The Daily Dish

Wealth Taxes and Workers

DOUGLAS HOLTZ-EAKIN | JANUARY 13, 2020

Eakinomics: Wealth Taxes and Workers

Friday AAF published an analysis of the proposed wealth taxes by Senators and presidential candidates Bernie Sanders and Elizabeth Warren, written by Gordon Gray and me. The taxes have similar structures, with increasing tax rates on wealth topping out at 8 percent (Sanders) and 6 percent (Warren).

The economic impact of these taxes is of interest because they constitute a reduction in the supply of capital, and as a result will reduce investment and innovation, lower productivity growth, and therefore reduce wage growth. Thus, while affluent households will send in the tax checks, these responses shift, at least in part, the effective burden of the taxes to the average worker.

Our estimates indicate that this shift is potentially quite large. In our base case, labor income falls by $1.6 trillion (Sanders) and $1.2 trillion (Warren) over the first ten years. Over the long haul, workers end up losing $0.63 for every $1 of wealth taxes collected.

In response, several questions have been raised:

1. How can a tax on a relative handful of individuals have such a large economic impact?

The key is that these individuals are targeted precisely because they own a disproportionate fraction of the investible capital in the economy. What matters is how much economic activity is taxed, not how many people are taxed. Also, the annual tax rates are quite draconian. If the rate of return on wealth is 8 percent (how many of you can find something with an 8 percent return these days?), the Sanders top tax is an effective rate of 100 percent on the return to capital. Draconian taxes on the return to a lot of capital have a big impact.

2. Doesn't this ignore the economic benefits of the programs the wealth taxes fund?

Our base case assumes the wealth tax revenue is handed back to households as transfer income (e.g., Social Security checks). In alternative scenarios we assume that the revenue is spent on a high-productivity government activity. The overall impact of the tax plus spend package is less negative, but that doesn't tell you anything about the wealth tax. It merely says that if the government has such productive opportunities, it makes more sense to finance them in a less destructive fashion.

3. Doesn't the transfer income outweigh the lost labor income, leaving households better off?

No. It works at first, but as the damage to investment, productivity, and real wage growth accumulates there is not enough transfer income to keep overall consumption from falling.

Even in the face of these findings, one might still argue that social justice demands that the wealth of the affluent be taxed. But it is a strange theory that argues the right way to make society better is to make everybody poorer.