The Daily Dish

Dueling Wealth Taxers

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Eakinomics: Dueling Wealth Taxers

Sunday the next Democratic primary debate will feature former Vice President Joe Biden and Senator Bernie Sanders. One of the latter's prominent proposals is to impose a tax on the wealth of affluent Americans. Specifically, married couples with a net worth over $32 million would be subject to an initial tax of 1 percent on net worth up to $50 million, 2 percent on $50 million to $250 million, 3 percent from $250 million to $500 million, 4 percent from $500 million to $1 billion, 5 percent from $1 billion to $2.5 billion, 6 percent from $2.5 billion to $5 billion, 7 percent from $5 billion to $10 billion, and 8 percent on net worth above $10 billion. Individuals would face the same rates, with the brackets cut in half.

AAF has produced the most detailed analysis of the damage this tax would inflict on the economy, and specifically the fallout on the working class. The damage derives from the fact that a, say, 8 percent wealth tax is a draconian tax on the earnings from capital. If the rate of return is 8 percent, the effective rate is 100 percent.

Joe Biden has opposed the wealth tax, but that hardly means he is a pro-growth standard bearer. He has an array of proposed tax increases that include raising the corporate rate to 28 percent, the top income tax rate from 37 percent to 39.6 percent, taxing dividends at ordinary income rates instead of the 20 percent rate under current law, and subjecting the labor earnings of individuals above $400,000 to the 12.4 percent Social Security payroll tax. These changes have big implications for capital accumulation.

To see this, suppose that you take an after-tax dollar of labor income and invest it in a corporation that earns a 15 percent pre-tax return. If there were no taxes whatsoever, that 15 percent would flow back to the individual and the $1 would translate to $4.05 after 10 years, $16.37 after 20 years, and $66.21 after 30 years. (This is why Einstein called compound interest the most powerful force on the planet.)

The current tax system dramatically slows that accumulation. The corporate return of 15 percent gets taxed at the 21 percent corporate rate, and a dividend distribution of what is left gets taxed at a 20 percent rate. Taken as a whole, these taxes reduce the net accumulation to $2.47, $6.12, and $15.14. Indeed, as it turns out, it would have been possible (see the first column of the table below) to achieve exactly the same result with an annual Sandersesque wealth tax at a rate ranging from 3.1 percent to 3.7 percent.

	Equivalent Wealth Tax	
Year	Current Law	Biden
10	3.1%	5.9%
20	3.4%	5.7%
30	3.7%	5.8%

The tax increases proposed by Biden would drop the dollar available for investment down to 87.6 cents because of the payroll tax, and raise the corporate and individual rates on the earnings. This would further diminish accumulation to $1.66, $3.16, and $6.01 over the 10-, 20-, and 30-year horizons. Again, an annual wealth tax could do the same trick; as shown in column two of the table, the Biden proposals are tantamount to raising the wealth tax to between 5.7 percent and 5.9 percent.

Now, as an important caveat, both candidates have lots of other proposals, so this is hardly a comprehensive analysis of the tax platforms. But from the perspective of taxing wealth accumulation, this is hardly “Sanders – pro” versus “Biden – con.” Sunday promises to be a debate between dueling wealth taxers.