

Saez Comments
John Karl Scholz
June 18, 2004

It is a treat to get a chance to comment on a paper and line of research as interesting as this one. In the last few years there have been at least 10 studies examining changes over time in the concentration of income or wealth. Studies of income concentration have been conducted for Canada, France, Netherlands, Switzerland, the United Kingdom, and the United States. Studies of wealth concentration have been conducted for France, Switzerland, and the United States. Professor Saez has been involved with at least 5 of these studies.

The paper is very fitting for a volume honoring Eugene Smolensky. It relates to several of Professor Smolensky's career-long interests in the measurement of inequality, interpreting the economic consequences of inequality, and using historical data to better understand important economic phenomenon.

The country studies presented here are a fascinating new line of work. Long time series of wealth and income shares can help shed light on the effects of taxation, business cycles, and other factors that influence income and wealth distributions. Moreover, cross-country studies may shed light on the consequences of alternative tax systems and institutional environments on central economic relationships.

There is a lot in the paper but I will summarize the paper by highlighting four particularly interesting findings.

- There were large reductions in the concentration of income across all countries studied, except for Switzerland, in the first part of the 20th century. Income concentration increased sharply in the English-speaking countries in the last 25 years, but not in Continental Europe.
- Like the evolution income shares, wealth shares held by households in the top one percent of the wealth distribution declined sharply from the beginning of the 20th century. But in contrast to top income shares, there has been only modest increases in wealth shares in the US and UK over the last 25 years.
- It is not surprising that top income shares fell over the period spanned by the Depression and the two world wars. The paper explains the fact that income shares did not recover following the World Wars and Depression in the following way: "The most natural and realistic ... explanation seems to be the creation and development of the progressive income tax (and the progressive estate tax and corporation income tax)."
- Macroeconomic performance of France, UK, US, and Switzerland "has been quite similar over the 20th century in spite of the quite different patterns of taxation and income and wealth concentration."

Specific comments on the paper

The paper is very clear about limitations and qualifications of the analysis. Nevertheless, I want to highlight a few issues since they may fundamentally influence the results and more needs to be learned about the issues.

The 'estate multiplier' approach and wealth inequality

The underlying approach for the wealth calculations uses the "estate tax multiplier" technique to make inferences about the aggregate wealth holdings of people (or households) at

the top of the wealth distribution from information contained on estate tax returns.¹ In brief, the approach multiplies the number (and wealth) of decedents in a group defined by age (and in some cases, gender) by the inverse of the mortality rate for the given group. This yields an estimate of the number of living persons and the amount of wealth held in that group. These estimates can be compared to estimates of the total adult population and total household wealth to generate estimates of the concentration of wealth.

There are at least two major complications that arise with the estate multiplier approach. First, in the words of Lampman, “The leading disadvantage of thus deriving wealth estimates from estate tax returns arises from the fact that the ‘sampling’ is done by death rather than by a random draw of living persons” (p. 380). If the wealthy have lower mortality rates (for a given age-sex group), the estate multiplier approach will overstate the concentration of wealth. A second concern is that wealthy households substantially reduce estate tax payments through estate planning. If the wealth reported on estate tax returns understate true holdings, the estate multiplier approach will understate the concentration of wealth.

These issues take on even greater importance when looking at changes over time in wealth inequality. If opportunities for tax evasion change over time, or if variation in mortality with respect to wealth changes over time, the estimates of wealth inequality over time will be biased. I do not think much is known about the empirical importance of these potential changes over time.

Measurement of income and income inequality

This paper adds to a large literature documenting sharp increases in U.S. income inequality in recent decades. The paper is particularly useful in documenting long-term trends. But there has been important changes in compensation in recent years in the U.S. – namely, there was unusually large increase in the use of stock options. These have been shown by others to be a very substantial portion of the incomes of top earners. An important feature of options is that individuals have discretion over when they are exercised. This raises a question about whether the surge in top U.S. incomes is driven by idiosyncratic patterns of option realizations rather than fundamental shifts in patterns of income inequality.²

The data underlying the results on income concentration come from information reported on tax forms. Hence, changes in tax evasion over time could also influence the results. Professor Saez reports that most audit studies suggest that tax evasion has declined over time. But for perhaps obvious reasons, empirical measures of the underground economy, tax evasion, and other types of illegal activities are potentially problematic. The evidence on U.S. tax evasion in recent years is also inconsistent with the paper’s assertion. The IRS reports that 31 percent more

¹Lampman (1959) was one of the earliest studies taking this approach. Also see Johnson (1998) and Johnson and Woodburn (1994) for a nice discussion of issues that arise when trying to estimate wealth from federal estate tax returns.

²Professor Saez, of course, recognizes this is an issue and describes other work showing that the increase in income inequality in Canada, which mirrors the changes in the U.S., are unaffected when income aggregated over several years is used instead of annual income. I know little about compensation in Canada, but I have the casual impression that use and magnitude of options there is less extensive than it is in the U.S. Hence, similar US-Canada patterns may indicate options do not influence income concentration, or the use of options largely offset other factors that affect income concentration.

in real dollars (\$232 billion in taxes) went uncollected in 1998 than in 1988. Former IRS Commissioner Charles Rossotti testified to Congress that “the health of the federal tax administration system is on a serious long-term downtrend.” As compliance resources have been sharply scaled back in recent years, the likelihood of a face-to-face audit fell to 0.1% of all return in 2001 from 2.0% of all returns in 1977. Burman (2003) provides more details.³

Wealth inequality

Given the potential difficulties of making inferences about the concentration of wealth from estate tax data, it is potentially interesting to see if the patterns documented in this paper for the U.S. are consistent with data from the Surveys of Consumer Finances (SCFs) – the “gold standard” dataset for understanding the distribution of wealth – as well as their predecessor survey, the 1962 Survey of Financial Characteristics of Consumers. The SCFs are triennial surveys of the balance sheet, pension, income, and other demographic characteristics of U.S. families that began in 1983.⁴ Additional details on the SCFs are given in Aizcorbe, Kennickell, and Moore (2003) and their citations. The 1962 Survey was the first large-scale household wealth survey conducted in the U.S. and is described in Projector (1964).

Net worth is defined broadly and includes housing assets less liabilities, business assets less liabilities, checking and saving accounts, stocks, bonds, mutual funds, retirement accounts, certificates of deposits, the cash value of whole life insurance, and other assets, less credit card debt and other liabilities. It excludes defined benefit pension wealth, defined contribution pension wealth held outside 401(k)s, social security wealth, consumer durables, and future earnings. The concept of wealth is similar (and in some cases identical) to those used by other studies of wealth and wealth inequality.

The wealth shares held by the top one percent of households in the SCF, shown in Table 1, are considerably higher than the figures shown in this paper (the underlying calculations are in Kopczuk and Saez, 2004). At least two factors might account for the discrepancy: tax evasion and avoidance might be very important among the extremely rich, and underlying assumptions about mortality rates of the very wealthy might be incorrect. Other factors could clearly come into play.

Despite the striking differences in the two series about the *level* of wealth inequality, the conclusion – that there has been only modest increases in the top wealth share in the U.S. over the last 25 years – appears consistent with both the estate tax data and the SCF. This, however, gives a perhaps misleading impression of changes in U.S. wealth inequality over time.

Figure 1 provides a different perspective on the evolution of U.S. wealth inequality. Here I plot the ratio of net worth at a given percentile to net worth of the median (or 50th percentile)

³Other subtle issues arise: as corporate and individual income taxes change people may shift activities from corporate to “pass-through” forms (where income shows up on individual income tax forms). These shifts clearly affect income changes before and after the 1986 tax reform. They may affect patterns across other years. There are also potentially important details when using the national income and product accounts to assess the total amount of income held by individuals – the denominator of the income share calculations. The household sector NIPA account, for example, includes the incomes of the not-for-profit sector as being held by households. This must be subtracted when comparing income concentrations over time.

⁴We do not include the 1986 survey because it was conducted by telephone, rather than face-to-face, and the data are suspected of being less accurate than the other surveys.

household. In 1962 the 75th percentile had 2.7 times the net worth of the median household. The 90th percentile household had 6.1 times, the 95th percentile had 9.8 times, and the 99th percentile had 35.8 times the net worth of the median household.

Between 1962 and 2001 there was little change at the 75th percentile (the ratio rose to 3.3 from 2.7). But the ratios of net worth at high net worth percentiles to the median increased sharply. The 95th percentile household had 15.3 times the net worth of the median household in 2001 (compared to 9.8 times in 1962). The 99th percentile household had 68.8 times the net worth of the median (compared to 35.8 in 1962). These figures suggest that increases in wealth inequality over this period were driven by the extreme upper end of the wealth distribution.

Future directions of the income and wealth concentration literature

This excellent paper raises many questions that should occupy scholars in the years to come. A central result in the paper is that income inequality has surged in the U.S., but wealth inequality has not. This raises a question, why not? The paper suggests that the “working rich” with very large salaries have replaced rentiers. If the income of households at the very top of the income distribution is composed solely of capital income, it is the case, almost by definition, that increases in income concentration will be directly related to increases in wealth concentration. If labor income accounts for incomes at the top of the distribution, the link between income and wealth concentration is less immediate. Nevertheless, the budget constraint dictates that there is a relationship between income, wealth, and consumption. To the extent there is not a relationship between income and wealth concentration, do we instead see substantial changes in consumption inequality? If there has not been an increase in consumption inequality, how long will it take for changes in income inequality to eventually affect wealth inequality?

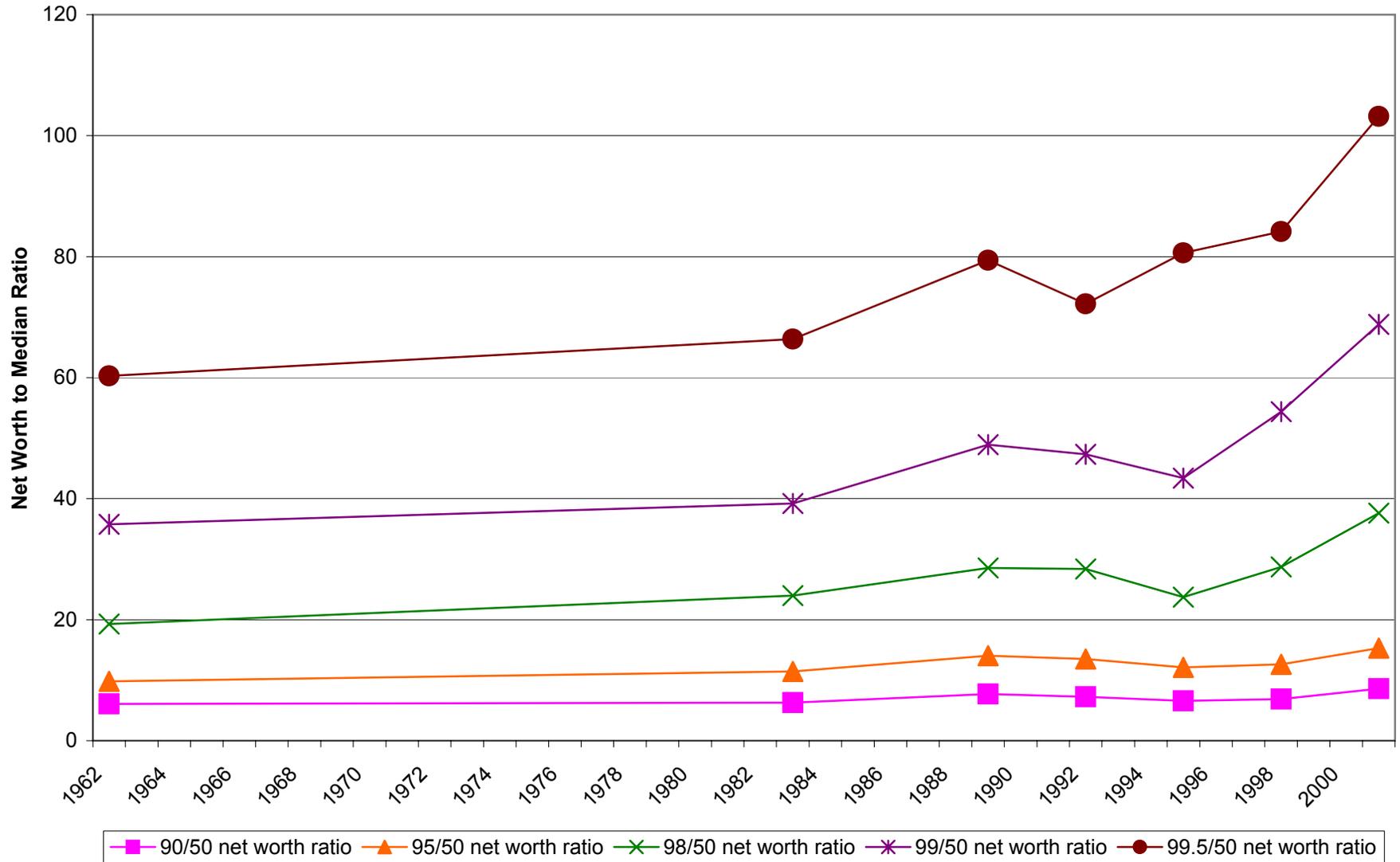
I look forward to future work that relates time series across countries on wealth and income concentration to behavioral hypotheses about the level and structure of taxation. This work will be challenging, since institutional differences across countries may also shape patterns of wealth and income growth. But, as made clear by the interesting use of data from Switzerland in this study, cross-country comparisons have considerable promise in teaching us more about the economic effects of taxation.

In closing, I would like to see more said about why scholars should care about inequality. Can the work tell us more about arguments that inequality erodes social cohesion and hence economic growth? Does income and wealth inequality influence political participation? Do changes in inequality lead to errors in expectations about life-cycle planning? Income and wealth inequality may influence many aspects of society. I look forward to reading future work by Professor Saez and his colleagues that examines the economic and social consequences of these developments.

Table 1: Concentration of Wealth, 1962 to 2001, SCF and Saez Data		
	Kopczuk and Saez (2004) estimates of top wealth shares	Estimates of top wealth shares from the SCF
	Top 1 percent	Top 1 percent
1962	24.4	31.6
1983	21.1	31.5
1989	22.0	30.0
1992	21.2	30.0
1995	21.5	35.3
1998	21.7	34.1
2001	20.8*	32.3

* The Kopczuk and Saez 2001 estimate is not available, hence the entry in the table is for 2000.

Figure 1: Net Worth Ratios Relative the Median, 1962-2001, SCF Data



References

Aizcorbe, Ana M., Arthur B. Kennickell, and Kevin B. Moore, 2003, "Recent Changes in U.S. Family Finances: Evidence from the 1998 and 2001 Survey of Consumer Finances," *Federal Reserve Bulletin*, vol. 89 (January), 1-32.

Burman, Leonard E., 2003, "Statement before the Committee on Ways and Means," July 17

Johnson, Barry W., 1998, "Updating Techniques for Estimating Wealth from Federal Estate Tax Returns," <http://www.irs.gov/pub/irs-soi/perwltes.pdf>, November

Johnson, Barry W. and Louise Woodburn, 1994, "The Estate Multiplier Technique, Recent Improvements for 1989," *Compendium for Federal Estate Tax Data and Personal Wealth Studies*, Treasury Department, IRS Publication 1773, 391-400

Kopczuk, Wojciech and Emmanuel Saez, 2004, "Top Wealth Shares in the United States, 1916-2000: Evidence from Estate Tax Returns" *National Tax Journal*

Lampman, Robert J., 1959, "Changes in the Share of Wealth Held by Top Wealth-Holders, 1922-1956," *Review of Economics and Statistics*, 379-392

Projector, Dorothy S., 1964, "Summary Description of 1962 Survey Results Survey of Financial Characteristics of Consumers," *Federal Reserve Bulletin*, vol.51 (March),. 285-293