

## Wealth Taxes and Workers

### Executive Summary

Senators and presidential candidates Elizabeth Warren and Bernie Sanders have recently proposed taxes on household wealth. Ostensibly, these taxes would impose the burden of government expansion on a small number of wealthy individuals. In reality, however, the disincentives created by the wealth tax would shift the burden of the tax away from its narrow base to affect the entire economy, as this study demonstrates.

Workers, in particular, would suffer from the loss of labor earnings created by less innovation and investment. In particular:

- The Warren wealth tax would cost workers \$1.2 trillion (in 2018 dollars) in lost earnings over the first 10 years, and ultimately, for every dollar of revenue raised, workers would lose more than 60 cents of earnings (see Executive Summary Table);
- The Sanders wealth tax would cost workers \$1.6 trillion (in 2018 dollars) in lost earnings over the first 10 years, and similarly impose over 60 percent of the burden of the proposal on workers (see Executive Summary Table);
- The magnitudes of the results are large despite a conservative approach to the analysis; and
- This study indicates that if the federal government needs to raise more revenue, these specific proposals are poorly designed and would have a uniquely negative impact on workers' real wages – ultimately imposing an effective tax of 63 cents on workers for every dollar the government raises in revenue from the wealthy.

<b>Executive Summary Table</b>		
	Warren	Sanders
Wealth Tax Revenue		

(\$ billions)		
2021-2025	\$1,498	\$1,882
2026-2030	\$1,754	\$2,205
2021-2030	\$3,252	\$4,087
Long Run* (annually)	\$380	\$478
Lost Labor Income (\$ billions)		
(% of Wealth Tax)		
2021-2025	\$437 (29%)	\$625 (30%)
2026-2030	\$785 (45%)	\$999 (45%)
2021-2030	\$1,222	\$1,624
Long Run (annually)	\$241 (63%)	\$301 (63%)

*\*Long Run indicates the impact after the economy has fully adjusted to the tax.*

## **Introduction**

Senators and presidential candidates Elizabeth Warren and Bernie Sanders have proposed new taxes on household wealth, with the stated goal of raising large amounts of revenue from a small number of affluent households. These wealth taxes impose high effective rates on investment returns of a narrow segment of the population. But more fundamentally the tax constitutes a reduction in the supply of capital, and as a result it will reduce investment in innovation, lower productivity growth, and thus reduce wage growth. These responses shift, at least in part, the effective burden of the taxes to the average worker.

This economic logic does not depend on a particular “model” or specific computer simulation. The reality of a market economy is simply at odds with the assertion that workers can be insulated from a significant change in the environment in which their work facilities, capital equipment, and intellectual property is accumulated. The only remaining question is the magnitude of the burden shifted to workers.

The American Action Forum (AAF) examines that magnitude in this analysis. The report is organized as follows. It first briefly describes the proposed wealth taxes by Warren and Sanders. Next, it describes the methodology employed in the study –

choosing an independent entity to do the formal modeling and assumptions that describe a reasonable base case that isolates the effects of the tax. In the next two sections, it covers the basic results and provides some sensitivity analysis. The final section summarizes and concludes. Included as Appendices is the entire work product exactly as provided to AAF by the modelers.

## **Description of the Proposals**

Senator Elizabeth Warren’s proposed wealth tax would apply to U.S. households with net wealth above \$50 million. The top rate is 6 percent. The wealth tax rate would start at 2 percent on wealth above \$50 million and rise to 6 percent on wealth above \$1 billion. The proposal does not distinguish between married and single taxpayers. Impacts are estimated assuming the tax is imposed beginning in 2021 and that the tax bracket thresholds would not be indexed for inflation.

Senator Bernie Sanders has proposed a wealth tax that would apply to U.S. households with net wealth above \$32 million. Its top rate would be 8 percent. In contrast to the Warren proposal, Sanders’s wealth tax distinguishes between married and single taxpayers. For taxpayers filing jointly, the wealth tax rate would be 1 percent of wealth from \$32 million to \$50 million, 2 percent of wealth from \$50 million to \$250 million, 3 percent of wealth from \$250 million to \$500 million, 4 percent of wealth from \$500 million to \$1 billion, 5 percent of wealth from \$1 billion to \$2.5 billion, 6 percent of wealth from \$2.5 billion to \$5 billion, 7 percent of wealth from \$5 billion to \$10 billion, and 8 percent of wealth over \$10 billion. The tax bracket thresholds for single taxpayers would be half those of taxpayers filing jointly. Impacts are estimated assuming the tax is imposed beginning in 2021 and that the tax bracket thresholds would not be indexed for inflation.

## **Analytic Strategy**

To move past a qualitative discussion of the wealth tax requires a formal model of the U.S. economy. AAF retained Robert Carroll, James Mackie, and Brandon Pizzola of EY’s Quantitative Economics and Statistics (QUEST) Group to conduct the analysis precisely because their “overlapping generations model” (see the Appendices) is similar to those used by the non-partisan Congressional Budget Office, the non-partisan Joint Committee on Taxation, and the U.S. Treasury Department. It thus embodies the consensus impacts in the research literature.

## **Base Case**

As a base case, AAF assumes that affluent households are able to legally avoid 15 percent of the wealth tax, which conforms to the official Warren and Sanders estimates. This assumption avoids the unrealistic (in AAF’s view) assumption of no

avoidance whatsoever but acknowledges that a new enforcement regime may be able to improve compliance. Regarding the disposition of the revenue, it is assumed that the wealth tax revenue is given back to the household sector as transfer payments; i.e., the government taxes the money away and then gives it right back. This assumption helps to isolate the impact of the wealth taxes without conflating the possibly productivity-enhancing effects of government spending with the wealth tax effects.

In addition, AAF views the underlying model used to analyze the effects of the wealth tax as conservative because it is built on the assumption that one-half of households are non-savers. These households are not, as a result, directly influenced by the changes in the net rate of return to capital that are central to our interpretation. This assumption tends to reduce the likely impact.

### **Base Case Results**

The basic results are contained in Table 1 (Warren) and Table 2 (Sanders). Consider Table 1. The first row shows that the wealth tax reduces the level of gross domestic product (GDP) by an average of 0.6 percent annually over the first five years, 0.8 percent annually over the second five years, and 1.0 percent annually over the long run (with “long run” meaning the effect of the tax after the economy has fully adjusted to it). These rate declines translate into corresponding losses of \$706 billion in GDP over the first five years, \$1.1 trillion over the second five years, and then \$283 billion annually over the long run (in 2018 dollars).

The next row shows the impact on consumption, which gets an initial boost because 50 percent of households will simply spend the transfer payments from the government. By the second five years, however, this effect gets outweighed by the smaller economy and reduced labor income. Over the long run, consumption declines by 1.0 percent.

Rows 3 and 4 indicate that (as expected) the incentives to invest are diminished, with the result that the capital stock is smaller than it would otherwise be. Over the long run, both decline by 1.7 to 1.8 percent.

The reduced accumulation of capital translates directly into lower productivity and real wages. Rows 5 and 6 show that the reduced real wages diminish the number of people working and their average hours of work – amounting to diminished total labor supply of 0.5 percent over the long run. Total labor earnings also decline markedly, down an average of 0.7 percent annually in the first five years, 1.1 percent annually over the second five years, and 1.6 percent annually over the long run.

These losses in labor income amount to \$437 billion in the first five years, \$785 billion in the second five years, and \$241 billion (annually) over the long run. Compared with estimated wealth tax receipts (row 7), the earnings losses imply that

workers are bearing a burden of the tax ranging from 29 percent in the near term to 63 percent over the long run.

In short, over the long run Warren’s wealth tax is more damaging to workers than anyone else.

<p style="text-align: center;"><b>Table 1</b>  <b>Impact of Warren Wealth Tax</b>  (\$ billions)</p>						
	<b>2021-25 (average annual loss)</b>	<b>2026-30 (average annual loss)</b>	<b>Long Run (annually)</b>	<b>2021-25 (cumulative)</b>	<b>2026-30 (cumulative)</b>	<b>Long Run (annually)</b>
GDP	-0.6%	-0.8%	-1.0%	-\$706	-\$1,075	-\$283
Consumption	0.3%	-0.3%	-1.0%	\$240	-\$274	-\$193
Private Investment	-5.2%	-3.4%	-1.8%	-\$1,050	-\$785	-\$88
Private Capital Stock	-0.2%	-0.7%	-1.7%	-\$532	-\$2,129	-\$1,090
Labor Supply	-0.8%	-0.7%	-0.5%			
Labor Income	-0.7%	-1.1%	-1.6%	-\$437 29%	-\$785 45%	-\$241 63%
Tax Revenue				\$1,498	\$1754	\$380

Table 2 tells precisely the same story, with the bad news coming in bigger magnitudes due to the higher wealth tax rates. In short, the Sanders wealth tax is even worse for workers than anyone else.

<p style="text-align: center;"><b>Table 2</b>  <b>Impact of Sanders Wealth Tax</b>  (\$ billions)</p>						
	<b>2021-25 (average annual loss)</b>	<b>2026-30 (average annual loss)</b>	<b>Long Run (annually)</b>	<b>2021-25 (cumulative)</b>	<b>2026-30 (cumulative)</b>	<b>Long Run (annually)</b>
GDP	-0.8%	-1.0%	-1.3%	-\$941	-\$1,344	-\$368
Consumption	0.4%	-0.4%	-1.3%	\$320	-\$366	-\$251
Private Investment	-6.6%	-4.5%	-2.3%	-\$1,333	-\$1,038	-\$112
Private Capital Stock	-0.2%	-0.9%	-2.2%	-\$532	-\$2,738	-\$1,411

Labor Supply	-1.0%	-0.9%	-0.6%			
Labor Income	-1.0%	-1.4%	-2.0%	-\$562 30%	-\$999 45%	-\$301 63%
Tax Revenue				\$1,882	\$2,205	\$478

## Sensitivity of Results

As noted above, the numerical results are expected to change in response to differing assumptions. This analysis focuses on three kinds of sensitivities: 1) more or less tax avoidance, 2) more or less productivity-generating government spending, and 3) more or less responsiveness by individuals to tax-based incentives. The Appendices contains a complete documentation of these variants.

The results are as one would expect. Higher productivity from government spending tends to offset the loss of productivity from the wealth taxes *per se*, diminishing the loss in labor earnings and the fraction of the burden shifted to labor. In the extreme, one could hope for productivity effects large enough to offset the wealth taxes entirely.

Increased avoidance lowers the effective taxation of wealth and diminishes the impacts on capital accumulation and labor; the reverse is true for less avoidance. In the same way, having households be more sensitive to the after-tax return to capital raises the level of impact on workers, and *vice versa*.

Another issue is the mix of capital income that is a “normal” return as opposed to a “supra-normal” return. The former is the risk-free opportunity cost of funds, while the latter is composed of a mix of economic rents (pure profits) and a risk premium. Of note, only the tax burden on the “normal” return creates a disincentive to save and invest. To check the sensitivity, and based on an average of the results in the literature, a scenario was run that assumed that 70 percent of the overall return to capital is the “normal” return. The impacts on GDP were similar but somewhat smaller. (See the Appendices for details.)

## Conclusion

To date, the discussion of the Warren and Sanders wealth taxes has focused on issues such as “fairness” – always in the eye of the beholder – constitutionality, and the ability of individuals to legally avoid the taxes. These are important issues but miss some basic nuts and bolts of tax policy. Good tax policy has a broad base and low rates, thereby minimizing the distortions of economic incentives.

On the former, note that if the annual rate of return to capital is 6 percent, the Warren top rate constitutes a 100 percent tax rate on the return to capital, while the

Sanders top rate is fully 133 percent. While only a small segment of the population would be subject to this top rate, its wealth holdings constitute a significant share of the investable wealth in the economy. As a matter of construction, the proposed taxes are a significant distortion of the economic incentives presented to capital accumulation in the United States.

AAF's assessment of how the economy will respond to these taxes indicates they will have broad impacts. In particular, the Warren and Sanders wealth taxes will mean an effective tax as large as 63 cents on American workers for every dollar the wealth tax raises in revenue.

There are many ways to raise revenue, and many of these are highly progressive. This examination of the potential effects of the Warren and Sanders wealth tax proposals suggests, however, that the impact of a tax targeting much of the economy's investable capital imposes a disproportionate burden on workers.