Emmanuel Saez: Saying Inequality Has Not Increased in the US “the Equivalent of Being a Climate Change Denier”

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Asher Schechter

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In an interview with ProMarket ahead of his upcoming Stigler Center visit this week, UC Berkeley economist Emmanuel Saez discussed the impact of the 2017 Trump tax cuts, the disproportionate political power of the super-rich, and whether he agrees with Bernie Sanders that billionaires shouldn’t exist.

Emmanuel Saez. Photo by Cayce Clifford

The rising popularity of the wealth tax is one of the biggest political stories of the past year. Once relegated to the fringes of academic economics, the idea of imposing a wealth tax on billionaires is now the signature policy of two leading presidential candidates: Elizabeth Warren and Bernie Sanders. A recent *Reuters/Ipsos* poll showed that nearly two-thirds of Americans—among them 77 percent of Democrats and 53 percent of Republicans—support higher taxes on the very rich. Previous polls have shown similar results.

At the heart of the wealth tax’s newfound popularity is a startling statistic, unearthed by UC Berkeley economists Emmanuel Saez and Gabriel Zucman: For the first time ever, America’s richest paid a lower total tax rate—comprised of federal, state, and local taxes

—than any other group in 2018. The effective tax rate of the 400 richest Americans was 23 percent last year, less than the tax rates paid by the bottom 50 percent.

The US tax system is usually characterized by analysts and policymakers as progressive. Partly, this is because, for a long time, it was: from the 1930s to the late 1970s, the US had one of the world's most progressive tax systems, with an effective tax rate of over 50 percent on the wealthiest Americans and a corporate tax rate of 50 percent.

But in the last few decades, Saez and Zucman argue in their recent book *The Triumph of Injustice: How the Rich Dodge Taxes and How to Make Them Pay*, the US tax system has become increasingly regressive. The vaunted progressivity of the American tax system is now only a "myth," they write. Instead, it looks like "the tax system of a plutocracy."

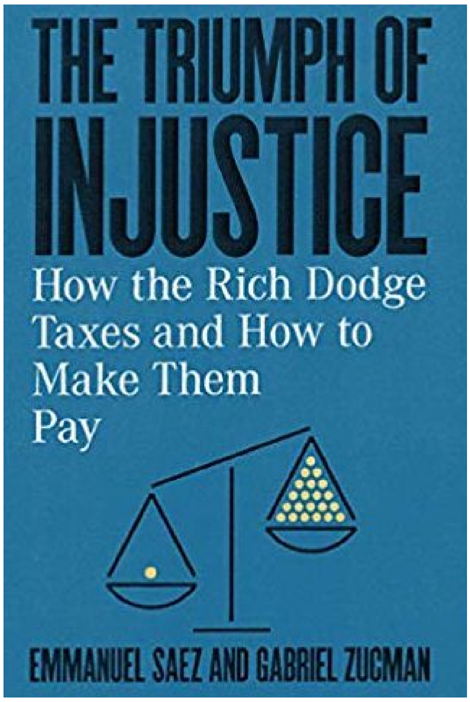
Saez and Zucman have gained prominence in the past decade thanks to their groundbreaking studies on inequality and taxation (you can read our 2018 interview with Zucman here). *The Triumph of Injustice* (one of *ProMarket*'s top 10 political economy books of 2019), which combines data-heavy economic analysis with jargon-free, accessible prose, has placed them at the forefront of the political debate as well: the two advised the Warren and Sanders campaigns on their respective wealth tax plans.

Saez, a professor of economics and director of the Center for Equitable Growth at UC Berkeley, will visit the Stigler Center this week for a debate with Chicago Booth professor Steven Kaplan moderated by Luigi Zingales [faculty director of the Stigler Center and one of the editors of this blog]. Mostly known for his joint work on inequality with Thomas Piketty, Saez is one of the world's most influential economists, recipient of both the American Economic Association's prestigious John Bates Clark Medal and a MacArthur "genius" grant.

Ahead of his upcoming Stigler Center event, we recently interviewed Saez on the impact of the 2017 Trump tax cuts, the disproportionate political power of the super-rich, and whether he agrees with Sanders that billionaires shouldn't exist.

[The following conversation has been edited and condensed for clarity and length.]

Q: Last week, President Trump's National Economic Council Director, Larry Kudlow, said that another round of tax cuts—"Tax Cuts 2.0," he called it—is planned. What has been the effect of the 2017 Tax Cuts and Jobs Act?



This reform had a large negative impact on the overall progressivity of the tax system. The US used to have one of the most progressive tax systems in the world and taxed the upper incomes much higher than the working and the middle class. That eroded over time.

With the Trump tax cut, it's eroded even further. Most notably because the Trump tax cut almost halved the revenues from the corporate tax—that is, the tax that falls on the owners of stocks and makes the overall tax system progressive.

Gabriel Zucman and I estimate that by 2018, the tax rate at the very top, the 400 richest American, is now only 23 percent when you include all taxes at all levels—23 percent of their true economic income. That's lower than pretty much any other group on the income spectrum.

Q: You begin your book with an anecdote from the presidential debate that took place in September 2016, where Trump bragged that evading taxes makes him smart. What was so significant about that moment?

It summarized well the shift that we've seen, starting around 1980 with the election of Ronald Reagan. Before, the view was that taxes were a way you contribute to the public good. Higher-income people have more ability to contribute, therefore they should contribute more. That was the tax law and that's how the tax system was enforced. With Reagan saying "Government is the problem," paying taxes was no longer seen as a moral duty.

What was really striking in that exchange is that Hilary Clinton didn't have a good answer. She couldn't really say, "With my plan, that's no longer going to be the case. You [Trump] are going to pay a lot in taxes." It appeared, indeed, to the public that she's the Democratic candidate, but she wasn't necessarily going to fix that. If you were on the left, it was disheartening to see. More broadly, Trump could boast that that proves the system is rigged and that's why we need somebody totally different.

Q: The US tax system is generally considered to be progressive, but you argue that it's become increasingly regressive. You characterize it as a "giant flat tax—except at the top, where it's regressive." How so?

Some elements of the US tax system are progressive. In particular, the federal individual income tax—the most famous and visible tax—is quite progressive. Most statistics focus on this tax. Sometimes, they add other federal taxes, but they ignore state and local taxes that are very regressive because a large chunk of them are taxes on consumption, sales, and excise taxes that are paid disproportionately by the poor.

The second issue that is missed in official statistics is that, at the very top, reported income for the individual income tax does not represent the true economic income of the very wealthy. The best example of that is Warren Buffett, who has wealth of something like $80 billion and reported that his income was only like $11 million in 2015. That's minuscule. Normal return would be like five percent, so his true economic income is more like $4 billion.

And yet, Buffett reports only a minuscule fraction because, if you are very wealthy and your wealth is in a big business like Berkshire Hathaway, you don't need to realize income. If your business doesn't pay dividends and you don't sell your shares, your individual income is almost zero. That's what makes the system really regressive at the very top.

Q: Polls show that most of the American public —even a majority of Republicans—actually support higher taxes on the rich and corporations. Yet, as we saw with Trump's tax reform, the opposite is happening. How do you explain that?

The public understands that we have a problem with inequality, and one of the most obvious ways to remedy that is to ask a bigger contribution from the rich.

The reason it doesn't happen is that the rich are very organized to leverage their economic power into political power. They do it at two levels. One is [through] the public discourse: they are going to influence the media through think tanks, through thinkers that say that taxing the rich is actually very bad for the economy. Or, they would push the argument that it's impossible to tax the rich—if you try to tax them then the income, the wealth, is going to move abroad.

They've more or less managed to have a grip on the consensus in Washington. That was true for Democrats like Clinton and Obama, who were in the view that maybe you can tax the rich a little bit more, but you can't really do anything radical like what we used to have.

It's only in this election cycle that you see major candidates proposing much more radical plans for taxing the rich more.

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Q: Several people, among them Paul Volcker and even Warren Buffett, have said in recent years that the US is either becoming or has already become a plutocracy. You and Zucman have warned of an "oligarchic drift." Is the US a plutocracy?

In the US certainly, the wealthy have disproportionate political power. That's true everywhere, but when wealth is highly concentrated, like it is in the US, that effect is magnified. That's a constant that you see throughout history and that Thomas Piketty has described vividly in his two books.

Whenever wealth is highly concentrated, wealth is also powerful [enough] to shape political outcomes. That's the situation we are in. It's perhaps no coincidence that our president is a billionaire himself. It was thanks to his fortune that he was able to start and fund his campaign.

Even on the Democratic side, this round it's striking: There are perhaps 10 candidates left, and two of them are billionaires, when there are less than 1,000 billionaires in our country.

Q: So does that mean that the US is indeed in danger of becoming a plutocracy?

We are in the direction of becoming [a plutocracy], in the sense that we've observed in recent decades an increase in income and wealth concentration and decreases in tax progressivity and other policies, regulations, and labor market regulations, that tend to favor the wealthy. The biggest example would be the sharp decline in the minimum wage. Another one would be the weakening of union power.

You see the feedback loop: more income and wealth at the top are leading to policy outcomes that are more favorable to [those at the top]. That's what I would call an oligarchic or plutocratic drift.

Q: As you noted, many on the right and the left are convinced that taxing multinational corporations or the wealthy is virtually impossible, either because of widespread tax avoidance or international tax competition. Is it really impossible?

If there is one message in our book, it's that this type of thinking is wrong. It's true that this sort of thinking has taken hold of what you could call the global elites. It's not only the US but also in Europe: The European Union is built upon the idea that tax competition is inevitable and we shouldn't do anything to try and combat it.

That's where I feel like the world has been stuck. The way we've implemented globalization fosters tax competition and prevents countries from doing progressive tax policy that can correct the direct effects of globalization.

That's not a sustainable situation. Certainly, on the tax side, it is possible for countries to develop ways of successfully taxing the biggest winners of globalization.

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Q: Some commentators and economists have criticized your proposals and/or data. One criticism has been that wealth taxes have failed in European countries that tried them: France, Germany, Sweden. How can we make sure that wealth taxes in the US don't fail?

This is, indeed, a valid criticism. We have to learn the lessons why wealth taxes have failed abroad so that we don't repeat the same mistakes if we are to have a wealth tax in the US. In our view, the wealth taxes in Europe failed because they were not well-designed. They were very susceptible to tax competition. For example, if you moved from France to London, after one year you were no longer liable to the French wealth tax.

We could do things very differently. If the US were to impose a wealth tax, you would continue to be liable as a US citizen wherever you lived. You wouldn't be able to move away from the wealth tax. You would have to renounce your citizenship and even then you could still be hit by a big exit tax to make you pay for renouncing citizenship. That would be a powerful way to block the possibility of tax avoidance.

On the issue of offshore tax evasion, the wealthy putting their wealth in secret bank accounts in Switzerland or other tax havens, that was very easy to do in Europe. France, for example, didn't have ways to compel Switzerland or the financial institution in Switzerland to provide information on bank accounts held by wealthy French residents in Switzerland.

The US could do things differently. The Obama administration took a very important step with the Foreign Account Tax Compliance Act (FATCA), which said that any foreign financial institution that has accounts that belong to US residents must provide the information to the IRS. If they don't, they are going to suffer severe penalties on any financial transaction they do with the United States. Those big financial institutions started to comply because they understood that they are at a very high risk of leaks and if they don't comply, there's a really serious chance that they could be severely punished. That's one way to fight offshore tax evasion.

These two examples show that the critical aspect is the design and the enforcement. You can't say in absolute that wealth taxes will never work.

Q: One high-profile critique by Larry Summers says that the amounts you say your proposed wealth tax would bring are too high, because abuse and avoidance are so widespread. What makes you so sure that the wealth tax would bring as much income as you say it will?

On avoidance, it's possible that Larry Summers could be right. His numbers essentially mean that if the US does a wealth tax, there will be an 85-90 percent tax avoidance by the very wealthy, while we estimate that tax avoidance could be only 15 percent. Who is right is going to depend on the design and the enforcement.

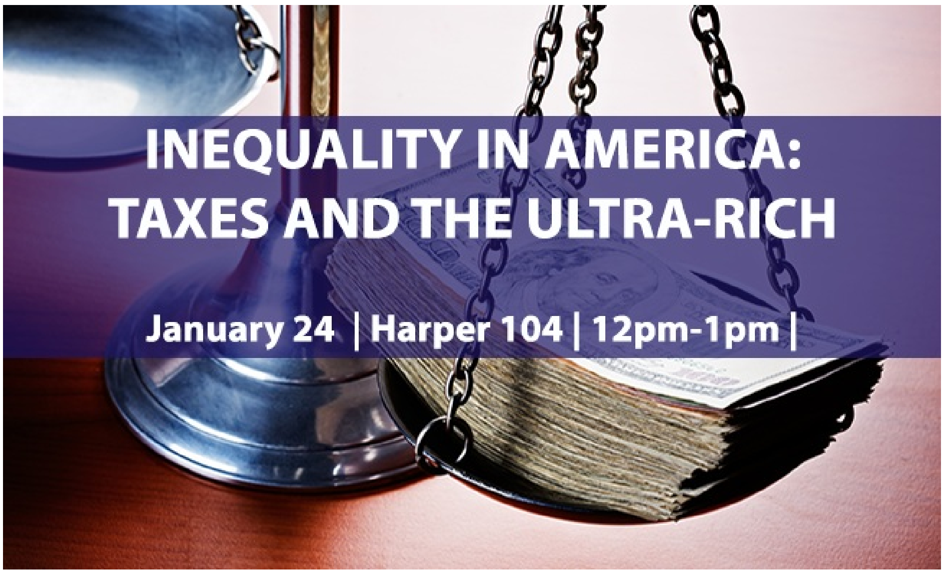
The candidates have said that they want a comprehensive tax base and strong anti-tax avoidance, anti-tax evasion measures. If that happens, we think evasion/avoidance would be low. But if the wealth tax were done like it was done in France, where it's easy to avoid and evade, and where there are very large exemptions, then you can lose an enormous fraction of the tax base and Summers's prediction would be right. For example, in France, assets of business owners who manage their businesses are exempt, which means that Jeff Bezos wouldn't be taxable by the wealth tax because all his wealth is tied in Amazon and he's managing the business.

It's an open question. We hope the wealth tax will be well-enforced, but there is a risk that it wouldn't.

Q: Do you think that the fact that many high-profile economists belong to the top one percent influence their perspective on issues like taxation and inequality?

I certainly think that economists belong to the happy class of the winners of these modern times. We are very well paid. We are part of the intellectual elite. For us, the world as it is works pretty well, and I think it influences the way we think about the system. Our economic models make sense for people like us. That probably contributes to creating a bias or at least a blindness to the situation of the broader economy and large fractions of the population.

In the book, we estimate that since 1980, the incomes of the bottom half of the US population have essentially stagnated in real terms. Half of the population has been shut off from economic growth. That's a striking figure, and I don't think economists are keenly aware of this fact. If you are, you immediately, objectively realize that we are not in a sustainable situation and that we need to think differently.



Q: Another issue is the lack of data on inequality and taxation, and disagreements about what kinds of data should be included in analyses. You, Zucman, and others have recently called it "the Dark Ages of inequality statistics."

We don't have perfect data to measure inequality. Nonetheless, when you look at the big body of work on inequality—and it's not just our work, it's hundreds if not thousands of studies—the overwhelming finding is that inequality is increasing sharply.

Like any science, for example climate change, you can perhaps make assumptions differently so that the picture doesn't look quite as bad. But to me, the body of work saying that inequality has not increased in the US is the equivalent of being a climate change denier.

Of course, as we've emphasized in our work, we'd like to get more data from governments. We think it should be the obligation of governments to provide more information.

That's also what sets us apart from the inequality deniers. If you read their studies, they essentially say, "We can't really know that well," but they never do the hard work that we've been doing, trying to improve things so we'd know better.

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Q: Many of your proposals are very ambitious. Do you see them as politically realistic, given the power that corporations and the wealthy have over the political system?

Well, I guess we're going to see. The first step is to debate the ideas in the press, in books, in academic work. Second, you need ambitious policy proposals developed by candidates. The hope is that if the democracy functions well and we elect a president and a Congress that want to do something, hopefully we can at least move towards that direction.

Q: You and Zucman are advising the Warren and Sanders campaigns, is that right?

We are not official advisors, but they've contacted us when they needed expertise on those issues of taxing the rich and, in particular, the wealth tax.

Q: Do you agree with Bernie Sanders that "billionaires should not exist"?

What I think is that billionaires should not stay billionaires for as long, and that's exactly what a sharply progressive wealth tax, like the one [Warren and Sanders] are proposing, would achieve.

With a high tax rate on billionaires, you can still become a billionaire. But if you are a billionaire, especially if you're a multibillionaire, you are going to have to pay a significant fraction of your wealth every year back to the government. Mark Zuckerberg would still have been able to create Facebook and become a multibillionaire, but as Facebook matures, if it doesn't keep growing, slowly the wealth tax is going to erode his wealth and he wouldn't stay a multibillionaire for as long.

What I want to point out is that the increase in wealth concentration has been so great that even if the Warren or Sanders wealth taxes had been in place since 1982, what those taxes would have achieved is that instead of having the share of wealth going to billionaires grow, it would've been stable. It wouldn't have eradicated billionaires, but would have kept them in check in terms of how much they weigh in the overall economy.

Q: Of course, some economists would argue that would have harmed economic growth.

If the next Mark Zuckerberg, working in his garage in Palo Alto right now, is thinking, "Wow, I see that Warren and Sanders are proposing wealth taxes, and if they get elected and if I create the next Facebook, I'll have to pay some of that back to the government. Therefore, I'm going to drop my startup business and become a university professor instead."—if that happens, then yes, you'd have an effect.

To us, that doesn't seem very realistic. When you are creating a startup, the wealth tax, especially a wealth tax on billionaires, is probably not a huge factor in your thinking.

From the New Deal to 1980, the US had very progressive taxes and was taxing the rich a lot, and that was a period with lots of innovation and very high, broadly-shared economic growth.

Q: We talked mostly about the US, but things like the tax avoidance industry and international tax competition are global problems—solving them would require a lot of international coordination. How do you envision a remedy to this?

We thought hard about that. Large countries, say the United States or the European Union as a bloc, have ways of moving unilaterally to change this. Indeed, that's something candidates are proposing already.

For example, if the US said, "US multinationals are going to have to pay 35 percent of their profits in taxes in any country they operate, and if the country already taxes them at 35 percent, the US is not going to add any extra tax. But if you are booking profits in a place that taxes you at five percent, the US is going to collect the 30 percent gap that you are not paying, relative to profits reported in the US."

That would be a very powerful way to police US multinationals. We describe this in the book, as well as how the US can deal with foreign multinationals operating in the US. We think a big country like the US doing that would have an enormous impact, demonstrating that you can tax multinationals and hopefully encourage others to follow suit.