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Too little, too late

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Too Little, Too Late: The Uneasy Case for a Wealth Tax as a Means to Mitigate Inequality

Laurens W.D. Wijtvet*

Economic inequality looming large, wealth tax is often applauded as a means to mitigate inequality and to break up large concentrations of wealth. This article argues that the advent of a wealth tax should nevertheless be met with scepticism and questions the suitability of a wealth tax to mitigate inequality. It is argued that a wealth tax does not offer a sustainable contribution to the pressing problem of inequality, because: (1) it fails to address the root causes of inequality, which are institutional, and (2) it leaves intact the conditions in the income tax that incite inequality. Instead, it is advisable to put a first break on wealth formation by implementing a comprehensive income tax before resorting to ultima remedia such as a wealth tax.

I INTRODUCTION

In a recent speech delivered at THEARC in Washington DC, US President Barack Obama expressed serious concerns about how economic inequality threatens the prospects of many people, stating that ‘the basic bargain at the heart of our economy has frayed’.¹ He is not the only one. At the 2014 World Economic Forum in Davos, income inequality was characterized as the risk ‘most likely to cause serious damage globally in the coming decade’.² The widening gap between rich and poor has also incited feelings of injustice among the masses. As illustrated by a recent Oxfam poll, people in all regions of the world worry about increasing inequality. Moreover, there appears to be an overwhelming sentiment that laws and regulations are designed as to benefit the rich.³

To turn the tide of increasing inequality, wealth taxes are often championed. Wealth taxes come in various flavours and cover a wide array of taxes. For the purposes

of this article, the wealth tax is defined as a net wealth tax, which is an annual tax on the net value of an individual’s assets. Both terms will be used intertwined. With its recent (re)introduction in Spain and Iceland and comparable ideas buzzing around in Germany, the wealth tax has gained momentum and is at centre stage when it comes to curbing large concentrations of wealth and reducing inequality.⁴ Moreover, given its large revenue potential, the wealth tax can be a welcome addition to the tax system for governments looking to increase their tax revenues.⁵

In spite of all this praise, it can be doubted whether the wealth tax should be so unconditionally accepted as a panacea for inequality. Rather, some scepticism is called for as it can be asked whether the wealth tax can really solve the apparently pressing problem of inequality. This article therefore questions the potential of a net wealth tax as a structural and sustainable measure against inequality. It is argued that the wealth tax cannot contribute to a

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¹ Whitehouse.gov, *Remarks by the President on Economic Mobility*, <http://www.whitehouse.gov/the-press-office/2013/12/04/remarks-president-economic-mobility>.

² BBC, *Davos 2014: Widening wealth gap ‘biggest risk’ in 2014* (16 Jan. 2014), <http://www.bbc.com/news/business-25761517>.

³ Oxfam, *Working for the Few: Political capture and economic inequality*, 178 Oxfam Briefing Paper 10 (20 Jan. 2014).

⁴ For example, Stefan Bach, Martin Beznoska & Viktor Steiner, *A Wealth Tax on the Rich to Bring Down Public Debt? Revenue and Distributional Effects of a Capital Levy in Germany*, 35 *Fiscal Stud.* (2014). In his masterpiece *Capital in the Twenty-First Century* (The Belknap Press of Harvard University Press 2014) Piketty likewise breaks a lance for the taxation of wealth.

⁵ Estimates by the International Monetary Fund reveal that a 1% tax on the net wealth of the wealthiest 10% of household could raise approximately 1% of GDP per year. See International Monetary Fund, *Fiscal Monitor October 2013: Taxing Times* 39 (International Monetary Fund World Economic and Financial Services, Publication Services 2013).

sustainable solution to the pressing problem of inequality.⁶ The rationale is twofold. First and foremost, the net wealth tax fails to grasp the root causes of inequality, which are institutional and for the most part outside the scope of the tax system. Second, as far as the tax system is concerned, inequality stems from an unequal treatment of income from labour and income from capital and a failure to implement a comprehensive income tax. As long as this systemic flaw persists, a net wealth tax is merely a treatment of symptoms.

The remainder of this article is structured as follows. Section 2 provides a short overview of the development of inequality of wealth in recent years. Section 3 discusses why a reduction of inequality would be desirable. Moreover, some of the reasons cited to justify wealth taxes pass in review. In order to investigate whether a net wealth tax can meaningfully reduce inequality, inequality's causes and their relation to the tax system are subsequently analysed in section 4. Section 5 argues that – at the end of the day – the net wealth tax is merely a drop in the ocean because it fails to address the root causes of inequality. Section 6 contains a brief conclusion.

This article – it should be stressed – is not intended to be an argument for or against more or less inequality. It merely attempts to challenge the apparent role that a net wealth tax is sometimes attributed as a means to mitigate inequality.

2 THE DISTRIBUTION OF WEALTH

The unequal distribution of wealth appears to be a world-wide phenomenon. In a recent series of studies on economic growth and income inequality conducted under

auspices of the OECD, researchers found that wealth is very concentrated. In all countries investigated, the bottom 50% households in the wealth distribution were found to hold only a tiny fraction of all wealth, whereas the top 10% owned up to 70%.⁷ In the United States, the 1% wealthiest Americans possess 31% of the country's total wealth. In other countries, the study found the top 1% to represent between 10% and 20% of all wealth.⁸

Davies *et al.* investigated the level of average household wealth for thirty-nine countries world-wide. Using purchasing power parity (PPP) valuations, the authors 'estimate that the top 10% of adults in the world owned 71% of household wealth in the year 2000 and that the Gini-coefficient for global wealth holdings was 0.802'.⁹ They further observe that wealth is more unequally distributed than income, which – according to another study by Milanovic¹⁰ – amounts to 0.642 and 0.795 on PPP and exchange rate basis respectively. Davies *et al.* further suggest that within-country differences in wealth-holdings are an important component of world wealth inequality.¹¹

In its 2013 Global Wealth Report, Credit Suisse likewise illustrates wealth's unequal distribution, showing that the top 8.4% of the world's population owned 83.3% of the world's assets, as opposed to only 3% in the hands by the bottom 70%.¹²

Data for the Netherlands appear in line with the above. Table 1 below provides an overview of the distribution of wealth in the Netherlands over the period 2007–2011.¹³ As can be inferred from this table, households in the top three deciles of the income distribution held almost 60% of all wealth during the years observed. The top 10% represented an average wealth of 34.47% of all wealth in the Netherlands during the same period.

Notes

⁶ It is submitted that in literature various other justifications for a net wealth tax have been put forward. An in-depth treatment of these justifications is outside the scope of this article. To this end, the reader is referred to the literature cited in this article. An extensive overview worth reading is provided by Tipke. See Klaus Tipke, *Die Steuerrechtsordnung - Band II: Steuerrechtfertigungstheorie, Anwendung auf alle Steuerarten, sachgerechtes Steuersystem* 768-808 (Verlag Dr. Otto Schmidt 1993).

⁷ Kaja Bonlesmo Fredriksen, *Less Income Inequality and More Growth – Are they Compatible? Part 6. The Distribution of Wealth* 5–6 (OECD Economics Department Working Papers, No. 929, OECD Publishing 2012).

⁸ *Ibid.*, 9.

⁹ James B. Davies, Susanna Sandström, Anthony Shorrocks & Edward N. Wolff, *The Level and Distribution of Global Household Wealth*, Econ. J. 121, 250 (March 2010).

¹⁰ Branko Milanovic, *Worlds Apart: Measuring International and Global Inequality* (Princeton University Press 2005). Davies reports the Gini coefficient for wealth to range between 0.50 and 0.80 in OECD countries. The range for disposable income is about 0.30 to 0.50. See James B. Davies, *Wealth and Economic Inequality*, in Wiemer Salverda, Brian Nolan & Timothy M. Smeeding, *The Oxford Handbook of Economic Inequality* 127 (Oxford University Press 2009). Also: James B. Davies & Anthony Shorrocks, *The Distribution of Wealth*, in *Handbook of Income Distribution: Volume 1* 605–675 (Anthony B. Atkinson & Francois Bourguignon eds., Elsevier Science 2000). Also: International Monetary Fund, *supra* n. 5, at 38.

¹¹ Davies *et al.*, *supra* n. 9, at 251.

¹² Credit Suisse, *Global Wealth Report 2013* at 22 (Credit Suisse 2013).

¹³ The percentages shown in the table are based on the author's calculations using data retrieved from the Statline Database at <http://statline.cbs.nl/StatWeb/publication/?VW=T&DM=SLNL&PA=80048NED&D1=1,3-4&D2=a&D3=0&D4=a&HD=130816-1116&HDR=G2,T&STB=G3,G1> (accessed 26 Mar. 2014). These numbers do not include – *inter alia* – pension claims and other old age provisions.

Table 1 *The Distribution of Wealth in the Netherlands 2007–2011*

Income Group	% of Wealth (2007)	% of Wealth (2008)	% of Wealth (2009)	% of Wealth (2010)	% of Wealth (2011)
1st 10% (low income)	3.54%	3.76%	4.16%	4.29%	4.21%
2nd 10% (income)	3.12%	2.96%	3.36%	3.02%	3.47%
3rd 10% (income)	3.73%	3.35%	4.26%	4.16%	4.55%
4th 10% (income)	5.42%	5.69%	5.61%	5.77%	5.74%
5th 10% (income)	6.66%	7.12%	7.27%	7.01%	6.94%
6th 10% (income)	7.96%	7.55%	7.94%	8.01%	7.83%
7th 10% (income)	8.56%	8.85%	9.27%	9.11%	8.71%
8th 10% (income)	11.41%	10.71%	11.11%	10.62%	10.28%
9th 10% (income)	14.86%	13.51%	13.89%	14.42%	13.86%
10th 10% (high income)	34.74%	36.50%	33.12%	33.59%	34.41%

Even in traditionally egalitarian countries such as the Netherlands, wealth is thus concentrated in the hands of a few, which may seem rather counter-intuitive. This peculiarity nevertheless appears omnipresent in welfare states. For a group of nine so-called Rhineland welfare states,¹⁴ Van Bavel and Frankema show that the inequality of the distribution of wealth might even exceed numbers

previously found by other researchers, reporting Gini-coefficients as high as 0.89 (Sweden; 2002), 0.78 (Germany; 2002) and 0.82 (the Netherlands; 2009).¹⁵ The authors hypothesize that the importance of collective arrangements and the way the tax system is set up to finance them may not only reduce incentives to save for unemployment, illness, old age and education. It could also favour private debt-creation. Moreover, the predominant taxation of labour and consumption to finance the welfare state is believed to reduce opportunities for low income groups to save and build wealth, while it does enable the wealthy to expand their fortunes.¹⁶

Piketty and Zucman observe a gradual rise of aggregate (household wealth) / (household income) ratios from about 200%–300% in 1970 to 400%–600% in 2010,¹⁷ especially in Continental Europe.¹⁸ These ratios indicate that national savings by far exceed national income. Piketty and Zucman argue that these ratios may be returning to the high values that were observed in Europe in the eighteenth and nineteenth century, i.e., about 600%–700%, signalling the potential dominance of inherited wealth in the future. The return of high aggregate (household wealth) / (household income) ratios ‘raises new issues about capital taxation and regulation’.¹⁹ Piketty and Zucman expect wealth to play a significant role in the overall structure of inequality in the twenty-first century and perceive a potential role for progressive capital and inheritance taxation that can help to reduce wealth concentrations in the long run. Besides this empirical trend, Piketty also mentions the currently unsatisfactory state of optimal capital taxation theories that are expected to undergo major developments in the future as a reason for increased attention for capital taxes.²⁰ In his magnum opus *Capital in the Twenty-First Century* he likewise promotes a global progressive tax on capital.²¹

Generally, wealth appears to be distributed unequally and often concentrated in a few hands. Moreover, even though high incomes can be earned through work, as will be illustrated in section 4 below, the bulk of the highest incomes comes from capital.²² However, the skewed

Notes

¹⁴ These ‘Rhineland welfare states’ include Denmark, Sweden, Switzerland, Austria, Germany, Belgium, the Netherlands, Norway and Finland. Such welfare states are characterized by ‘socio-economic policies that prioritize employment protection, income redistribution and encompassing systems of social security based on political cooperation between various stakeholders in the labour market’. See Bas van Bavel & Ewout Frankema, *Low Income Inequality, High Wealth Inequality. The Puzzle of the Rhineland Welfare States 3* (CGEH Working Paper Series, Working paper no. 50, November 2013).

¹⁵ Van Bavel & Frankema, *supra* n. 14, at 3–10.

¹⁶ *Ibid.*, 11–12.

¹⁷ Thomas Piketty & Gabriel Zucman, *Capital is Back: Wealth-Income Ratios in Rich Countries 1700–2010*, 129 Q. J. Econ. 1257 (2014). See also: Piketty, *supra* n. 4, at 25–27 and chs. 5 and 6.

¹⁸ See also Thomas Piketty, *Commentary by Thomas Piketty*, in *Dimension of Tax Design. The Mirrlees Review 827* (J.A. Mirrlees ed., Oxford University Press 2010).

¹⁹ Piketty & Zucman, *supra* n. 17, at 3. On a side note: Piketty & Zucman authors do not explicitly state what they consider capital taxation to encompass.

²⁰ Piketty, *supra* n. 18, at 825.

²¹ Piketty, *supra* n. 4, at 515–539.

²² Davies, *supra* n. 10, at 128.

distribution of wealth cannot in itself justify its taxation and a reduction of differences in wealth holdings. Nor can potential revenues and apparent budgetary wants justify the existence or the enactment of a net wealth tax in particular: they can merely justify taxation in general.²³ In the author's opinion, simply stating that people's wealth is 'where their money is' constitutes a rather cynical approach to taxation that fails to justify a particular wealth tax. Another pretext for taxing wealth and mitigating wealth inequality is thus required.

In this regard, research has revealed certain drawbacks to wealth inequality and highlighted potential threats inequality can pose to society, which could arguably justify taxing wealth. Roughly speaking, these drawbacks are of a social, democratic and economic nature. These elements will be discussed next.

3 INEQUALITY'S UNDESIRABLE SIDE-EFFECTS

3.1 Introduction

The previous section illustrated how wealth is distributed unevenly across the population. Moreover, as was discussed in the Introduction, inequality has stirred up feelings and many expect much good to come from a wealth tax as a solution to the pressing question of inequality. The use of the tax system to reduce inequalities of wealth requires a contextual pretext and presupposes a pressing social need ensuing from the prevalence of widespread and undesirable inequalities of wealth. A rather straightforward explanation would suggest that inequality of accumulation occurs as a by-product of the free market and the capitalist system itself. In this view, private wealth is an outcome of social conditions that society can simply distribute at will.²⁴ Society thus has an interest in accumulated wealth that it has largely produced itself.²⁵ This argument, however, can only morally justify taxation as such. It fails to explain why a redistribution of wealth and a reduction of wealth inequalities would be desirable. A pretext can be found in the potential dangers inequality entails.

Although a certain degree of inequality is inevitable and arguably desirable and vital to economic progress,²⁶ inequality has on various occasions been linked to a myriad of defects of social, democratic and economic nature. Cheryl Cole's lyric 'too much of anything can make you sick' thus appears to have a germ of truth in it. The remainder of this section will discuss this wide array of dangers that have been cited in literature.

3.2 Wealth Inequality's Social Economic Dimension

3.2.1 Social Dysfunctionalities

Various authors have underscored the adverse societal and economic consequences inequality can have. To an extent, these consequences appear intertwined and they will therefore be discussed together. A case in point is delivered by Richard Wilkinson and Kate Pickett, who show a wide range of social dysfunctionalities – from mental illness to drug abuse and from obesity to teen pregnancy – to be more prevalent in more unequal rich countries.²⁷ Wilkinson and Pickett argue that these problems exist regardless a country's absolute income levels. Rather, a person's relative position on the income ladder appears to be decisive. As the prevalence of the above-mentioned dysfunctionalities also affects the rich, they too would benefit from reduced inequality.

3.2.2 Economic Growth

Inequality is further related to countries' reduced economic performance. Based on a review of thirty-six studies on the relationship between inequality and economic growth, Caron and Repetti found that inequality hampers economic growth in the long run. Similar results were observed for concentrations of income and wealth, which also appear to be bad for growth.²⁸ A recent paper by Ostry *et al.* shows lower net inequality to

Notes

- ²³ Compare Tipke, *supra* n. 6, at 537–539 and 773, who rhetorically asks 'Der Gesetzgeber kann alle Steuergerechtigkeitserwurgen in den Wind schlagen, wenn er sich zur Ausschopfung einer Steuerquelle aus Grunden des Steuerbedarfs oder wegen der Ergiebigkeit der Steuerquelle entschliet (...)?'
- ²⁴ Reuven S. Avi-Yonah, *The Three Goals of Taxation*, 60 Tax L. Rev. 1, 13 (2006–2007). See also Erik Nelson, *Two Stories of Taxation of Capital*, 16 Lewis & Clark L. Rev. 1049 (2012).
- ²⁵ Mark L. Ascher, *Curtailing Inherited Wealth*, 89 Mich. L. Rev. 69, 87 (1990–1991).
- ²⁶ Economic inequality can, for example, spur economic activity and good private enterprise. In this regard, the OECD in its 2008 report *Growing Unequal* states that 'A society in which income was distributed perfectly equally would not be a desirable place either. People who work harder, or are more talented than others, should have more income. What matters, in fact, is *equality of opportunity*, not equality of outcomes.' See OECD, *Growing Unequal? Income Distribution in OECD Countries* 16 (OECD Publishing 2008). See also Paul L. Caron & James R. Repetti, *Occupy the Tax Code: Using the Estate Tax to Reduce Inequality and Spur Economic Growth*, 40 Pepp. L. Rev. 1255, 1264 (2013) and the literature there cited.
- ²⁷ Richard Wilkinson & Kate Pickett, *The Spirit Level: Why Greater Equality Makes Societies Stronger* (Bloomsbury Press 2010).
- ²⁸ Caron & Repetti, *supra* n. 26, at 1264–1274.

be robustly correlated with faster and more durable growth, for a given level of redistribution.²⁹

Remarkably, various studies have found high tax rates not to play a negative role in this respect.³⁰ Some studies even suggest that higher taxes correlate with higher growth.³¹ Although short-term studies provided mixed results, a three-year period study by Morck, Strangeland and Yeung suggests that per capita GDP in countries at a similar level of development grows faster if self-made billionaire wealth is a larger fraction of GDP and slower for larger fractions of inherited wealth.³²

In a similar vein, Caron and Repetti argue that when inequality persists across generations, its adverse effects can be especially pernicious. They discuss a number of studies that show that upward social mobility can be hampered in more unequal societies.³³ Wilkinson and Pickett find comparable results, implying that lack of upward social mobility is correlated to inequality.³⁴

Taking into account that wealth is frequently inherited and dynastic,³⁵ inequality's impact on upward mobility is likely to be stronger in case of dynastic wealth as compared to wealth held by different families in successive generations. Repetti observes that dynasties could severely limit the chances of other families 'moving up the ladder' and could decrease pluriformity of society:

Where different families hold wealth each generation, it is likely that each new family will bring new perspectives, life experiences, and concern to the political process and the media. Moreover, since the wealth will have been created by those that possess it, it is likely that such wealthholders also will have significant talents. In contrast, where wealth simply is transmitted from a generation that created it to subsequent generations in the same family, it is less certain that the subsequent generations will have new perspectives, life experiences, or great talent. (...) Families seeking to preserve their power may exercise it to prevent others from acquiring wealth.

This would decrease diverse views and ideas which help create a vibrant society.³⁶

Another social downside of inequality mentioned in literature stems from the potential ability of the rich 'to use their wealth to acquire goods and to contribute to charities',³⁷ which some believe to lead other people to court such acquisitions and contributions.

Partisans of net wealth taxes claim that such taxes 'would siphon off the fuel for these publicly hurtful ventures'.³⁸ A case in point is US Attorney General Ramsey Clark's 1976 proposal for an annual net wealth tax. Clark declared that economic justice 'required the leveling of America's wealthiest families through taxation so that the vast economic power of this group would be prevented from perpetuating itself from generation to generation'.³⁹ In Clark's opinion the estate and gift taxes failed to check extraordinary concentrations of fortune and thus needed to be supplemented by an annual tax on wealth.

3.2.3 Market Power

In a market society, the affluent can further use their wealth to invest in enterprises that employ great multitudes and that can dominate large sectors of the economy. Moreover, it is feared that the rich may use their fortunes in order to 'manipulate markets and reap supercompetitive returns at the expense of less muscular market actors',⁴⁰ which would result in price distortions and inefficient resource allocations. Where corporate power can be checked by anti-trust laws and ultimately the dismantling and splitting up of market players that become too powerful,⁴¹ there are no such laws to curb individual's excessive powers. As Mombrun aptly states:

There is a danger that just as corporate greed can lead a corporation or a few corporations to dominate a segment of

Notes

²⁹ Jonathan D. Ostry, Andrew Berg & Charalambos G. Tsangarides, *Redistribution, Inequality, and Growth*, IMF Staff Discussion Note, SDN/14/02, February 2014, at 6.

³⁰ For example, Charles B. Garrison & Feng-Yao Lee, *Taxation, Aggregate Activity and Economic Growth: Further Cross-Country Evidence on Some Supply-Side Hypotheses*, 32 *Econ. Inquiry* 172 (1992).

³¹ Roberto Perotti, *Growth, Income Distribution and Democracy: What the Data Say*, 1 *J. Econ. Growth* 149, 170 (1996).

³² Randall K. Morck, David A. Stangeland & Bernard Yeung, *Inherited Wealth, Corporate Control, and Economic Growth: The Canadian Disease* (NBER Working Paper No. 6814, November 1998).

³³ Caron & Repetti, *supra* n. 26, at 1262–1264.

³⁴ Wilkinson & Pickett, *supra* n. 27, at 157–169.

³⁵ In 2010, the top ten of the Dutch Quote 500 was almost solely populated by families or heirs to family fortunes.

³⁶ James R. Repetti, *Democracy, Taxes, and Wealth*, 76 *N.Y.U. L. Rev.* 825, 850 (2001).

³⁷ Reuven S. Avi-Yonah, *Why Tax the Rich? Efficiency, Equity, and Progressive Taxation*, 111 *Yale L.J.* 1391, 1406 (2002).

³⁸ Eric Rakowski, *Can Wealth Taxes be Justified?* 53 *Tax L. Rev.* 263, 292 (1999–2000).

³⁹ Barry L. Isaacs, *Do We Want a Wealth Tax in America?* 32 *U. Miami L. Rev.* 23, 24 (1977–1978).

⁴⁰ Rakowski, *supra* n. 38, at 292.

⁴¹ An example is John D. Rockefeller's *The Standard Oil Company*, whose curtains as the world's first and largest multinational corporation fell when the US Supreme Court ruled that Standard held an illegal monopoly position under the Sherman Antitrust Act and subsequently ordered its breaking up into ninety independent companies. See *Standard Oil Co. of N.J. v. United States*, 221 U.S. 1 (1911) and *United States v. N. Sec. Co.*, 193 U.S. 197 (1904).

the economy and produce anti-competitive tendencies resulting in economic inefficiency, the same can happen with unchecked individual greed. The government deals with corporate greed through anti-trust laws. There is no such law for individuals. Estate taxation is the only check on uncontrolled wealth accumulation. At the very least, it serves as a warning to the next generation that the wealth of the previous generation may not be passed on wholly. Thus, if the next generation wants to keep the lifestyle they have become accustomed to, they need to add value to their inheritance.⁴²

3.3 Democratic Deficiency

Apart from inequality's impact on the prevalence of social dysfunctions and its negative economic impact, large concentrations of wealth are sometimes said to be at odds with elective and representative government because they can give the wealthy disproportionate political power and influence.⁴³ As US Supreme Court Justice Louis Brandeis is attributed to have stated: 'We can have democracy (...), or we can have wealth concentrated in the hands of a few, but we cannot have both.'⁴⁴

Wealth's powers and influence are manifold. Not only have the wealthy been said to exert baneful sway over legislation,⁴⁵ wealth could also potentially influence politicians, threaten the impartiality of public officials and undermine independent media. The inconsistency between great wealth and elective representative government is one of accountability. Private accumulations of wealth are neither elected by the people nor delegated from people's representatives. They are unaccountable to the majority, which, as Avi-Yonah clearly describes, is an unhealthy phenomenon in a democratic society.⁴⁶

Fears of the rich abusing their fortunes to gain political influence are by no means imaginary. History shows an abundance of examples of large fortunes being used at the expense of political and media independence. In his *Rights of Man* Thomas Paine already expressed his concerns about how inheritances could have a corrupting effect on the democratic process because 'the freedom of elections [is]

violated by the overbearing influence which this unjust monopoly of family property produces'.⁴⁷ It led Paine to propose a progressive tax on the amount inherited by each individual – with marginal tax rates of up to 100%. Far from being a denouncement of substantial fortunes, Paine merely advocated to not have them remain in the same hands.

As Wilkinson and Pickett remind us, at the time Paine wrote his seminal work, the capitalist system was still in its infancy and his critique was directed at the aristocracy, the nobility and the monarchy. Had Paine lived in more recent times, they claim, he would have been likely to also have included the alleged economic and undemocratic power of multinational corporations in his sight. Wilkinson and Pickett underscore the economic importance of such corporations:

[O]ther estimates suggest that half of the world's largest economies are multinationals, and that General Motors is bigger than Denmark, that DaimlerChrysler is bigger than Poland; Royal Dutch/Shell bigger than Venezuela, and Sony bigger than Pakistan. Like the aristocratic ownership of huge tracts of land, (...) these productive assets remain effectively in the hands of a very few, very rich people, and make our claims to real democracy look pretty thin.⁴⁸

An example of corporate influence on the democratic process is provided by Repetti, who discusses the so-called Middletown Studies⁴⁹ that were conducted in the 1920s and 1930s in Muncie, Indiana (USA). The authors of the Middletown Studies observed that over the years business class advertisers had more and more become the supporters of the newspapers (instead of the rank and file of readers of the papers), at the expense of the independence of editorial comments. In fact, '[i]ndependence of editorial comment happens to be in rough inverse ratio to the amount of advertising carried. The leading paper rarely says anything editorially calculated to offend local business men (...)'⁵⁰ Papers that carried less or no advertising were found to comment on local affairs more frequently and vociferously. The authors further observed increased control over the news content of the local papers and employers putting

Notes

⁴² Reginald Mombrun, *Let's Protect Our Economy and Democracy from Paris Hilton: The Case for Keeping the Estate Tax*, 33 Ohio N.U. L. Rev 61, 76 (2007).

⁴³ Repetti, *supra* n. 36, at 840–841. Repetti makes a comparable case in a more recent contribution to the Vanderbilt Law Review. See James R. Repetti, *Democracy and Opportunity: A New Paradigm in Tax Equity*, 61 Vand. L. Rev. 1129, 1152–1162 (2008). See also Martin J. McMahon Jr., *The Matthew Effect And Federal Taxation*, 45 B.C. L. Rev. 993, 1109–1111 (2003–2004). Also: Rakowski, *supra* n. 38, at 291–292.

⁴⁴ Martin Gilens, *Affluence and Influence: Economic Inequality and Political Power in America 1* (Princeton University Press 2012).

⁴⁵ Rakowski, *supra* n. 38, at 292.

⁴⁶ Avi-Yonah, *supra* n. 37, at 1413.

⁴⁷ Thomas Paine, *Rights of Man* 207 (Wordsworth Editions Limited 1996).

⁴⁸ Wilkinson & Pickett, *supra* n. 27, at 251.

⁴⁹ Repetti, *supra* n. 36, at 841–843 citing Robert S. Lynd & Helen M. Lynd, *Middletown: A Study in American Culture* (1929) and Robert S. Lynd & Helen M. Lynd, *Middletown in Transition: A Study in Cultural Conflicts* (1937).

⁵⁰ Repetti, *supra* n. 36, at 842 citing Lynd & Lynd (1929), *supra* n. 49, at 475.

pressure on their employees to stampede local opinion in favour of a single presidential candidate.⁵¹

Whereas the *Middletown studies* present merely anecdotal evidence, statistical analysis of the effect of wealth on the electoral process and the conduct of public officials has revealed that the wealthy can wield significant influence by making large donations.⁵² Such contributions cause them to have a disproportionate voice and enable them to influence election results. As Bartels has shown, the interests and preferences of wealthy citizens are consequently overwhelmingly represented compared with those of the middle classes. The lowest classes appear truly on their own: the opinions of the bottom third of the income distribution were found to have no statistical effect on senators' roll call votes.⁵³ Gilens likewise observes that 'the preferences of the vast majority of Americans appear to have essentially no impact on which policies the government does or doesn't adopt'.⁵⁴ If this trend were to continue, it could lead to political marginalization of the lower income-classes and give rise to conditions that worsen economic inequality.

Other examples of wealth's political extravagances are billionaires Steve Forbes' and Ross Perot's self-financed presidential campaign runs⁵⁵ and BMW's controlling shareholders' donations to German Chancellor Angela Merkel's party.⁵⁶

It should be emphasized that wealth's anti-democratic character is not only reflected in the power to buy political favours and influence election results. Avi-Yonah describes how politicians will constantly be weighed down by the threat of corporate wealth relocating at the detriment of jobs and welfare in their jurisdiction:

As long as General Motors and Ford employ tens of thousands of Michigan voters, their views will resonate with the Michigan delegation to Congress, even if they are strictly prohibited from donating a penny to any politician (directly or indirectly).⁵⁷

3.4 Side-Effects of the Tax System

It is often believed that a wealth tax could help suppress the downsides to inequality mentioned above. In fact,

when confronted with socially undesirable phenomena it is often a first response to invoke the tax system to undo harm done, regardless its causes. The same appears to be true when it comes to inequality and its related issues. A net wealth tax could arguably provide a suitable means for dissolving concentrations of wealth and reducing inequality. After all, the power to tax involves the power to destroy. Prudence in taxing wealth is nevertheless called for and the use of the tax system to curb excessive and harmful concentrations of wealth meets with various objections that make the case for wealth taxes a little uneasy. Rakowski,⁵⁸ for example, points out that a periodic tax on wealth to protect political and economic institutions would only have to apply to a tiny range of the population. He argues that the mere possession of a few millions is not enough to pose a serious threat to the functioning of democracy and the free market. Consequently, Rakowski points out, the tax would have to break into the highest echelons of the wealth distribution. At the risk of being over-inclusive and overbroad to its justification, the tax thus should be aimed at only a very tiny fraction of the top 1% or maybe even of the top 0.1% of wealth holders to reach those who can potentially imperil political and economic institutions. But even when limited to this fraction of the population, the net wealth tax would be like a sledgehammer used to crack a nut as it would apply without regard to persons and also tax those who simply quietly enjoy their wealth.

Apart from this obvious overkill, the net wealth tax would have to be levied at confiscatory rates to meet its stated objective: an annual tax of only a few per cent would do little to break up society's largest fortunes. The potential constitutional impediments to taxing wealth in some countries left aside,⁵⁹ the advent of a wealth tax with high marginal tax rates could backfire and cause the wealthy to seek political influence. As Rakowski puts it, 'the advent of a stiff tax, (...), likely would galvanize the most fearsome elements of the economic elite to attempt to do precisely what a wealth tax of this kind was engineered to prevent – the buying of politicians' votes or the unequal influencing of other citizens' opinions'.⁶⁰ Maybe it would then be better to let sleeping dogs lie.

Notes

⁵¹ Repetti, *supra* n. 36, at 842–843.

⁵² Repetti, *supra* n. 36, at 843–849 and the literature there cited. A 1997 study discussed found that 81% of the large campaign contributors to congressional candidates (i.e., those contributing USD 200 or more) had annual family incomes exceeding USD 100,000.

⁵³ Larry M. Bartels, *Economic Inequality and Political Representation* (Working Paper August 2005), <http://www.princeton.edu/~bartels/economic.pdf>.

⁵⁴ Gilens, *supra* n. 44, at 1.

⁵⁵ Avi-Yonah, *supra* n. 37, at 1412, n. 114.

⁵⁶ Anton Troianovski, *Timing of BMW Donation to Merkel's Party Draws Fire*, WSJ.com, 15 Oct. 2013, <http://on.wsj.com/1cSHORb>.

⁵⁷ Reuven S. Avi-Yonah, *Corporations, Society, and the State: A Defense of the Corporate Tax*, 90 Va. L. Rev 1193, 1242 (2004).

⁵⁸ Rakowski, *supra* n. 38, at 292–293.

⁵⁹ Moris Lehner, *The European Experience With A Wealth Tax: A Comparative Discussion*, 53 Tax L. Rev 615, 681 (1999–2000). Also: Avi-Yonah, *supra* n. 24, at 21 and Beverly Moran, *Wealth Redistribution and the Income Tax*, 53 Howard L.J. 319 2009–2010, at 329–331.

⁶⁰ Rakowski, *supra* n. 38, at 293.

It can further be wondered whether the threat to democracy and the market economy is posed by individuals or by corporate entities. In the latter case, a tax on personal wealth would do little to ‘keep the lions from the lambs’.⁶¹

Wealth taxes levied at dauntingly high rates could further trigger fraud and evasion through capital flight and emigration, as illustrated by the tax-induced exodus of prosperous individuals to low-tax jurisdictions.⁶² As once famously quoted by Adam Smith, ‘the proprietor of stock is properly a citizen of the world, and is not necessarily attached to any particular country’.⁶³ In this view, burdensome taxation creates an environment hostile to capital, prompting wealthy individuals to emigrate, triggering job loss and causing investments to dry up. Interviews with some of the world’s leading corporate executives, held by the Stanford Center for the Study of Poverty and Inequality,⁶⁴ point in the same direction. Lafarge’s honorary chairman Bertrand Collomb, for instance, remarked:

If our marginal income tax rate doesn’t go above 50% altogether, it’s probably acceptable in terms of economic value creation. People will not probably leave the country because they’re taxed at 50 and they could be taxed at 40 somewhere else. But if you go to 70 or 80, clearly they will leave.⁶⁵

The cost of such capital flight can potentially be high. For example, the French *Impôt de Solidarité sur la Fortune* or Solidarity Wealth Tax was estimated to have given rise to a EUR 200 billion capital flight since its enactment in 1988. The tax has been found to cause an annual fiscal shortfall of EUR 7 billion, which amounts to twice its annual yield.⁶⁶ The wealth tax has further been said to harm economic growth. Hanson, for instance, finds the wealth tax to dampen economic growth between 0.02 and 0.04 percentage points for a 1% increase in the tax rate.⁶⁷ She further finds support for wealth taxes being more harmful to economic growth than other taxes on capital or labour.

More fundamental is the way in which the tax system is apparently perceived and is frequently used as a panacea for socially undesirable developments as well as to steer individual behaviour. Doubts can be cast over the tax

system’s suitability to remedy the various inequality-related ailments discussed in this section. Frequently, alternative, less invasive and arguably more effective legal and other instruments are available. For example, corporate power could be restrained by anti-trust laws. Political influence of private and corporate sponsors can be contained by legally limiting private donations to political parties or even by prohibiting donations to individual politicians. Limitations on the deductibility of gifts to political parties can also be considered. Instead of taxing wealth per se, equal opportunity is arguably better served by providing free education, financed by taxes on inheritance and estates, by publicly announcing job openings and by quota to protect those less privileged. As will also be discussed in section 4, the overriding penchant for using the tax system as the ‘silver bullet solution’ demonstrates a cockeyed, even myopic view of the matter, since the tax system is incapable of tackling the market economy’s excrescences at the source.

The commonly shared desire to reduce inequality is one thing. Taking the bull by the horns and meaningfully mitigating it is another which requires an analysis of the causes of inequality. If those causes are outside the tax system, more structural and fundamental solutions may be better suited for this task. The next section will therefore explore what drives inequality.

4 THE CAUSES OF INEQUALITY

4.1 Inequality is Institutional

It is often stated that inequality is simply the outcome of market forces. This statement is only partially true. Rather, inequality is driven by institutional factors, as is also illustrated by the 2011 report *Divided We Stand*,⁶⁸ in which the OECD identifies key drivers behind the process of widening inequality.

Frequently stated as the main cause of inequality is globalization and the observation that the benefits of productivity gains accrue mostly, if not exclusively, to highly skilled and highly educated workers.⁶⁹ Apart from globalization, technological progress – which is often

Notes

⁶¹ Rakowski, *supra* n. 38, at 293.

⁶² See, e.g., Robert Frank, *The Mass Migration of the Super Rich*, *CNBC Inside Wealth*, CNBC.com, 29 May 2012, <http://www.cnbc.com/id/47599766>.

⁶³ Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* 612 (Wilder Publications 2008) (originally published in 1776).

⁶⁴ Roland Berger, David Grusky, Tobias Raffel, Geoffrey Samuels & Christopher Wimer, *The Inequality Puzzle. European and US Leaders Discuss Rising Income Inequality* (Springer 2010).

⁶⁵ Berger *et al.*, *supra* n. 64, at 25.

⁶⁶ Eric Pichet, *The Economic Consequences of The French Wealth Tax (ISF)*, 14 *La Revue de Droit Fiscal* 5 (April 2007).

⁶⁷ Åsa Hansson, *Is the Wealth Tax Harmful to Economic Growth?* *World Tax J.* 19–34 (February 2010).

⁶⁸ OECD, *Divided We Stand: Why Inequality Keeps Rising* (OECD Publishing 2011).

⁶⁹ *Ibid.*, 24.

considered skill-biased – is also listed among the factors that increase inequality.⁷⁰ Due to lack of proper education and the right skillset, some people fail to compete in the modern economy and lose out in a globalizing world. Policy choices, regulations and institutions further have a significant impact on the distribution of income, including the weakening of trade unions, the lack of adequate minimum wage legislation, policies that aim to increase labour market flexibility, and the denationalization and privatization of previously state-run enterprises.⁷¹ Other research reveals the so-called transparency movement that meant to deter egregious compensation by publicizing CEO remunerations and pay to have effectively set in motion a rat race to the top ‘by engendering competition rather than self-limitation’.⁷²

Increasing inequality is thus not as much an outcome of the market economy itself, as a consequence of changes in the rules, regulations, norms and institutions that govern it. The so-called invisible hand of markets should be subjected to rules and regulations, as the market will otherwise sharpen inequality and trigger public outcry for reform. Governments slackening the reins of markets brutally tear the stitches that prevent the already gaping wound that is inequality from festering. As Van der Klundert illustrates:

If capitalism is not regulated, then capital accumulation involves various negative effects. The income distribution becomes less equal and external effects gain importance, while moral values erode. After a while, this triggers a broadly supported response, which may induce an adjustment of the institutions.⁷³

Since the main drivers of inequality are institutional, it is hard to imagine of what avail a net wealth tax can be in this respect. A tax on wealth would fail to grasp the roots of the institutional problems that underlie inequality and is thus incapable of providing a sustainable solution to inequality, which should primarily be found among the very same institutions that gave way to the rise in inequality in the first place.

The OECD has, for example, underscored the importance of facilitating and encouraging equal access to employment for underrepresented groups, thus enabling them to avoid and escape poverty.⁷⁴ If the problem is a lack of minimum wage legislation, an increase in

minimum wage would seem appropriate. Government policies aimed at fostering investment in the human capital of the workforce, at stimulating higher educational attainment and at promoting the upskilling of the workforce and education for the low skilled could provide an answer for those who lack the skills to keep up with technological change.⁷⁵ If labour market flexibility is at the detriment of the workforce, laws and social rights protection are the answer. Social security could appease anti-globalist sentiments and provide a safety net to those who fail to cope with competitive pressures in the market place. Wilkinson and Pickett further emphasize the potential role of labour unions, democratic employee-ownership and participative management methods, which have been shown not only to generate substantial performance benefits and to increase workplace democracy, but also lead to a more equal sharing of earnings.⁷⁶

The above-mentioned approaches are all outside the scope of the tax system. As far as these causes and the problems stemming from them are concerned, a wealth tax will simply do too little, if anything at all. However, this does not mean the tax system could not play any part whatsoever. Where taxes contribute to rising inequality, the tax system can play a role in mitigating this process. The next sections discuss what role. But first, the tax system’s impact on inequality is discussed.

4.2 Tax-Induced Inequality

4.2.1 *Reduced Rates, Preferential Treatment and Indirect Taxes*

One factor that has remained underexposed until now is the tax system. To the extent the tax system has contributed to the conditions for inequality to blossom, it may very well help reverse this situation. This subsection briefly examines how the tax system has contributed to increased inequality.

Over the past decades, tax systems around the world have steadily become less progressive and have shifted towards indirect taxes. Moreover, top marginal tax rates have been cut⁷⁷ and capital income is often taxed favourably. Based on a review of studies and literature on

Notes

⁷⁰ *Ibid.*, 26.

⁷¹ Wilkinson & Pickett, *supra* n. 27, at 242–252.

⁷² Berger *et al.*, *supra* n. 64, at 181–184.

⁷³ Theo van der Klundert, *Capitalism and Democracy – A Fragile Alliance* 43–44 (Edward Elgar 2013).

⁷⁴ OECD, *supra* n. 68, at 41.

⁷⁵ *Ibid.*

⁷⁶ Wilkinson & Pickett, *supra* n. 27, at 252–263.

⁷⁷ International Monetary Fund, *supra* n. 5, at 34.

the development of top incomes and their soaring, Hoeller, for example, observes that top income tax rates have declined over time.⁷⁸ He further concludes that tax regimes may have tilted the mix of compensation of top earners toward capital gains, stock options and carried interest arrangements, which are often taxed at a lower rate than income from labour, or may even go untaxed in some countries. Likewise, the OECD notes that the share of capital income in total income at the top of the income distribution increased in countries such as the Netherlands, Sweden and the USA in the 2000s. Generally, the importance of capital gains as an income component of the top income groups has grown in most countries.⁷⁹ The preferential treatment of certain kinds of income can increase the ability of high-income earners to accumulate wealth, potentially triggering a rise in wealth concentrations. The same is true for the increased share of top incomes.⁸⁰

It is worth mentioning that modern economic literature does not categorically dictate this non-taxation or preferential treatment of income from capital. In fact, the dynamic optimal tax literature has emphasized various arguments for taxing capital. A neat summary of the current state of this literature is provided by Boadway, who shows that capital income taxation can serve as a useful adjunct to redistribution. Taxation of income from capital can further be called for when future earnings are uncertain and uninsurable, when earnings tax rates cannot be varied over the life cycle, and in case of unobservable inheritances.⁸¹ Under circumstances, limiting the tax rate on capital income can nevertheless be desirable.

Apart from the preferential treatment of income from capital, wealth accumulation is further enhanced by increased reliance on indirect taxes or taxes on consumption (at the expense of direct taxes). Such a shift in the tax mix sharpens inequality for two reasons. For one, indirect taxes tend to be regressive, putting a larger effective burden on lower incomes,⁸² and lack the

potential of taking account of the taxpayer's personal circumstances. In the aftermath of the financial and the euro crises, the impact of such regressive taxes and deep spending cuts have been said to 'have started to dismantle the mechanisms that reduce inequality and enable equitable growth'.⁸³ For another, indirect taxes leave income, savings, investments and their returns untaxed until money is actually spent, allowing wealth to grow tax free. As amounts spent as a percentage of income decline in income, the rich can already save more than those less well-off. A shift towards indirect taxes would thus not only make it easier for the rich to accumulate wealth, but also to increase their capital income in the future.⁸⁴ The same is true for the increased share of top incomes and reductions of the rates at which they are taxed.⁸⁵ Some studies also highlight dwindling taxation of property, wealth, inheritances and gifts, which could reduce the progressivity of the tax system.⁸⁶

Accumulations and concentrations of wealth have further been found to depend on inheritance patterns. In this regard, Piketty has shown that, in 2010, annual inheritance flows in France amounted to 15% of national income. Using disposable income as a denominator, the observed annual inheritance flow is about 20%, which is 'typically much larger than the annual flow of new savings, and almost as big as the annual flow of capital income'.⁸⁷ Using a model of wealth accumulation, growth and inheritance, Piketty finds that 'the annual bequest flow might reach about 20%–25% of national income by 2050'.⁸⁸ Conversely, in countries with very large economic and/or demographic growth rates, inheritance flows are likely to amount to only a small fraction of national income. These findings, Piketty states, promote the thought that 'wealth will most likely play as big a role in twenty-first century capitalism as it did in nineteenth century capitalism'.⁸⁹

The tax system finding itself among the culprits in the dock of inequality could potentially absolve itself from all

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⁷⁸ Peter Hoeller, *Less Income Inequality and More Growth – Are they Compatible? Part 4. Top Incomes* 10–11 (OECD Economics Department Working Papers, No. 927, OECD Publishing 2012) and the literature there cited.

⁷⁹ OECD, *supra* n. 68, at 359.

⁸⁰ Piketty, *supra* n. 18, at 828–829.

⁸¹ Robin Boadway, *From Optimal Tax Theory to Tax Policy – Retrospective and Prospective Views* 85–138 (The MIT Press 2012).

⁸² See, e.g., Ian Crawford, Michael Keen & Stephen Smith, *Value Added Tax and Excises*, in *Dimension of Tax Design. The Mirrlees Review* 285 (J.A. Mirrlees ed., Oxford University Press 2010). Warren also underscores the regressive impact of taxes on consumption, even when accounting for methodological differences between the various studies he reviewed. See Neil Warren, *A Review of Studies on the Distributional Impact of Consumption Taxes in OECD Countries* (OECD Social, Employment and Migration Working Paper, No. 64. 2008).

⁸³ Oxfam, *supra* n. 3, at 13.

⁸⁴ OECD, *supra* n. 68, at 358.

⁸⁵ Piketty, *supra* n. 18, at 828–829.

⁸⁶ Isabelle Jourard, Mauro Pisu & Debbie Bloch, *Less Income Inequality and More Growth – Are They Compatible? Part 3. Income Redistribution via Taxes and Transfers Across OECD Countries* 29–32 (OECD Economics Department Working Papers, No. 926, OECD Publishing 2012).

⁸⁷ Thomas Piketty, *On the Long-Run Evolution of Inheritance: France 1820–2050*, 126 Q. J. Econ. 1074 (August 2011).

⁸⁸ Piketty, *supra* n. 87, at 1071. The annual inheritance flow is defined as 'the total market value of all assets (tangible and financial assets, net of financial liabilities) transmitted at death or through inter vivos gifts during a given year'. (p. 1072).

⁸⁹ Piketty, *supra* n. 87, at 1072.

guilt, taking the lead as a ‘white knight’ and curb large concentrations of wealth and defy the risks involved. Or so it is sometimes believed. If inequalities tend to get politically unacceptable, it may indeed be tempting to resort to an emergency tax measure and crack those inequalities using net wealth taxes. However, as will be discussed next, on a systematic and more fundamental level the net wealth tax will not be able to accomplish much, as it leaves intact the conditions in the tax system that gave rise to inequality in the first place, i.e., the differential treatment of various sources of income.

4.2.2 Twofold Interaction

The interaction of taxes and wealth concentrations is twofold.⁹⁰ On the one hand, personal income tax and the net wealth tax can directly limit the rate of private wealth accumulation, thereby reducing wealth inequality in the long run. In literature, this has been dubbed the limiting function of taxation.⁹¹ On the other hand, cuts in the progressivity of income taxes, differential treatment of income and reduced taxes on wealth transfers, such as former US president Bush’ estate tax cuts and its temporary repeal,⁹² can contribute to a rise in wealth inequality in the long run and reinforce the impact of the share of top incomes.⁹³ There appears to be a tendency for the latter developments to take place, with countries reducing top tax rates for income, increasingly relying on indirect taxes and favouring capital over labour.

As far as inequality is incited by this differential treatment, policy makers would be well-advised to scratch their heads and to ascertain whether and to what extent continued preferential treatment of certain kinds of income is truly justified, desired and considered equitable. It was already discussed above that modern economic theory provides various arguments for taxing capital income. More importantly, from the perspective of the principle of ability-to-pay, there are no apparent reasons for preferential treatment of capital over labour whatsoever. This principle, which is the embodiment of tax equity, dictates the taxation of all increases in a person’s economic power or faculty between two points in

time, regardless its origin and appearance.⁹⁴ In literature, income has been considered the terminus of the development of ability-to-pay and has been crowned ‘the best workable test [of faculty or ability-to-pay; LW] that governments can secure’.⁹⁵ Income is, in turn, ‘the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and the end of the period in question’.⁹⁶ The essential part of income is a ‘gain to someone during a specified time or interval’.⁹⁷ This comprehensive or foundation concept of income is a benchmark against which different interpretations of income can be assessed.⁹⁸

From an ability-to-pay perspective, it is irrelevant whether the increase in a person’s economic power stems from a capital gain, dividends, interest, labour or a gift or inheritance. Nor does it matter whether the increase in a person’s wealth has been realized or whether his or her wealth can easily be converted into monetary equivalents or not. All that matters is the increase in the economic power of an individual over time, regardless its source or origin.

To the extent inequality of income and wealth stems from an apparent lack of willingness to adopt a more comprehensive concept of income – and the tax system thus having contributed to an environment for inequality to blossom – a more sustainable solution to the containment of inequality at its source can be found in first moving towards a more uniform treatment of income from labour and capital. In other words, instead of putting out all the stops of the tax system and using a net wealth tax, one had better first arrange other income taxes and seriously contemplate whether the unequal treatment of various types of income is truly justified before deploying heavy fiscal artillery against wealth inequality. For all that and in order to not put all one’s eggs in one basket, wealth taxes could at best only serve as *ultima remedia* in case other taxes (temporarily) fail to yield sufficient revenue.

However, first and foremost, the income tax should play a pivotal role in comprehensively taxing income. As long as countries fail to implement a comprehensive income tax, the tax condition for inequality to develop will persist and a wealth tax will simply come too late.

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⁹⁰ Compare Piketty, *supra* n. 18, at 829.

⁹¹ Reuven S. Avi-Yonah, *And Yet It Moves: A Tax Paradigm for the 21st Century* 9 (University of Michigan Law School Law and Economics Working Paper 12-008, May 2012).

⁹² See, e.g., Daniel W. Matthews, *A Fight to the Death: Slaying the Estate Tax Repeal Hydra*, 28 Whittier L. Rev. 663 (2006–2007).

⁹³ See, e.g., Thomas Piketty & Emmanuel Saez., *Income Inequality in the United States 1913–1998*, 118 Q. J. Econ. (February 2003).

⁹⁴ Georg Schanz, *Der Einkommensbegriff und die Einkommenssteuergesetze*, Finanzarchiv 1896, Vol. 13, Bd. I, at 23. See also: Robert M. Haig, *The concept of income – economic and legal aspects*, in *The Federal Income Tax* 7 (Columbia University Press 1921). Also: Henry C. Simons, *Personal Income Taxation, The definition of income as a problem of fiscal policy* 50 (The University of Chicago Press 1938).

⁹⁵ Edwin R.A. Seligman, *Essays in Taxation* 15 (The Macmillan Company 1921).

⁹⁶ Simons, *supra* n. 94, at 50.

⁹⁷ *Ibid.*, 50.

⁹⁸ Kevin Holmes, *The Concept of Income, A multidisciplinary analysis* 83 (IBFD 2001).

5 TOO LITTLE, TOO LATE

Thus far, it has been argued that widening inequality is a consequence of various institutional factors. Although the key drivers of inequality are outside the tax system, the tax system has also been cited among the factors that have incited inequality. Reduced marginal income tax rates for top incomes, the preferential treatment of capital and capital income and increased reliance on indirect taxes have made it easier for the higher income households to accumulate wealth and are likely to exacerbate existing inequality even further in the future. On a more fundamental level, the apparent lack of willingness to properly incorporate the principle of ability-to-pay and its accompanying comprehensive income tax has created an environment friendly to increased inequality by allowing a shift in the compensation mix towards items that are taxed favourably or that even escape taxation altogether.

Various scholars writing about potential solutions to mitigate inequality and combat its accompanying threats frequently invoke the tax system. On various occasions they also perceive a role for phenomena such as progression⁹⁹ and consumption taxes.¹⁰⁰ Given the likelihood of taxes on consumption sharpening wealth inequality, the latter comes as a surprise. It appears rather counterproductive to leave savings, investments and their returns untaxed, thereby spurring exactly the kind of situation one means to counter.

In mitigating wealth inequality and its various excrescences, net wealth taxes are sometimes attributed a potential part. If inequalities tend to get politically unacceptable, it may indeed be tempting to resort to an emergency tax measure and crack those inequalities using wealth taxes. However, the use of the tax system to curb excessive wealth meets with various objections. It was illustrated in section 3 how wealth taxes can potentially distort economic decisions, put a brake on economic growth, and trigger fraud and evasion. Moreover, many drivers of inequality were found to lie outside that tax system. As was discussed in section 4, there is thus a potential for many non-tax instruments to redress such drivers at their source and to more structurally and sustainably narrow the gap between rich and poor than by ad hoc and incidentally taxing wealth. Since a wealth tax fails to address these root causes, it cannot be part of a sustainable solution. In this regard, the wealth tax can simply achieve too little.

As far as inequality stems from the tax system's preference for capital and capital income over labour, little

good is to be expected from the net wealth tax either. Using the tax system to reduce tax-incited inequality while leaving intact the tax conditions that gave rise to inequality in the first place is like a dog chasing its tail: a hopeless and endless task. It is a prime example of what the Germans would call 'Kurieren am Symptom'. Instead of being behind the times, only to treat inequality's symptoms when the patient gets intolerably ill, it would be better to expose the roots of the problem and to find a more vigorous cure in order to hold back and limit inequality at its source. *In fiscalibus* this source is the lack of a comprehensive concept of income and the cure is called the principle of ability-to-pay. Only by fully incorporating the principle of ability-to-pay, thereby comprehensively and equally taxing all income, the development of large fortunes can be contained at source, and a solid brake can be put on their growth. After all, income is the first instance in which the development of wealth can be limited. Continuation of the status quo and allowing certain income to go un(der)taxed will only prove that a wealth tax will simply come too late.

6 CONCLUSION

This article has examined the potential of a net wealth tax as a means of mitigating inequality of wealth. To this end, the key drivers of inequality were investigated. It turns out that these drivers are mainly institutional and largely unrelated to the tax system. As far as these institutional causes are concerned, little is therefore to be expected from a net wealth tax. Not only is the tax system unable to address the heart of these problems, which are institutional. Other, better suited instruments are also often available. By the same token it is questionable whether a net wealth tax could effectively suppress inequality's various excrescences. It was shown that there too, other non-tax instruments are available.

As far as the tax system is involved, inequality largely stems from a failure to properly implement a comprehensive income tax. As long as certain types of income can thus effectively escape taxation or be taxed at favourable rates, the tax system will foster inequality. There is little a wealth tax can do about this. It is therefore advisable to put a first break on wealth formation by properly and comprehensively taxing income, for if the status quo persists, a net wealth tax will do too little and will simply come too late.

Notes

⁹⁹ For example, McMahon Jr., *supra* n. 43.

¹⁰⁰ For example, Robert H. Frank, *Falling Behind: How Rising Inequality Harms the Middle Class* (University of California Press 2008).

[A] Aim of the Journal

This established international tax journal offers detailed coverage of direct tax, indirect tax, and social security from both legal and economic angles, and provides 12 issues a year of practical, up-to-date, high-level international tax information. Coverage includes all aspects of transnational tax issues. The journal includes authoritative, reliable content, written for tax attorneys, practitioners (litigation and transactional) in other areas where international tax issues are a concern, and academics.

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Manuscripts should be submitted to the General Editor, Fred de Hosson.

E-mail address: Fred.deHosson@bakermckenzie.com

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