Comments on Piketty-Saez

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A Handbook Chapter Torn from the Front Pages

- PS bring a palpable moral concern to this issue, evident in their terminology (e.g., “greed,” as in Obama’s “breathtaking greed of a few”, and their willingness to assign a zero social weight to the utility of the rich.)
- I am sympathetic to these concerns (and note without comment being referred to as “left-wing”).
- But, as George Will once wrote about US Iraq policy, “there can be no more moral duty to do what cannot be done.”
- How much redistribution can/should be done?

Taxing the Rich

- Recently, academic attention has shifted from labor supply response of the rich to their avoidance and evasion.
- But this requires us to get our hands dirty in the arcana of tax shelters, etc.
- E.g., a recent *NYTimes* article detailed how Ronald Lauder uses:

1. A Bermuda corporation to avoid US corporation income tax
2. Non-profit and charitable foundations to obtain deductions for his art collection.
3. Borrowing against stock to avoid capital gains tax.
4. Variable prepaid forward contracts to postpone cg tax.
5. Family trusts to minimize estate tax.

Is the ETI A Sufficient Statistic?

- “Old” answer. Yes, because at all margins taxpayers will give up a dollar to save a dollar of tax liability.
- “New” answer. Three elasticities must be distinguished (Raj has suggested a fourth):

1. Real
2. Avoidance—in PS just base shifting
3. Bargaining—implications close to stealing

Avoidance (1)

- A definition would be helpful.
- SY definition: “responses to taxation that do not involve changes in individuals’ consumption basket.”
- In PS avoidance is just income shifting, which preserves ETI’s sufficiency in a multi-base, multi-period interpretation.
- We don’t need two elasticities, we just need to track down shifted revenue.

Avoidance (2)

- Yes, the ETI is endogenous to the base breadth and enforcement.
- But it sounds a bit naïve to posit that the first-best solution is to close up *all* avoidance avenues and then choose the optimal progressivity.
- Wojtek has demonstrated that the ETI depends on base definition.
- But, an income tax is inherently incoherent, as David Bradford argued
- I recommend that PS confront the reasons why these avoidance opportunities persist, and e.g. whether a consumption base is preferable.

Avoidance (3)

- The excess burden of avoidance arises because tax systems feature *surrogate* tax bases, where tax liability depends on actions other than objects of utility.
- E..g, capital gains realizations, goods rather than characteristics, IRAS rather than consumption, etc.
- This leads to “utility attainment distortions.”
- There are *practical* reasons we might tolerate these distortions, related to observability.
- Holy Grail: optimal progressivity and base, with “deep” reasons for a narrow base.

Empirical Analysis

- The objective is to assess the relative magnitude of the three elasticities, which matters for policy.
- PS provide “suggestive” evidence from the US time series and cross-country comparisons.
- The evidence won’t satisfy the “instrument police,” but is fascinating and stimulating.
- Handbook chapter should assess the robustness of the findings.

Bargaining

- Its relative marginal importance increases optimal progressivity because it directly reduces the income of the 99%, and so is similar to an externality.
- In its presence we want to push the top rate past the maximum of the Laffer curve: we collect less revenue from the 1%, but induce less “bargaining” that takes from the 99%.
- PS call it bargaining, and transferring, but is model-related to costly (taxable) stealing.

Claim: Real Response is Not the Story

- Argument: There is no compelling cross-country negative relationship between the top MTR and economic growth.
- I agree, although the paper should cite the previous valiant attempts to tease out such a relationship, such as Lee and Gordon (*JPubEc*, 2005), and the econometric problems that must be confronted.
- It's not a precisely estimated zero, for sure.

Claim: Avoidance is Not the Story

- Argument: if it was, as the top MTR fell in the US, avoidance would have fallen a lot, so that fully-taxed income would have grown more quickly than FTI plus avoidance, measured by PS as realized capital gains. It did not.
- In explaining, add the usual control suspects for determinants of CGs, such as the level of the stock market.
- Need to admit the possibility of technological progress in avoidance: it’s not about preferences any more, it’s about tax avoidance technology.

Is Bargaining the Story?

- The bargaining story is supported by a process of elimination, and marshalling other evidence of bargaining.
- What positive evidence could make the story compelling?
- It’s more plausible in some settings—can this be exploited empirically?
- Does the tax rate affect those on the other side of the bargaining table?

Some Random Thoughts

- Top 1% is endogenous to income composition; capital gains are especially volatile.
- Technological innovation in avoidance.
- Look at consumption trends?
- Doesn’t avoidance affect the effective MTR?
- Avoidance opportunities and the non-tax costs of tax-favored behavior are very heterogeneous—compare CEOs to Marc Zuckerberg to hedge fund managers to footloose rentiers to Albert Pujols.

Some Suggestions

- The tenor of a Handbook paper should be more circumspect. Tone down sentences like "the tax avoidance elasticity could be made minimal."
- Be more careful about language—e.g., differentiate evasion and define avoidance.
- I think it's fine for some (maybe not all) Handbook chapters to pulsate with moral concern.

Concluding Thoughts

- To have policy relevance, research focusing on the behavior of the rich must address the dirty real world of sophisticated tax avoidance.
- Whether we *can* tax the rich with an incoherent income tax in a global economy with sophisticated avoidance technologies is still an open question.
- PS have led the way to answering this question.