CRESUS

Measuring and mobilizing wealth for a cohesive, inclusive and fair society

SARAH KUYPERS[1], ANDRÉ DECOSTER[2], JUSTINA KLIMAVICIUTE[4,3], MATHIEU LEFEBVRE[6,3], IVE MARX[1], SERGIO PERELMAN[3], PIERRE PESTIEAU[3], JEROME SCHOENMAEKERS[3], KEVIN SPIRITUS[5,2], GERLINDE VERBIST[1]

(1) Herman Deleeck Centre for Social Policy, University of Antwerp
(2) Research Centre of Public Economics, KU Leuven
(3) CREPP, HEC, University of Liège
(4) Vilnius University
(5) Erasmus University Rotterdam
(6) University of Strasbourg

RESUME IN ENGLISH

Context

Intuitively income and wealth are often considered to be two sides of the same coin because an important part of wealth accumulation originates from the saving of earned income. However, their relationship is more complex than that; wealth can also be accumulated by receiving inheritances and gifts, by means of mortgages and loans, through rising asset prices and the income generated by wealth itself. Hence, although the relationship between income and wealth is strong, it is far from perfect. In other words, those who earn the highest (lowest) income do not necessarily own the highest (lowest) wealth. This in turn implies that analysing just one of the two distributions provides only partial insights. It is only recently that the importance of analysing income and wealth jointly has been acknowledged. Throughout modern history we have witnessed a shift of focus from wealth, which was mainly studied until the early twentieth century, to income around the World War period and then recently back to wealth as a way to address new socio-economic and demographic issues such as the threat of robotisation, increasing levels of inequality, population ageing and the recent financial crisis.

Under the impulse of these socio-economic and demographic processes the number of wealth studies has increased exponentially over the last decade, further stimulated by the influential work of Thomas Piketty and his colleagues. This renewed interest in wealth research has gradually also resulted in an expansion of available wealth data. Yet, although the interest in wealth is booming, attention towards some of the issues we addressed in the CRESUS project is still remarkably low. In particular, there remains an important void regarding wealth research from a social viewpoint, i.e. what does the wealth distribution and its correlation with income imply for the definition and analysis of poverty and inequality, taxation and redistribution, long term care, etc.?

Objectives

At the start of the CRESUS project we knew quite a lot about the distribution of market and disposable incomes in Belgium, while we knew hardly anything about the distribution of net wealth. Our first set of objectives was to describe for Belgium the distribution of wealth and its relationship with the distribution of income. We also studied the long-term evolution of top income shares based on fiscal data. The second aim of the project was then to take this information to improve the traditional approaches to measure poverty, inequality and redistribution by accounting for wealth. Another objective was to assess the role of wealth in social policy design, where we focused on the design and effects of asset-tests in minimum income protection schemes, the potential for introducing asset-building policies which might be able to complement existing protection schemes for the poor and estimating the substitution effect of public pension entitlements on private savings and assets. Furthermore, we studied wealth taxation both from a theoretical and empirical perspective. The last objective focused on describing the incidence of and motives for intergenerational transmission of wealth and how this information affects the design of an optimal long-term care insurance policy.

Methodology

Our analyses mostly rely on data from the Eurosystem Household Finance and Consumption Survey (HFCS) and the Survey of Health, Ageing and Retirement in Europe (SHARE). For the study of the top income share fiscal data were used. For the joint analysis of the income and wealth distribution, the stock of wealth was transformed into an annual annuity which was then added to income to end up with an ‘augmented income concept’. The policy analyses mainly relied on microsimulation techniques, for which the HFCS data were transformed into a an underlying database for the EU-wide tax-benefit microsimulation model EUROMOD and extended with additional policy sheets on wealth taxation and another microsimulation model was constructed to compute detailed entitlements to social security wealth. The optimal progressive taxation of wealth and capital income was developed within the framework developed by Mirrlees (1971, 1976) and Atkinson and Stiglitz (1976).

Main results

Thanks to the research carried out in the framework of the CRESUS project we now know much more about the distributions of net wealth, intergenerational transfers and the share of top incomes, as well as the extent to which income and wealth go hand in hand. We find that wealth is much more unequally distributed than income, but that Belgium appears to be somewhat of an exception in international comparison. Indeed, inequality levels for both income and wealth are relatively low, especially in combination with their high average levels and there is no clear evidence for an increase in inequality or top income shares. Furthermore, wealth and income are positively correlated, but far from perfectly. Households who are at high risk of having both low income and low wealth are mainly those who have a reference person that is young, unemployed or inactive, low educated, migrant, single, and above all a tenant, while there is much less risk among the elderly. Estimations of the long-term evolution of inheritances indicates that both its annual flow as a percentage of national income and its accumulated stock as a share of the total stock of wealth followed a U-shaped pattern. Both indicators show that the importance of inheritances has increased substantially over the last decades, such that today about 80 per cent of total wealth consists from inherited wealth rather than wealth accumulated through own savings and merits.

Measuring poverty based on a joint indicator of income and annuitized wealth results in lower poverty rates when the poverty line is kept at the same level as for income poverty, while it increases when a fully relative approach is used (i.e. the poverty line is set at 60% of the median of the augmented income concept). In the multidimensional approach towards joint income-wealth poverty about 60 per cent of income poor people are found to own sufficient assets not to be considered asset poor, while in contrast 4.6 per cent of Belgians are currently not considered poor but own little or no assets to fall back on. When applying the augmented income concept including annuitized wealth to inequality and redistribution, we find that redistribution is considerably lower when wealth is taken into account, such that inequality is much higher.

The decomposition of the total redistributive effect showed that all tax-benefit instruments are less effective if assessed against the joint distribution of income and wealth. Social benefits are, however, the important exception; they remain a strongly pro-poor instrument. In other words, social benefits are primarily received by households who are both income and asset poor, which is mainly due to the effect of asset-testing in the awarding of minimum income benefits. Yet, since minimum income benefits often lie below the poverty line, we also looked into the prospects of supplementing existing social provision with so-called asset-building

policies. Our results indicate that such a policy would preferably focus first on the accumulation of liquid asset holdings and that it would costs less than the tax exemptions and credits currently awarded in the tax system for the accumulation of assets. Yet, finding a correct balance between asset-testing on the one hand and encouraging asset accumulation among the poor on the other hand might be a difficult trade-off. We estimated the potential crowding out effect of another important social provision, public pensions, on private wealth accumulation, which is found to be about 14 to 25 cents. Furthermore, we identified that intergenerational transfer motivations are mainly driven by altruism and family norm reasons, which are argued to matter for the design of an optimal public long-term care policy.

Finally, with regard to wealth taxation our results point towards the optimality of taxing capital income and combining it with a comprehensive inheritance & gift tax. Moreover, all types of capital income should be treated equally, which means that also capital gains should be taxed and tax expenditures need to be abolished. The best way to tax capital income would be through the so-called 'Rate of Return Allowance', taxing mainly excess returns to capital income. Our empirical analysis indicated that a comprehensive tax system does not exist today. Indeed, although capital income taxes and the general net wealth taxes of France and Spain are progressively distributed, their size is just too small to achieve any redistribution. This is mainly because effective tax rates are a lot lower than marginal tax rates due to the many tax exemptions, deductions and credits.

Conclusions and policy recommendations

Our results lead to many interesting policy recommendations. First, we highlight the need to complement existing social indicators with indicators including information on wealth. Second, asset-testing seems to be able to exclude the better-off of the income poor from benefit entitlements. But this comes of course at the cost of increased complexity in the claiming process and hence substantial non-take-up. Third, pro-poor asset-building policies might be an interesting new policy path supplementing existing provisions for the poor, but more research into this matter is needed. Fourth, our results regarding the substitution effect between public pensions and private savings is highly relevant for the ongoing pension reform debates and we recommend that reforms affecting individuals' pension rights must be announced several years in advance, such that people will have the opportunity to adjust their retirement savings accordingly. Next, we recommend to introduce the deductible formula in both private and public LTC insurance and to better control the phenomenon of strategic impoverishment that makes middle class households benefit from schemes that are targeted to the poor. Finally, the wealth tax system should consist of a broad-based comprehensive tax on capital income and inheritances & gifts. Yet, how it should look like in practice remains subject for further research. However, it is clear that in order to be able to tax wealth efficiently and fairly we need to introduce a wealth register. The proceeds of increased or new capital or wealth taxes could then be used to finance the proposals on asset-building policies and/or LTC social insurance.

Keywords

Wealth, inequality, poverty, redistribution, optimal taxation, inheritance, long-term care insurance