Unit V 32: Redistribution of assets over 5 million euros?

1. Summary

As a rule, the greater the wealth, the faster it continues to grow. Economically desirable is a sustainable and efficient redistribution of wealth from top to bottom. However, a wealth ceiling should be set above which redistribution takes place systematically and efficiently. Wealth below this upper limit is desirable and should be encouraged.

2. Wealth tax as a means of wealth redistribution

2.1 Private wealth on the planet

Globally, Crédit Suisse estimated in 2014 that all private wealth combined amounted to 263,000 billion US dollars (cf. Neue Zürcher Zeitung, 15.10.2014:22). Between mid-2013 and 2014, assets totaling 20,100 billion dollars were created around the world, an increase of 8.3% over the previous year.

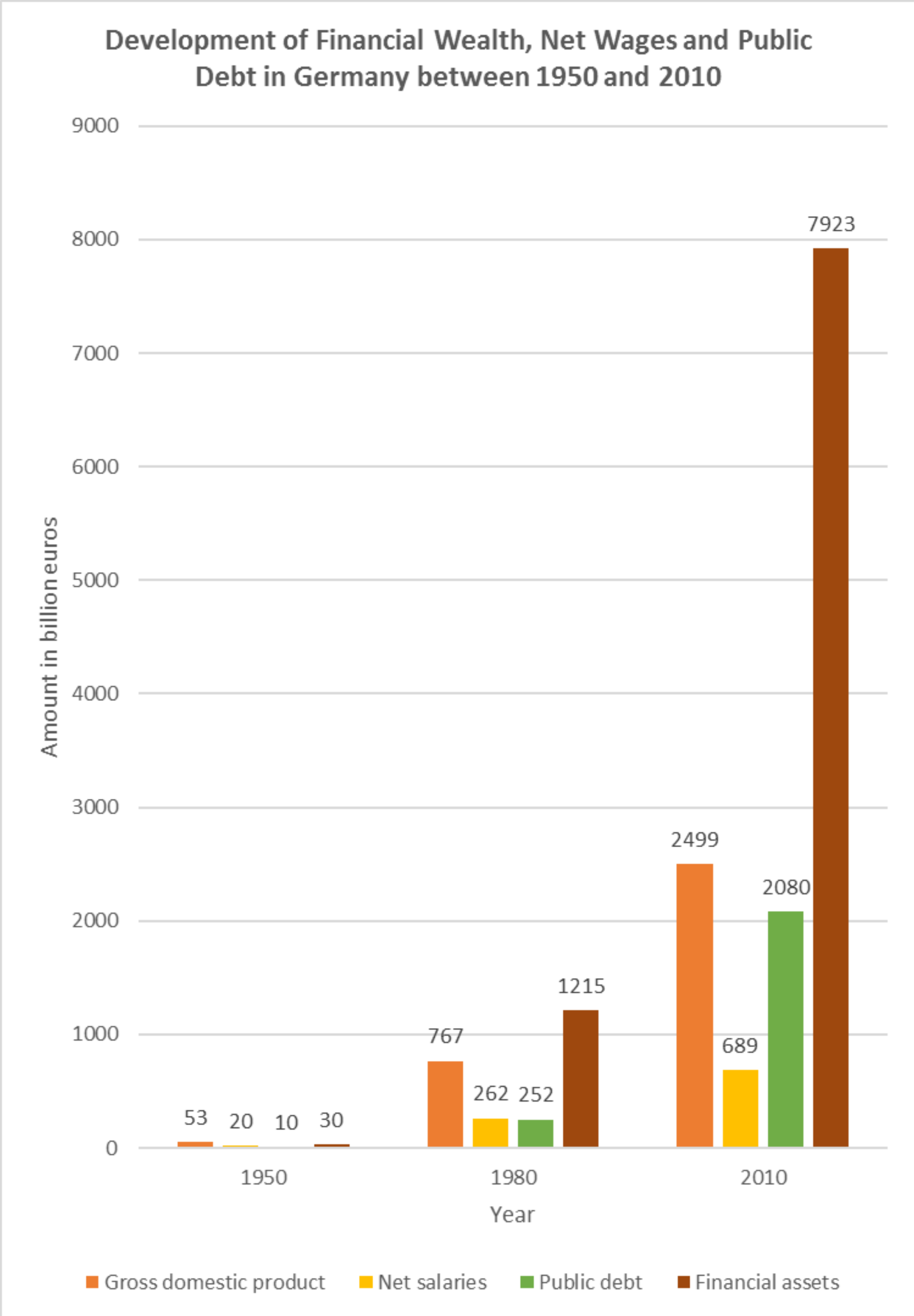
If one were to distribute the world's global private wealth among the world's population of 8 billion people, this would give a wealth of 32,875 US dollars per person. But these assets are extremely unevenly distributed.

This is true not only within individual countries, but also between nations. In 2014, the most super-rich people were in North America, Europe and Australia, but also in China and in Russia (see Neue Zürcher Zeitung of 15.10.2014:22 as well as Speiser in Schweizerische Handelszeitung of 25.9.2014:18).

2.2 Wealth Inequality

The main focus of economics is not on the distribution of wealth. However, at the latest after the 2008-2009 financial crisis, it is clear that pressure from the super-rich and the hunger of extremely financially strong institutions for ever higher profits in the financial sector is one of the decisive causes for the emergence of increasingly risky, complex and hardly manageable investment vehicles, which are euphemistically referred to as "innovative financial products". According to calculations by Allianz Global Investment, private financial assets in Germany rose to 4.88 trillion euros in 2010. Thus, they were three times as high as in 1991 and amounted to 200% of the German gross domestic product (Schmid in Humane Wirtschaft of March/April 2011:7).

Above a certain size of wealth, any relationship between the - possible! - consumption of wealth or the consumption of the wealth yield and the real amount of wealth and its yield is lost. And although multi-billionaires can hardly give any more rational reasons for further accumulation of their wealth - perhaps with the exception of further growth of their social, political and economic power and influence - the largest fortunes continue to increase massively.



Source: Creutz in Humane Wirtschaft Juli/August 2012:13; own representation.

The chart not only makes Germany's rapid economic development visible (gross domestic product), but it also shows that assets have grown ever faster than the overall economy - and at an ever greater pace.

This is worrying from an economic point of view because, on the one hand, the increasingly unequal distribution of wealth is destroying societal, economic and social solidarity, and, on the other hand, wealth on the one hand always means corresponding debt on the other. Without the huge fortunes, the current enormous national debt would not even be conceivable.

2.3 On the Much Discussed Theory of Thomas Piketty

In 2013 and 2014, the book "Capital in the 21st Century" by French economist Thomas Piketty (2014) was hotly debated.

Piketty (2014:27) assumes a fundamental inequality in the distribution of wealth, which he calls r>g inequality. Here, r means the average annual rate of return of capital, by which is meant all profits, dividends, interest, pensions and other forms of income from capital. By g is meant economic growth-or more precisely, annual growth in income or output (see Piketty 2014:25). According to Piketty, the more perfectly the capital market functions in the economic sense, the more likely is the inequality r>g.

There is a close relationship between the size of assets and the investment of money: First, the larger the assets, the greater the choice of investment opportunities. Secondly, the larger the assets, the better the advice and service when it comes to investing. Third, investment costs decrease as assets increase. Thus, the small saver only has a choice between a few expensive investment offers. Conversely, the wealthiest individuals have all investment options open to them and their information options are much better: "Instead of just reading prospectuses, you meet fund managers in person" (Stamm in Neue Zürcher Zeitung, 21.11.2015:39).

At the same time, the income situation of the richest decile of the population, which lives almost exclusively from returns on assets, developed significantly better in the USA - as in other countries - than that of the rest of the population, and has done so to an increasing extent since 1980: Between 1910 and 1940, the richest 10% of the US population already had 40 and more percent of national income. After World War II until the 1980s, their share was below 35%, rising again to 40% from around 1985 and to an average of close to 47% from 2000 (see Piketty 2014:24).

According to Piketty (2014:24), the reason for the high incomes of top managers is not so much their allegedly high productivity - as they like to pretend - but primarily the fact that top managers have the ability to largely determine their own wages and additional compensation (Piketty 2014:24).

One reason for the relative decline in the income share of the richest decile of the population in national income between 1945 and 1980 may be that during this period the economy boomed and wages - i.e., direct labor income - increased at an above-average rate.

It is a fact that the richest own a disproportionate amount of wealth and accordingly have a disproportionate amount of income.

Added to this is the fact that income per capita in rich countries remains permanently higher than in poor countries - even though investors from rich countries increasingly invested in poor countries (see Piketty 2014:70).

According to Piketty (2014:52), the formula $\alpha = r \times \beta$ expresses the ratio of capital (capital stock) and the flow of income from capital. Here, β is the capital/income ratio and r is the rate of return on capital. Piketty (2014:52) refers to this formula as the first law of capitalism. The rate of return on capital is calculated using the following formula:

$$\frac{\text{Net income - Dividend}}{\text{Total capital}}$$

As the second law of capitalism, Piketty (2014:166) formulated: $\beta = s / g$, where β stands for the capital-income rate, s for the savings rate and g for growth. If economic growth is 2% and the savings rate is 12%, then the capital-income rate is 600%. In other words: In this case, a country will accumulate capital of six years' national income (see Piketty 2014:1669. According to Piketty, $\beta = s / g$ is a long-term law that every economy approaches over years and decades.

According to Piketty (2014:244), inequality is always greater for capital income than for labor income: "The distribution of capital ownership (and of income from capital) is always more concentrated than the distribution of income from labor" (Piketty 2014:244).

Thus, one can speak of inequality of wealth and income in a threefold sense: Within individual countries, between rich and poor countries, and between capital and labor income.

2.4 Possible solutions

Over time, many proposals have been made to redistribute wealth from top to bottom - but surprisingly, for decades the only effective redistribution of wealth has been in the opposite direction, from bottom to top.

Unfortunately, most redistribution models have not worked, either because they were too radical - e.g. the Marxist ideas of abolishing private property, nationalizing industry, agriculture and land - or because they did not go far enough and only scratched the surface, such as higher and or more progressive wealth taxes, inheritance taxes, social security contributions on all wages, but benefit caps at the top - as in Switzerland for example with the state pension scheme AHV.

2.4.1 Inheritance taxes

Recently, the so-called inheritance tax initiative has been particularly discussed in Switzerland. This initiative was submitted by the Swiss Social Democratic Party, the Green Party, the Protestant People's Party and the Swiss Federation of Trade Unions.

Federal popular initiative "Tax millions of inheritances for our AHV (inheritance tax reform)".
I
The Federal Constitution shall be amended as follows:
Art. 112, para. 3, subpara. abis (new)
3 The insurance shall be financed
abis. from the proceeds of the inheritance and gift tax;

Art. 129a (new) Inheritance and gift tax
1 The Confederation shall levy an inheritance and gift tax. The tax shall be assessed and collected by the Cantons. Two-thirds of the proceeds shall be paid to the compensation fund of the old-age and survivors' insurance scheme, and one-third shall remain with the Cantons.
2 Inheritance tax is levied on the estate of natural persons who were domiciled in Switzerland at the time of death or for whom the inheritance was opened in Switzerland. Gift tax is levied on the donor.
3 The tax rate is 20 percent. The following are not taxed:
a. a one-time allowance of 2 million francs on the total of the estate and all taxable gifts;
b. the portions of the estate and gifts made to the spouse, registered partner or registered partner;
c. the parts of the estate and the gifts made to a legal entity exempt from tax;
d. Gifts of no more than 20,000 francs per year and person receiving the gift.
4 The Federal Council shall periodically adjust the amounts in line with inflation.
5 If companies or farms are part of the estate or gift and are continued by the heirs, legatees or donees for at least ten years, special reductions in taxation shall apply so that their continued existence is not jeopardized and jobs are preserved.
II
The transitional provisions of the Federal Constitution are amended as follows:
Art. 197 item 9 (new)
9 Transitional provision on Art. 112, para. 3, subpara. abis and Art. 129a (inheritance and gift tax)
1 Articles 112 paragraph 3 letter abis and 129a shall enter into force on 1 January of the second year after their adoption as directly applicable law. On the same date, the cantonal decrees on inheritance and gift tax shall be repealed. Gifts shall be added to the estate with retroactive effect from 1 January 2012.
2 The Federal Council shall issue the implementing regulations for the period until the entry into force of an implementing act. In doing so, it shall observe the following requirements: a. The taxable estate shall be composed of:
1. the market value of the assets and liabilities at the time of death;
2. the taxable gifts made by the testator or decedent;
3. the assets that have been invested in family foundations, insurance policies and the like in order to avoid tax.
b. Gift tax shall be levied as soon as the amount referred to in Article 129a(3)(a) is exceeded. Gift taxes paid shall be credited against the inheritance tax.
c. In the case of companies, the reduction pursuant to Article 129a(5) shall be implemented by granting an allowance on the total value of the companies and reducing the tax rate on the taxable residual value. In addition, an installment payment may be granted for a maximum of ten years.
d. In the case of agricultural enterprises, the reduction pursuant to Article 129a(5) shall be implemented by disregarding their value, provided that they are farmed by the heirs, legatees or donees themselves in accordance with the provisions on farming land rights. If they are abandoned or disposed of before the expiry of the ten-year period, the tax shall be demanded pro rata thereafter.
Source: http://www.admin.ch/ch/d/pore/vi/vis414t.html; translated by DeepL.

The inheritance tax initiative was massively rejected in the referendum of June 14, 2015, with 71% of the vote (see Amrein in Neue Zürcher Zeitung, June 15, 2015:9). There are undoubtedly good reasons for this rejection:

From an exemption amount of 2 million francs per testator, inheritances should have been subject to a tax of 20%. The main initiator of the inheritance tax initiative was Hans Kissling, economist and former head of the Statistical Office of the Canton of Zurich (cf. Wegelin in WochenZeitung, 2.4.2015:3). Although SMEs are exempt from tax - i.e. up to an amount of 50 million Swiss francs - the initiative was problematic. Although the concern made sense in principle, the exemption amount was set too low: Many properties - i.e. single-family houses and condominiums - are worth significantly more than 2 million today. If the initiative had been accepted, this would have forced many heirs of properties to sell them or to take on massive debt (increasing the mortgage) in order to pay the inheritance taxes. This was neither economically desirable nor sensible. If anything, an exemption amount of up to 5 million francs would have been appropriate. Above all, the very large fortunes would have to be taxed. Even if two-thirds of the tax revenue generated by the inheritance tax would have benefited the state pension scheme (AHV), this does not change the fact that many citizens were very skeptical about state redistribution measures. Moreover, the retroactivity clause stipulated in the initiative was legally unacceptable as of the beginning of 2012 and would have led to legal uncertainty. Even though other countries know relatively high inheritance taxes for direct descendants, such as Germany up to 30%, USA up to 40% and France up to 45% (cf. Wegelin in WochenZeitung of 2.4.2015:3), inheritance taxes are problematic and - in contrast to other redistribution models, cf. chapter 2.4 - do not lead to a broader distribution of wealth. In addition, Switzerland, unlike all other countries, has a taxation of imputed rental value in the form of a taxation of a fictitious income, which considers the use value of the owner-occupied apartment or property as income - without generating even one franc of income.

Worldwide, the taxation of wealth varies widely. The table below shows that wealth taxes in Switzerland are the highest compared to other European OECD countries - although still low when measured against income taxes:

Wealth taxes in selected OECD countries (as % of total tax revenue)			
	1995	2005	2015
Switzerland	2,87	3,40	3,62
Luxembourg	1,59	1,45	2,00
Norway	1,31	1,02	1,01
Iceland	1,16	0,00	0,00
Netherlands	0,54	0,02	0,00
Spain	0,44	0,42	0,32
Sweden	0,41	0,36	0,00
Germany	0,26	0,01	0,00
France	0,25	0,40	0,52
Italy	0,21	0,00	0,00
Denmark	0,19	0,00	0,00
Finland	0,08	0,18	0,00
Austria	0,06	0,00	0,00
Greece	0,05	0,00	0,00
* listed are all OECD countries with wealth taxes in 1995			

Source: Brühlhart/Schmidheiny in Die Volkswirtschaft 5-2017:35.

2.4.2 Direct redistribution of large assets by their owners

Measures for wealth redistribution must be **simple and transparent**, **far-reaching enough** to ensure a long-term redistribution of wealth, especially at the top and highest levels, and without too much government bureaucracy.

One possible solution would be to set an upper wealth limit of **5 million euros or 5 million U.S. dollars** for each person. With a modest return of 2%, the annual return on assets would be 100'000.-, which is very comfortable to live with in practically all countries.

For non-adults, the limit could be 2.5 million euros or US dollars.

An important reason why models of wealth redistribution - such as the wealth tax or the inheritance tax initiative in Switzerland - failed again and again was, apart from the resistance of the wealthy, mainly that the exemption limit was set too low, which created fear of loss among small and medium-sized fortunes. Saving should be worthwhile, but excessively large assets should be curtailed.

Globally, this means that with (2012) 6.5 billion (adult) people, assets of $32.5 quadrillion - that is, $32,500,000,000,000 - would be needed to give each person $5 million. If we calculate a maximum wealth of $2.5 million for children and young people, this amount would be reduced even more significantly. If one considers that in 2012, according to estimates, 800,000 billion - or 800 trillion - dollars alone were in circulation in the form of libor-linked financial products - cf. Schweizerische Handelszeitung of July 12, 2012:19 - thus covering assets in the corresponding amount - , then one can easily imagine that assets in the form of real estate, shares and precious metals alone are likely to exceed this amount by far.

In Switzerland, the assets of private households amounted to 2691.2 billion Swiss francs in 2011 (see Lüscher 2012:85), more than 5 times the gross domestic product. Arithmetically, this resulted in - with 7 million inhabitants - 384,442.- per person. If the assets of companies and - non-governmental - non-profit organizations (associations, foundations and cooperatives) are added, this amount increases considerably. In 2009, according to the accounts of the Swiss National Bank, Switzerland's financial assets amounted to 7430 billion francs, or more than 1 million francs per inhabitant (cf. Lüscher 2012:90).

Should it become apparent in the longer term that an interest rate of 2% will not (or no longer) be possible, then the permissible asset limit can also be raised by a consensus of society as a whole, e.g. to $10 million with an average interest rate of 1%.

But what happens to asset holdings above this limit? History has shown that government skimming of wealth - e.g., through taxes - does not work: Either the siphoned-off funds are spent on pointless prestige projects or even dangerous purposes - such as high-armament projects - or they lead to the enrichment of individuals or groups.

For this reason, it is preferable in any case that the owners of assets over 5 million decide for themselves to whom they will give these assets: to their partner, children, relatives, friends or needy people in Switzerland or abroad. For people who do not want to or cannot pass on their surplus assets personally, there is the option of transferring them to funds or companies.

From an economic point of view, it is not so crucial who the beneficiaries are individually; what is more important is that the assets - and thus also the income from the asset income - are distributed broadly and support consumption accordingly. Or, to put it another way: that this income not only remains in the highly speculative money cycle, i.e. in the financial cycle, but also, as far as possible, to a large extent in the goods and production cycle of the economy and drives the real economy. Assets invested in the real economy tend to boost production and thus do not have an inflationary effect per se. By contrast, highly speculative assets tend to increase inflation because they inflate the amount of financial capital without being matched by a corresponding increase in output on the goods production side.

In this context, it is also of interest to know what share of the gross domestic product would accrue to each person if the entire gross domestic product of the earth were distributed among all people. If the current global gross domestic product of around 60 trillion dollars were distributed among all people, this would result in a monthly pension of just under 800 dollars per person (cf. Wegelin in WochenZeitung of August 20, 2009).

3. Control Questions

1. Why is an extreme distribution of wealth not desirable?
2. What is the basic thesis of Thomas Picketty?
3. Explain Picketty's first and second laws of capitalism.
4. What has caused previous redistribution proposals to fail?
5. Name the main points of the inheritance tax initiative.
6. What are the advantages and disadvantages of an upper wealth limit, and where could it be set and why?
7. What should owners of assets above the redistribution limit be able to determine themselves?

4. Links

Vermögenssteuern (Schweiz)
http://www.hls-dhs-dss.ch/textes/d/D26201.php

Eidgenössische Volksinitiative „für eine Reichtumssteuer“: Initiativtext
http://www.admin.ch/ch/d/pore/vi/vis116t.html

Steuerpolitik: Reiz des Reichtums
http://www.focus.de/finanzen/steuern/steuerpolitik-reiz-des-reichtums_aid_400698.html

Informations about Thomas Pikettys „Capital in the twenty-first Century“:
http://piketty.pse.ens.fr/fr/capital21c

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15.6.2015: Amrein, Marcel: Klares Nein zur Erbschaftssteuer-Initiative. 9.
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