/evasion plays a major part in this
- Pre-tax income is closely correlated with top income tax rates – but does not seem to correlate with economic activity