Taxation of Wealth in Low- and Middle-Income Countries: Theory, Evidence, and Gaps

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[1] I thank Kuda Maposa and Juan Schiavoni for outstanding assistance

Motivation

- Increasing demands to tax **capital** more
  - Conventional wisdom (zero capital tax results) has been overturned
  - **Inequality:** Increasing consensus inequality $\uparrow$ & that the rich don't pay their fair share (Rio G20 Declaration)
  - **DRM:** Increasing revenue needs

- Strengthening the taxation of the wealthy?
  - **Wealth tax** (WT) or/and **capital income tax** (KIT)
  - Trade-offs between imperfect instruments

Outline: Taxing wealth in a globalized world

1. Overview: Global trends and L&MICs currently taxing wealth

2. Should L&MICs tax wealth?

3. What do we know? What's next?

Global Trends in WT

- WT rare/abandoned in most advanced countries that had one
- Renewed interest on progressive WT in L&MICs and U.S. (to curb rising ineq & DRM)
- 'Proud to Pay More': an open letter from 260 billionaires begging global leaders to tax the extremely wealthy
- EU-TO's proposal: a coordinated 2% min tax on global billionaires (Zucman, 2024)

Proud to Pay More [link]

- Remarkable call to tax extreme wealth
- *"Our request is simple: we ask you to tax us, the very richest in society. This will not fundamentally alter our standard of living, nor deprive our children, nor harm our nations' economic growth. But it will turn extreme and unproductive private wealth into an investment for our common democratic future"* (link to report)

L&MICs currently taxing wealth? Non-exhaustive overview

- **LAC:** Argentina, Colombia, Uruguay.
  More recently: Suriname, Ecuador, Bolivia, Venezuela, Chile (luxury only)
- **Africa:** Algeria (0.15-1% on wealth >USD 750k), Zimbabwe (real estate)
  - Specialized HNWI units in many countries (e.g., Santoro & Waiswa, 2024)
- Tax schemes vary in design and scope (OECD, 2018; Hebous et al, 2024)
  $\rightarrow$ some recent experiences...

Bolivia's 'Tax on Large Fortunes (IGF)'

- Since 2020, progressive tax of 1.4%-2.4% on wealth >USD 4.3m
- Collected USD 65m from 225 taxpayers in 2021–22 [link]
- Highly targeted on ultra-wealthy; little revenue (0.4% of total tax revenue)

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Zimbabwe's wealth tax (real estate)

- Since 2024, 1% tax levied on properties worth >USD 250k (a notch)
  - Tax liability capped at USD 50k per property. People aged 65+ exempt [link]
- Revenue earmarked for urban infrastructure
  - Roads, water systems, sewage networks, and community health centers
- Handled by ZIMRA with assistance from local councils (pivotal role)
- Policy's effectiveness and long-term effects are yet to be studied
  - E.g., revenue, non-compliance, bribes, investment, relocation

Should L&MICs tax **stocks** of the wealthy? WT vs KIT

Key aspects:

- Increasing inequality and revenue needs
- Equity–efficiency trade-off at the heart of the academic/policy debate
- WT taxes 'normal returns'/unrealized gains, but not 'excess returns' (spent or saved?)
  $\rightarrow$ High-yielding investments bear light taxation
- Wealth in the utility function: confers advantages beyond consumption it finances (e.g., Saez & Stantcheva 2018, Kopczuk 2013)
- Externalities from excessive wealth concentration (political influence, democracy)
- Adding WT to diversify revenue sources and prevent any one tax from getting too high? (but new admin costs)
- 'Third-best' context: tax agencies face significant info and capacity constraints

Can the benefits outweigh the costs?

Should L&MICs tax **stocks** of the wealthy? Recent developments

Disagreement on (i) practical/political considerations, and (ii) optimality
[Kopczuk 2013 2019; Hebous et al 2024; Adam & Miller 2021; Saez & Zucman 2019; Piketty et al 2023]

Recent normative studies (relevant for L&MICs):

1. Guvenen et al (2023). Use It or Lose It: Efficiency & Redistributional Effects of Wealth Taxation
2. Guvenen et al (2024). Book-Value Wealth Taxation, Capital Income Taxation, and Innovation
3. Rotberg & Steinberg (2024). Tax Evasion and Capital Taxation
4. Aguiar, Moll, Scheuer (2024). Putting the 'Finance' into 'Public Finance'
5. Schjelderup & Zoutman (2024). Wealth Taxation: The Key to Unlocking Capital Gains
6. Also: Adam & Miller (2021), Piketty et al (2023), Bastani & Waldenström (2023)

Guvenen et al (QJE 2023)

Advantage of WT over KIT: use-it-or-lose-it mechanism

- Study capital taxation under return heterogeneity (Fagereng et al, 2020)
  - Assume: (i) excess returns created by productive activities (not by luck or rent-seeking); (ii) incomplete credit markets (credit-constrained entrepreneurs); (iii) no evasion
  - **Broad-based WT** rather than targeted at the top; levied on the **book value** of assets
- Idea: KIT borne disproportionately by high-ability entrepreneurs; WT borne by low-ability $\rightarrow$ KIT creates more capital misallocation
- Under WT, taxpayers with =wealth pay =taxes regardless of productivity $\rightarrow$ WT shifts tax burden toward unproductive taxpayers, expands tax base, encourages savings of productive taxpayers, boosts overall productivity/growth
- Optimal WT delivers higher average welfare than optimal KIT

  Bulk of gains come from a higher capital level and improved allocation of capital

Rotberg and Steinberg (JPE 2024)

- GE model w/ tax evasion: taxing **capital** more heavily would lead to $\uparrow$ offshore evasion, tax revenue $\uparrow$ marginally or $\downarrow$, $\uparrow$ inequality, and widespread welfare losses
  - 2 pp KIT hike would $\uparrow$ concealed wealth and lost revenue by 50%
  - Flat 1% WT would $\uparrow$ concealed wealth by 500%
- Progressive WT on ultrawealthy (above a cutoff) would be even worse ($\downarrow$ 0.9% GDP)
- One-time progressive WT delivers more promising results (as in Adam & Miller 2021)

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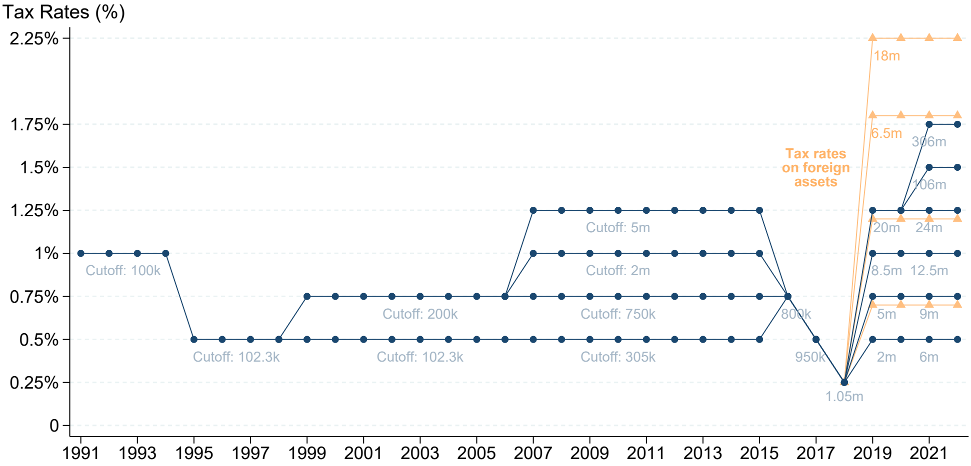
Caveat! Model's implied elasticity of reported wealth is a bit off w.r.t existing studies

- e.g., Short run e: 10 here vs 2-4 in Londono-Velez & Avila-Mahecha (2024)
- So, people are too responsive in their model?

Example: reported wealth in Argentina less sensitive to τ than model suggests

Londoño-Velez & Tortarolo (2023) ▸ Bunching



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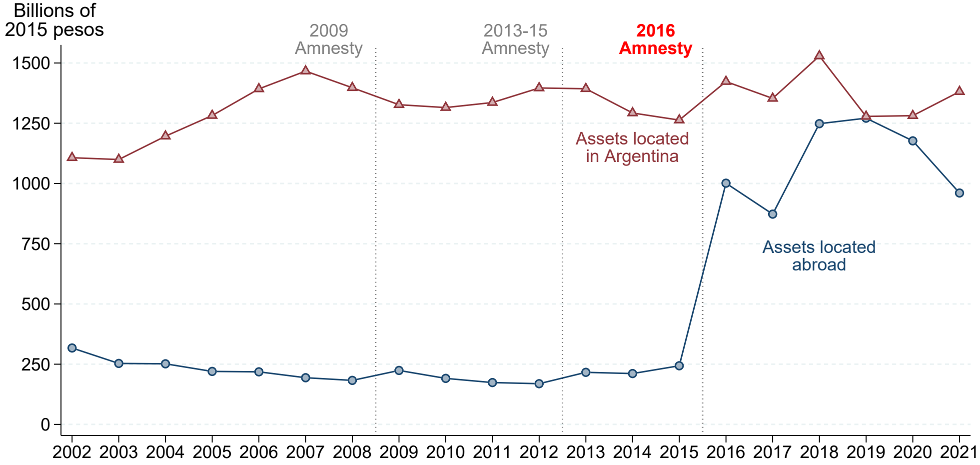


Empirically, what do we know about WT?

The Good, the Bad, and the Ugly

- **A lot in developed economies**
  (Alvaredo & Saez 2009; Agrawal et al 2023, Jakobsen et al. 2020; Brülhart et al. 2022; Seim 2017; Duran-Cabré et al 2019; Ring 2020, Garbinti et al 2024; Iacono & Smedsvik 2023; Zoutman 2018; Marti et al. 2023; Baselgia & Martinez 2024; Jakobsen et al. 2024; Alstadsæter et al. 2018 2019; Johannesen et al. 2020; Leenders et al 2023; Baselgia 2024; Boas et al 2024)

- **Not so much in L&MICs**
  (Londono-Velez & Avila-Mahecha, 2021, 2024; Czajka et al 2021; Londono-Velez & Tortarolo 2024)

The EU (negative) experience shaped much of the debate

EU history shows that wealth taxes are fragile (Saez & Zucman 2019)

Four main (historical) weaknesses:

1. No comprehensive tax base (tax avoidance)
2. Mobility of residence (avoidance) and assets (offshore evasion)
3. Liquidity problems when exemption threshold is too low
4. Valuation concerns (self-assessment; base can't be fully covered by info reporting)

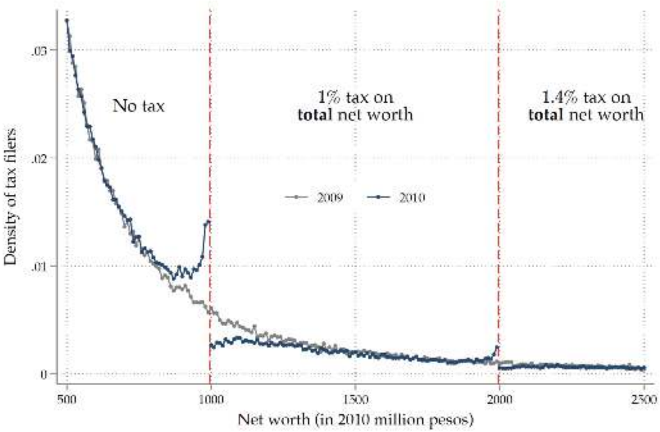
Piketty, Saez, Zucman (2023) optimistic that issues can be resolved in today's world

Taking stock of knowledge

- Capital income and wealth highly concentrated at the top [Chancel et al, 2022]; even more so in developing countries [Bergolo et al, 2023]
- People respond to WT, but anatomy varies a lot [Scheuer & Slemrod, 2021]
  - Declared wealth, asset composition, savings/accumulation, mobility, price capitalization
  - Advani & Tarrant (2021): design features, context, and methodology matter
- Avoidance/evasion (e.g., offshore) are common, and concentrated at the top too
- Current landscape of global tax coordination has enabled better enforcement of capital taxes at the top

Responses to Colombia's WT

Londoño-Velez & Avila-Mahecha (2024)



1. Taxpayers bunch below higher WT thresholds
2. Hysteresis: lasting impact even after WT abolished
3. Driven by misreporting of unverifiable assets (non-3rd-party-reported)
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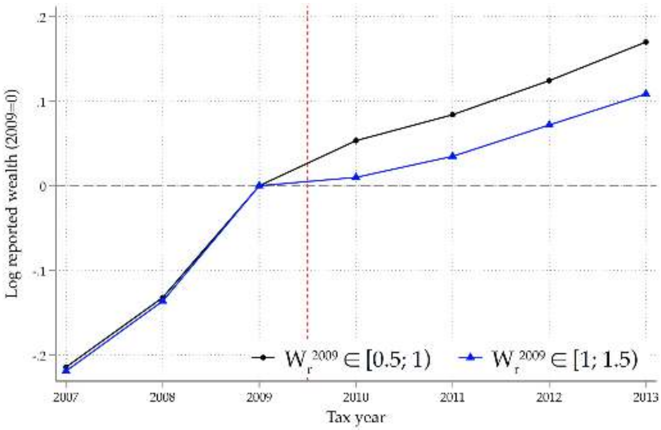

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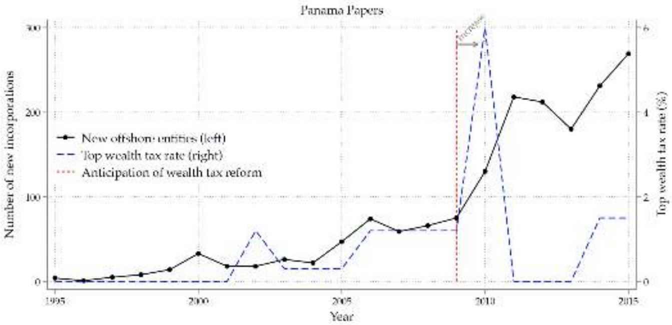

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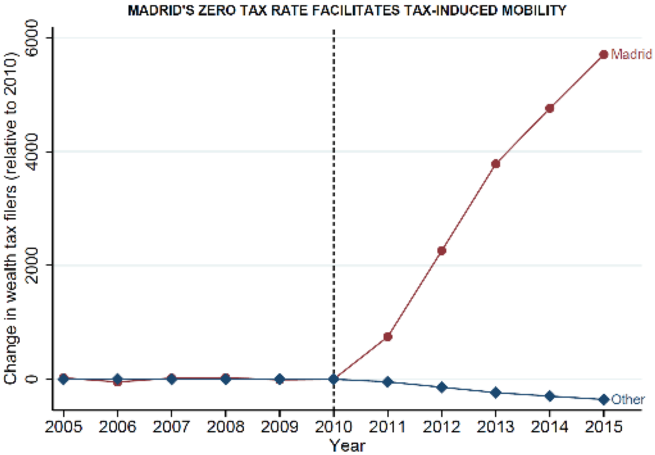
Mobility Responses to WT: large in Spain, small in Scandinavia

Agrawal, Foremny, Martínez-Toledano (2023); Jakobsen et al (2024)



Concern: mobility may undermine the goals of WT (but also PIT!)

1. N wealthy individuals living in Madrid ↑ 7.5% following Madrid's 0% WT after 2011
2. Wealth tax repeal significantly reduced out-migration rates in Sweden & Denmark

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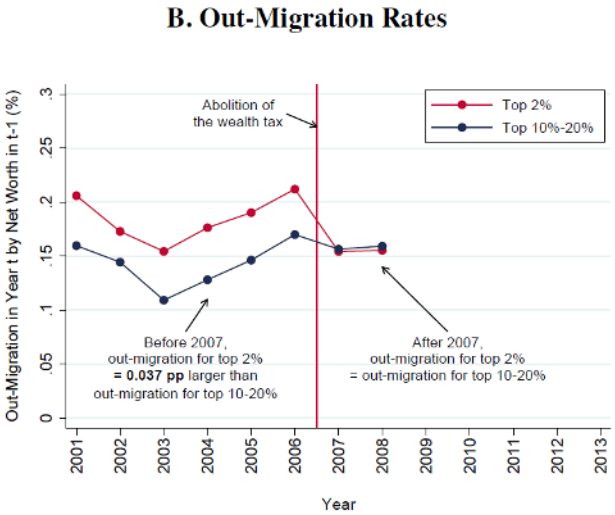

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Offshore tax evasion and WT

- Offshore tax evasion is an important threat to progressive WT (Londoño-Velez & Avila-Mahecha 2021; Rotberg & Steinberg 2024)

- But tax evasion is not a law of nature (Alstadsæter et al, 2024)
  $\longrightarrow$ Taxing wealth must come in tandem with cracking down on offshore evasion

- Substantial disclosures of offshore assets can take place in the current landscape of global tax coordination $\longrightarrow$ even in countries with low baseline tax compliance
  - **Colombia**: Londoño-Velez & Avila-Mahecha (2021)
  - **Argentina**: Londoño-Velez & Tortarolo (2023)

Argentina is actively using CRS/FATCA info to crack down on offshore evasion

LA NACION

Dólar: Oficial $97,75 $103,75 Blue $180,50 $184,50

"ELEVADOS PATRIMONIOS".

La AFIP tiene bajo la lupa 3000 cuentas bancarias de argentinos en el exterior

No fueron declaradas ante el fisco durante los periodos 2016 y 2017; la Administración Federal de Ingresos Públicos seguirá investigando información que recibió de otras entidades tributarias del mundo

Source: La Nacion, October 9, 2021.

- Translation:

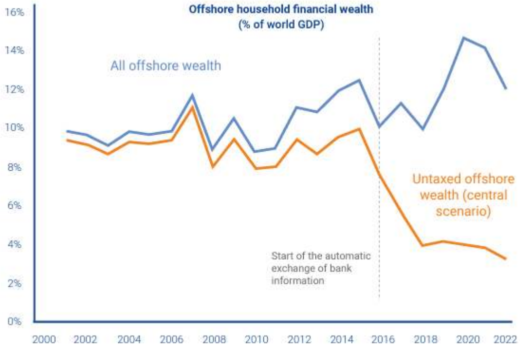
  "3,000 foreign bank accounts under investigation"

  "They were not reported to AFIP in 2016 and 2017; AFIP will continue to investigate information received from other tax entities around the world"

- Reinforces the value of AEOI
  More news: [1] [2] [3]

Globally, efforts to curb offshore tax evasion have paid off

Figure 1
The success of the automatic exchange of bank information



Notes: This figure reports the evolution of global household offshore financial wealth (expressed as fraction of world GDP), and of untaxed offshore financial wealth in the central scenario detailed in chapter 1. In this scenario 27% of offshore financial wealth is untaxed in 2022, representing 3.2% of world GDP. Source: for global offshore financial wealth, Souleymane Faye, Sarah Godar, and Gabriel Zucman (2023), "Global Offshore Wealth 2001 – 2022", EU Tax Observatory working paper; for untaxed wealth: EU Tax Observatory computations; see chapter 1 for complete details.

- Offshore tax evasion by wealthy individuals has shrunk (Alstadsæter, Godar, Nicolaides, and Zucman, 2024)
- Thanks to the AEOI, it has decreased by about 3x in the past decade
- With political determination, tackling tax evasion is feasible

Open question

- Despite the challenges and limitations (e.g., valuation, state capacity)
  - **Could the WT be an improvement over the status quo?**
  - **Is a minimum level of development required?**
- Recent theoretical & empirical work are both optimistic/pessimistic
- Still limited evidence in L&MICs

What's next? Gaps and a Call for More Work

"*Tax evasion is a global problem that requires global cooperation*" (and data analytics!)
– Martin Dvořák (Minister for European Affairs of Czechia)

- **Better diagnostics**
  Who owns the wealth in L&MICs? How concentrated is it?
  Distribution of comprehensive income and ETR (e.g., Del Carmen et al, 2024)

- **More evidence from current wealth-taxing L&MICs**
  Behavioral responses, the role of AEOIs in recent years

DATAX

A Lab to Study Taxes, Firms and Jobs using Micro Data

Thanks!

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- Historically, the bulk of offshore wealth belonged to residents of high-income countries

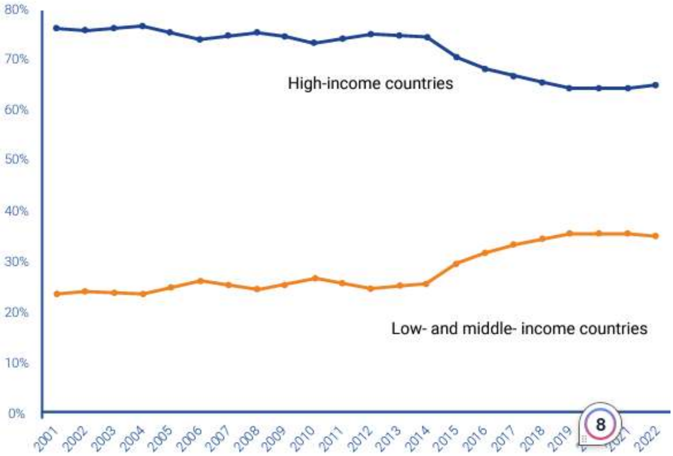
- Today, as the wealth of emerging economies grows fast, so too is their share of global offshore wealth

- Identifying the residence country of the owners of offshore assets still faces data limitations and requires assumptions

- A body of evidence also shows that ownership of offshore financial wealth is concentrated towards the top of the wealth distribution

Figure 1.3

Offshore wealth owned by high-income vs. middle- and lower-income countries
(% of total offshore wealth)

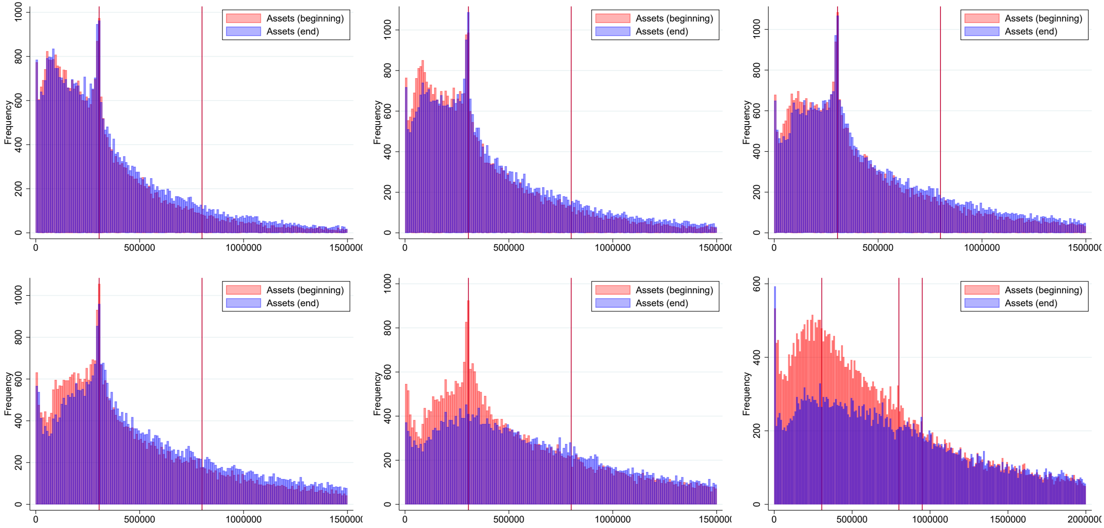


Notes: This figure plots the evolution of the share of global household financial wealth owned by residents of high-income countries vs. residents of low- and middle-income countries over the period 2001 – 2022. Countries are grouped following the World Bank classification as of 2022. Source: Souleymane Faye, Sarah Godar, and Gabriel Zucman (2023), "Global Offshore Wealth 2001 – 2022", EU Tax Observatory working paper. Data available on the Atlas of the Offshore World, https://atlas-offshore-world.org.

Distribution of wealth (assets)

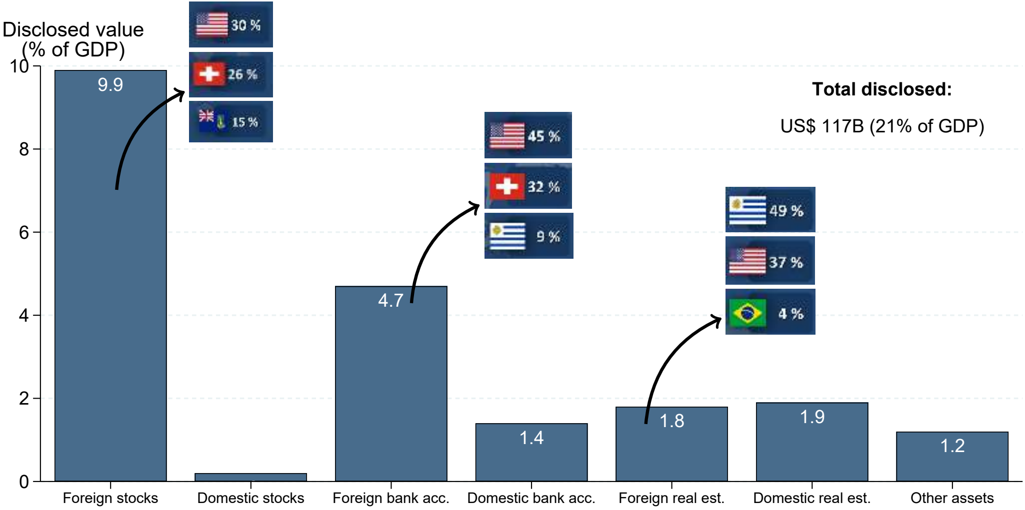
Bunching at the exemption cutoff

▸ Back



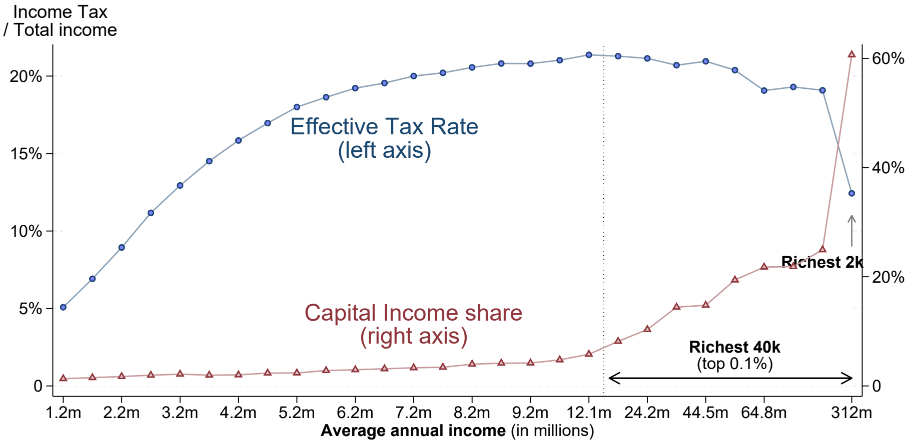
Disclosed assets made under the 2016 amnesty by 255k participants

80% hidden abroad (mostly financial); raised 1.8% of GDP from a one-time tax



The income tax becomes regressive at the top (FY 2021)

Driven by preferential tax rates on capital income (note: wealth tax paid would offset part (all?) of it)



Source: Own elaboration based on AFIP's statistical yearbook FY 2021 which report income tax tabulations split into 30 bins of increasing income. The adult population aged 20+ is 31,583,402. N filers in 2021 = 859,873. Richest 40k account for 45% of PIT collected. Richest 2k (top 0.006%) account for 11% of PIT collected.