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Wealth Inequality in the United States (panelist)

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Remarks
for

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WEALTH INEQUALITY IN THE UNITED STATES
Jonathan Barry Forman

AN OVERVIEW OF INEQUALITY IN THE UNITED STATES
There is substantial inequality in the distribution of earnings, income, consumption, and wealth in the United States today. **SLIDE.** Figure 1 compares the distribution of these resources by quintiles of family units. The distribution of consumption is the most equal, while the distribution of wealth is the most unequal. Earnings and income fall in between.

Consumption is probably the best overall measure of economic well-being at any point in time. However, to achieve a reasonably low level of consumption inequality, a society will inevitably have to adopt policies that also reduce inequality in distribution of earnings, income, and wealth.

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WEALTH INEQUALITY
More specifically, let’s consider Professor Edward N. Wolff’s recent research on wealth holdings in the United States.²

SLIDE. Figure 2 shows that, in 2001, the top 1 percent of American households controlled 33.4 percent of total household wealth. At the same time, the bottom 80 percent of households held only 15.5 percent of total household wealth. Wolff himself has noted that inequality in wealth holdings is “extreme and substantially greater than income inequality.”

In fact, wealth is extraordinarily concentrated in the top 1 percent of households. In 2001, for example, the mean wealth holdings of the top 1 percent was almost $13 million, and more than 338,000 households had a net worth over $10 million. Indeed, the top 1 percent of households had more than 1,000

² Edward N. Wolff, Top Heavy: The Increasing Inequality of Wealth in America and What Can Be Done About It (1999); Edward N. Wolff, Changes in Household Wealth in the 1980s and
times as much wealth as the entire bottom 40 percent. Also that year, Bill Gates and Warren Buffett topped the *Forbes* list of the 400 richest Americans with net worths of $54 billion and $33.2 billion, respectively. The distribution of household wealth is also quite skewed: in 2001, for example, median household wealth was just $73,500, but average household wealth was $280,100.

Wealth and income are positively correlated (that is, high-income families tend to have greater wealth), but that correlation is tempered somewhat by the fact that older people tend to have accumulated more wealth but have lower earnings. All in all, however, wealth is much more unequally distributed than income or earnings.

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In that regard, one popular measure of inequality is the so-called Gini index. Basically, the Gini index is a mathematical measure of inequality that can range from 0.0, indicating perfect equality (for example, where everyone has the same amount of wealth), to 1.0, indicating perfect inequality (where one person has all the wealth, and the rest have none).

According to Professor Wolff, the Gini index for wealth inequality in 2001 was an astonishingly high 0.826. By way of comparison, the Gini index of income inequality was just 0.466 (in 2004), and the Gini index of inequality in earnings in 2001 was just 0.409. Moreover, wealth inequality tends to be perpetuated through countless generations as a substantial portion of wealth is passed on through inheritance.
**GOVERNMENT INTERVENTION SHOULD PROMOTE GREATER ECONOMIC JUSTICE**

When the market distribution of economic rewards is unfair, it falls to the government to adopt policies that promote greater economic justice. In particular, I believe that the government should redesign its tax, transfer, and regulatory policies to increase the economic rewards for workers, as opposed to wealthy investors.

For the most part, the distribution of earnings, income, and wealth in America is determined by market forces. Economic “laws” of supply and demand set most prices in America, including the prices of labor (wages) and capital (interest). For example, those workers who have skills in short supply can command higher salaries, and those with low skills must settle for low wages—or none at all. The market is very efficient at
generating these differential rewards, and it is clear that differential compensation is needed to assure production. After all, if everyone got paid the same, who would do the nasty and distasteful jobs?

Still, almost nobody seriously contends that the distribution of earnings, income, and wealth that results from the operation of market forces is fair.

For example, labor markets don’t miraculously pay people what they “deserve.” SLIDE. If they did, preschool teachers might make more than advertising executives, and garbage collectors might make more than lawyers. But they don’t.

All in all, it seems fair to conclude that the market’s distribution of economic resources is far from perfect. Market
forces result in a system in which many workers get less than they “deserve” while others get more than they “deserve.”

In that regard, Stephen Nathanson notes that:

Much of what people possess is undeserved—either because it came to them through processes (such as inheritance) that have nothing to do with effort or contribution, or because, even where their efforts were required, they do not deserve the specific holdings that they have acquired through the market system.

Nathanson suggests that we consider an example from baseball. He says “a good player may deserve a high salary, but he does not deserve a salary that is one hundred times larger than that of a school teacher.”

All in all, I believe that the government should do more to reduce economic inequality. In particular, I believe that we should redesign government tax, transfer, and regulatory
policies to increase the economic rewards for low-income workers.

**IS THERE A ROLE FOR TAXING WEALTH?**

Is there a role for taxing wealth? Wealth per se is not taxed by the federal tax system. Much of the income from wealth, however, is taxed under the income tax, and certain transfers of wealth are taxed by the estate, gift, and generation-skipping taxes. For example, interest, rents, dividends, and royalties are subjected to the income tax; estates of $2,000,000 or more (in 2007) may be subject to the federal estate tax; gifts of more than $12,000 (in 2007) may be subject to the gift tax; and certain generation-skipping transfers are also subject to tax.

Over the years, many analysts have called for toughening the estate and gift taxes. Alternatively, some analysts have suggested the adoption of an inheritance tax or an accessions tax
as an alternative to the taxation of wealth transfers. An estate tax is based on the amount of property left to heirs by the deceased, while an inheritance tax is imposed on each heir by reference to the value of property received from a deceased.

An accessions tax is an excise tax imposed on the transfer of property by gift or at death. While any of these approaches to taxing the transfer of wealth could help equalize the distribution of resources, none of them directly measure a taxpayer’s wealth on a regular basis as would seem appropriate under a tax system that tries to tax individuals based on their ability to pay.

AN ANNUAL WEALTH TAX
Many analysts have suggested the adoption of a direct annual wealth tax, and a number of European countries already have annual wealth taxes. The typical European wealth tax is
imposed on the value of assets less liabilities of an individual or family, but many assets are excluded from the tax base. High exemptions are provided to exclude taxpayers with few economic resources. The tax rates are graduated, but the maximum tax rates are 3 percent or less.

Wealth taxes can be powerful revenue raisers. For example, according to Professor Wolff, even a very modest wealth tax system would have raised $45 billion in 1995. Wolff based his estimate on a wealth tax system like the Swiss have, with marginal tax rates of from 0.05 percent to 0.30 percent and an exclusion of about $50,000.

Moreover, because their burden falls heaviest on those with greater economic resources, wealth taxes might more accurately measure the ability to pay of taxpayers and so help achieve
greater economic justice. After all, taxpayers with greater wealth have a greater ability to pay taxes.

On the other hand, wealth taxes inevitably raise numerous valuation questions. Also, opponents of wealth taxation have expressed the concern that they would impose further burdens on capital and so might reduce savings and investment. There are also significant timing questions because people tend to accumulate wealth in their working years in order to support themselves in their retirement years. Moreover, there may be constitutional problems with a direct annual federal wealth tax.

**INCOME PLUS WEALTH**

Another possible tax base would be income plus wealth. After all, the sum of one’s income plus wealth is the total amount that a person can spend in a year (without borrowing). Thus, income-plus-wealth could be a respectable measure of
one’s control over economic resources and the ability to pay taxes. Moreover, according to one estimate, a flat 4 percent tax rate applied to an income-plus-wealth tax base would yield about as much revenue as the current income tax.\textsuperscript{3} Given our concerns about work disincentives, a tax rate that low would certainly be attractive, especially for low- and moderate-income workers with lots of earned income and relatively little wealth.

**MY APPROACH**

All in all, the federal tax system needs to raise about $2.5 trillion a year, and most of that will come from high-income individuals. The key is to design a system that promotes greater economic justice, but does so with a minimum of work and savings disincentives.

Eventually, the federal government is likely to adopt a Value-Added Tax (VAT) system for a large portion of its revenue needs, while retaining some form of progressive income, consumption, or wealth tax on high-income individuals. Such a system would collect all its value-added tax revenues from just 10 or 20 million producers and sellers, and it would collect additional revenues from progressive income, consumption, and/or wealth taxes imposed on just 20 or 30 million high-income families.

In the near term, however, it is more realistic to think about restructuring the existing tax system, rather than replacing whole portions of it with new and untried taxes like the VAT or a wealth tax. This approach follows that old maxim of tax design, “an old tax is a good tax.”
We could, for example, combine the individual income tax, Social Security payroll tax, corporate income tax, and estate and gift taxes into a single, comprehensive income tax system. That integrated tax system could have a logical tax rate structure, as opposed to the roller-coaster rate structure of the current system, and it could easily accommodate a few tax credits to help low-income workers and their families.

I would also reform the welfare system. Right now, 85 separate federal programs provide income-tested welfare benefits. To keep costs manageable, virtually all of these programs phase benefits out as family income increases. Unfortunately, these phase-outs often combine with income and payroll taxes to subject recipients to confiscatory tax rates, especially on low-income workers. SLIDE. For example,
Figure 4 shows the average tax rates confronting low and moderate income families. At some points between $10,000 and $25,000 of income, the cumulative tax rate on a single parent can even exceed 100 percent. Needless to say, such high tax rates discourage low-income Americans from working or from improving their work skills.

I believe that we should replace most of the current welfare system with a system of refundable tax credits. The general idea is to “cash out” food stamps and as many other welfare programs as possible and use that money to pay for refundable personal tax credits, earned income credits, child care credits, and health care credits.

Third, we should increase the minimum wage and index it for inflation. Figure 5 shows how the value of the

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4 Adam Carasso & C. Eugene Steuerle, *The True Tax Rates Confronting Families with Children*, 15
minimum wage has fallen in recent years relative to poverty levels. I believe that combining a modest increase in the minimum wage with an expanded earned income tax credit would help ensure that virtually every low-income worker would make enough to bring his or her family out of poverty.

**CONCLUSION**

**SLIDE.** In conclusion, I believe that government can, and should, intervene in the free market to encourage work and to reduce inequality. We simply do not have to settle for a society where the top 5 percent of households have dozens of times as much income as the bottom 20 percent and hundreds of times as much wealth.

The tax, spending, and regulatory proposals that I have outlined today would encourage low-income Americans to enter and remain in the workforce. Consequently, these proposals

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*Tax Notes, October 10, 2005, at 253.*
would increase the size of the economic pie and allow us to divide it more equally. Over time, improving the earnings and incomes of low and moderate income workers could help reduce the phenomenally high level of inequality in the distribution of wealth. In short, these proposals would help make America work even better than it already does.