Booming wealth alongside fiscal concerns about ageing populations

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Introduction

Billionaires are treating space as a new playground while the rest of us are being warned that population ageing means there will not be enough to go around when the present working generation expects to retire. The IMF warns that "the G-20 countries are in the midst of stark demographic change.…[p]opulation aging can have significant macroeconomic implications… Aging would … exert pressure on public finances as outlays for pensions and health care increase" (IMF Staff 2019).

The OECD conveys similar messages when it says:

> "Populations are ageing rapidly across advanced economies… because of rising life expectancy and declining fertility… The number of people over 65 for each working-age person will at least double in most G20 countries by 2060… Rising old-age dependency ratios will put unprecedented stress on the financing of public pensions, health and long-term care, especially in a slow growth environment… ageing pressures could increase the public debt burden by an average of 180% of GDP in G20 advanced economies …Alternatively, tax revenue would need to increase by between 4½ and 11½ percentage points of GDP by 2060 … Pension reform should address the triple challenge of improving fiscal sustainability and reducing old-age poverty risk, while ensuring a fair sharing of the burden across generations." (OECD 2019)

The Congressional Budget Office has projected spending to 2050 and finds federal spending will grow from an average of 21.3 per cent of GDP over the period 2010 to 2019, to 29.3 percent, average over the years 2041 to 2050 (CBO 2020).

The European Commission has said:

> "The long-term budgetary projections show that population ageing poses a challenge for the public finances in the EU. The fiscal impact of ageing is projected to be high in most Member States, with effects becoming apparent already during the next decade. The projected change in strictly public age-related expenditure … is almost 2 pp. of GDP in the period to 2060… the increase between 2013 and 2060 is mostly driven by health care and long term care

> spending, which combined is projected to rise by about 2 pp. of GDP." (European Commission 2015).

The concern in all this is what government spending means as a share of GDP. Common to all these expressions of concern about fiscal "viability" are the comparisons to GDP.

On the issue of health care, the OECD observes that over the 20 years to 2015, public health spending exceeded GDP growth in all OECD countries and was on course to reach almost 9 per cent by 2030 and 14 per cent by 2060. It put the pressures down to "new technologies which extend the scope, range and quality of medical services; rising incomes, which engender higher expectations on the quality and scope of care; and population ageing." (OECD, 2015, 20). Officials in charge of government budgets complained that because:

> "…health care is perceived by citizens as a very high priority, and government policies in this area are closely watched. In addition there are many stakeholders who intervene between the beneficiary of health care (the citizen/patient) and the public resources that finance it. These include purchasers (Ministries of Health, social security institutions, social insurance funds or sub-national governments); a wide ranges of service providers (clinicians with different specialities, operating within hospitals and other health facilities); providers of medicines, tests and equipment (pharmaceutical companies and laboratories); and other bureaucratic and administrative intermediaries." (OECD, 2015, 20).

While these issues are being debated throughout OECD countries and elsewhere, the present paper will attempt to highlight the general problem but with reference to Australian experience to illustrate the issues involved. The Australian government has also warned of the looming fiscal "problems" with the publication of an Intergenerational Report (IGR) roughly every five years and was clearly designed to scare us into accepting a neoliberal/austerity agenda. Indeed the 2015 IGR was a political exercise to the extent that it gave three scenarios, first the government's austerity plan which would "solve" the fiscal challenge, second, the government plan modified by not including measures it was still lobbying to get passed by the Australian Senate and third was the continuation of the policies from the last Labor Government (Australian Government, 2015). They showed fiscal projections that were respectively good, better and worst in terms of debt and deficit outcomes. The last report released this year (2021) is more moderate but still raises concerns about the ageing population and the fiscal implications and invites us to wonder if Australia will be able to "afford" the government expenditures associated with the aging population (Australian Government 2021).

What is missing in these exercises?

Whatever the subject of fiscal burdens and the like are discussed there is a reference to income or GDP in the international and country reports that cover these issues.[1] The "tax burdens" are expressed as a share of income or GDP for example. Ability to pay, intergenerational issues and so on are also typically expressed in terms of proportions of GDP or are sometimes so obvious the comparison with GDP does not have to be spelt out. Hence the emphasis is based on GDP as if other measures of income and wealth were irrelevant. Capital gains for example are only rarely mentioned and then it is in the context of realised capital gains that might be included in personal income.

This is an important limitation of the meaning of income and the analysis can look dramatically different if capital gains are taken into account in a wider definition of income. When considering such things as living standards, wellbeing and so on it is also important to add back some of the things missing in traditional macroeconomic outlooks. Income as measured in the national accounts is a very inadequate measure of wellbeing. Wealth should be considered and, of course, if properly measured income itself would be so much higher if capital gains are included.

Net worth is another measure of affluence. Household net worth in Australia in March 2021 was $12.7 trillion (ABS 2021b), over six times national income. The increase in wealth has taken us by surprise to some extent. in March 1990 household net worth was a modest 3.58 and by March 2021 it stood at 6.37 times GDP. Australia is not unique in this respect. In the US wealth to income (net national income) increased from approximately 3.8 times in 1990 to 5.5 times in 2017 (Robins, 2019). Likewise in the UK the ratio of wealth to national income rose from 3.7 in 1995 to 5.7 in 2018 (Advani et al, 2020).

> "In 1970, private wealth-national income ratios ranged from around 200%–350% in most developed countries … The past four decades saw a sharp rise in these ratios in all countries. By 2007, the year in which the global financial crisis began, private wealth-national income ratios in the countries observed averaged 550%, peaking at 800% in the extreme case of Spain." (Alvaredo et al, 2018).

The evidence would seem to suggest there has been a very substantial shift in the structure of the economy. Wealth is extremely important as a resource at the disposal of households and now looms so much larger than it did three decades ago. Wealth also generates capital gains, the increments in the value of wealth as a result of price changes. These are too often ignored in macroeconomic commentary and are not taken into account at all in the IGRs. The distribution of income and wealth is almost entirely neglected in these exercises but will become increasingly serious as the distribution of income and wealth worsens into the future. With increasing inequality there are also worsening political power imbalances.

We now take a step back and consider the treatment of capital gains in public finance discussions about revenue.

[1] In principle income and production are equal in a national accounting sense (United Nations 2003). However, national income needs to adjust GDP for income accruing to foreigners, and residents' earnings from overseas.

Haig-Simons income concept

Public finance courses have stressed for generations that fiscal policy discussions should be using something along the lines of a comprehensive definition of income. Those definitions say that one's income over a time period must be equal to consumption plus any increase/decrease in one's financial assets. Most discussions refer to the Haig-Simons (H-S) income concept which is simply defined as "consumption plus changes in net worth" (Staff of the joint Committee on Taxation, 2012). The references are to economists, Robert Haig (1921) and Henry Simons (1938). While tax systems tend to include only realised capital gains for practical reasons, the H-S definition definitely includes capital gains on an accrual basis (Armour et al, 2013).

Given capital gains are an essential part of the ideal measure of capacity to pay, attention should have been given to the behaviour of capital gains and their implications for macroeconomics generally and especially fiscal/budgetary policy and related topics. As a measure of capacity to pay tax measures of comprehensive income should also be relevant also for distributional analysis. Indeed, it might even be suggested that the onus should be put on analysists who do not include capital gains to justify that omission.

For most of the present discussion GDP *plus* capital gains as measured by the change in household net worth from year to year is used. Arguably household income should be used instead of GDP but GDP may still be appropriate given a large part of the tax revenue is taxes on production. The reader may keep in mind that there is a significiant difference and there may be valid arguments in favour of either. The other consideration is whether the analysis should include any capital gains accruing to other sectors, the government, corporations, and the rest of the world. The view here is that capital gains in especially the corporate sector are likely to be reflected in higher valuations of corporate equity held by the household sector so that including the latter should be sufficient. Otherwise there would be an element of double counting. The paper now turns to examine the empirical importance of net worth and increases in net worth among households.

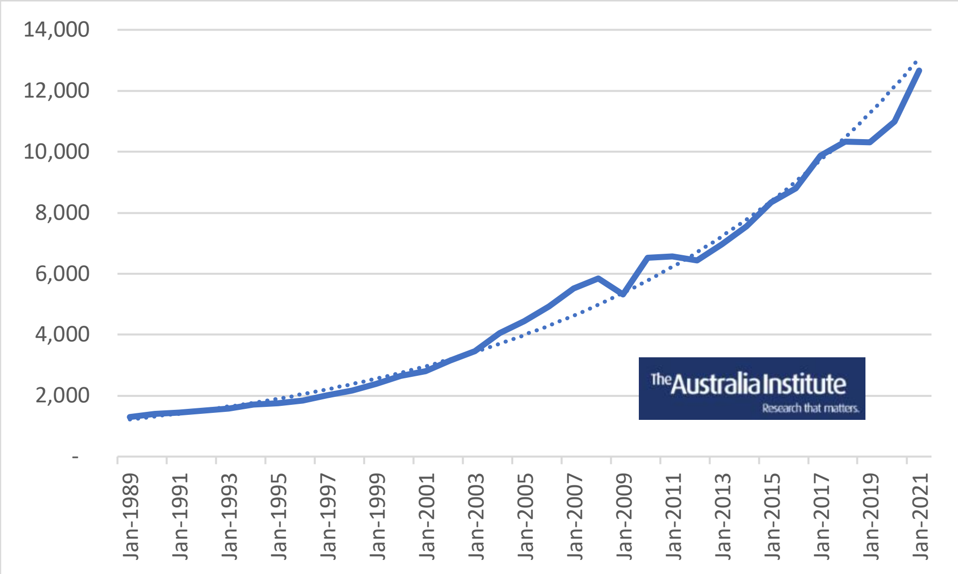
Wealth

Figures for Australia show that since September 1988 net worth has been growing at 7.5 per cent per annum and, as mentioned above, is now (March 2021) $12,665 billion.[2] At that rate in 40 years it would be $228,521 billion or roughly $89,160 billion in 2021 prices. Figure 1 plots household net worth over that period. These figures are shown in the solid line in Figure 1 with a trend line included as the dotted line in Figure 1.[3]

[2] September 1988 is the first data point in the ABS series for household net worth.

[3] To cope with the volatility of capital gains other researchers have used cumulative measures of income. Here the preference is to use trend annual data. Experimenting with alternatives in excel it appeared the exponential functional form was the best fitting equation for the data with a high correlation coefficient of 0.9859.

Figure 1: Household Net Worth, $billions



Source: Author's calculations and ABS (2021b).

Figure 1 shows a very steady upward trend in the movement of household net worth over the period since 1989. There is a hint in the graph that the upward trend might have been even higher were it not for the global financial crisis on the one hand and the weak economy just prior to pandemic and then the pandemic itself on the other hand. The strength of the trend suggests it is likely to continue well into the future.

Of the total $12,665 billion in household net worth, household savings contributed just $1,215 billion in the period since March 1989 (ABS, 2021c), the rest was capital gains worth some $10,116 billion over that period together with the opening balance of $1,298 billion in March 1989. At the moment (2021) household net wealth is 6.37 times GDP and on the projections net household wealth will increase to 14.0 times GDP in 2060–61. It is not clear what has driven the large increases in wealth either in Australia or elsewhere. Monetary policy has been implicated. Reductions in interest rates can increase the value of many assets since they increase the discounted value of any stream of income that may be associated with the ownership of particular assets or businesses. However, just looking at the graph in Figure 1 it is hard to discern the influence of the low interest rate policy. The trend before the global financial crisis was at least as strong under higher interest rates.

Capital gains

The consequences of leaving capital gains and wealth out of the analysis is very important. The hidden income will have a lot of consequences for notions of capacity to pay tax and general wellbeing and how those might be estimated. Moreover, given the relative stability of the estimated equation in Figure 1 it can be used to make rough projections over the next 40 years which show household net wealth grows at a very fast rate. One of the implications already mentioned is that capital gains will swamp income and/or GDP as measured in the national accounts. Using the equation in Figure 1, trend capital gains are 44 per cent of GDP in the year to March 2021. This means that a conventional analysis misses almost half the actual income in Australia.[4] When it is assumed that household net wealth continues to grow at 7.5 per cent over the next 40 years and using the average growth in nominal GDP assumed by the IGR (5.0 per cent) then in the year 2060–61 capital gains will increase to $18.2 trillion and will equate to some 132 per cent of GDP at that time. Some of that $18.2 trillion will be household savings ($0.42 trillion) implying capital gains of $17.8 trillion which will be 127 per cent of GDP. This is a large increase in the wealth to GDP ratio driven by just the small gap in the assumed growth in wealth, 7.5 per cent, compared with the 5.0 per cent increase in GDP. The gap of just 2.5 per cent per annum is sufficient to generate the rapid rise in wealth to income ratio that concerns Piketty (2014) for example.

Conventional thinking about income needs to be thoroughly re-examined because conventionally measured GDP will only be 43 per cent of H-S income in 40 years' time on these trends. This type of finding suggests Australia and many other OECD countries are on their way to some new Belle Époque as foreshadowed by Piketty (2014). While Belle Époque applied to the lifestyle of the elite, the importance of the period for Piketty was the extreme inequality in which the ranks of the wealthy could live in a style that was unattainable to those with even the best of wage and salary jobs.

Note too, income itself may be incomprehensibly bigger. Unlike conventionally measured income, there does not appear to be any mechanism that would stabilise a net worth to GDP ratio nor a capital gains to GDP ratio. The productive capital stock in an economy might also asymptote towards an equilibrium share of GDP.[5] However, wealth not only includes the industrial capital stock but also a lot of other assets, such as art works, jewellery, private dwellings, commercial real estate and so on.

Further reflections on wide conceptions of income

In considering why macroeconomic discussions traditionally ignore capital gains it might be noted that the traditional conception of income as equal to production has a lot of appeal. Most of the concepts in the national accounts are based on transactions between different players in the economic system. Capital gains, however, are not transactions. There are exceptions but for the most part the national accounting income concepts derive from transactions and subsequently on transfers made out of the original income. H-S income is not constrained at all by GDP or any other magnitude. The capital gains component of H-S income as a valuation phenomenon can in principle lead a life completely independent of other GDP magnitudes as seems to be the case.

The use of GDP has been criticised in other contexts. As is well known, national accounting aggregates were never intended as a measure of wellbeing. Instead, they merely set out to measure what was being bought and sold in the market. Those who designed the national accounts in the 1930s and 1940s knew they were not designing measures of human welfare but merely aimed "to provide a gauge of the size and health of the economy" (Syrquin, 2011).

[4] GDP is much larger than household income with capital gains being 54 per cent of measured household income.

[5] If net investment is say 25 per cent of GDP and GDP is growing at 5 per cent, then the capital stock to GDP ratio will stabilise at 5 (= 25/5). But there is no mechanism that ties capital gains to any national accounting magnitude. It is very important to distinguish wealth from the capital stock which is used in the production of goods and services.

Critics point to examples such as the contraction in GDP if someone marries their housekeeper or that cleaning up pollution can increase GDP. Hence GDP can be a perverse measure of wellbeing. These and other limitations of GDP are discussed in a report by Stiglitz and others commissioned by the French Government which kicked off a renewed worldwide discussion on the limitations of GDP (Stiglitz et al, 2009). It is interesting that to date there has been little analogous discussion about whether GDP is the appropriate yardstick for evaluating fiscal issues such as the fiscal consequences of ageing discussed here.

During the Second World War Keynes was interested in measures of GDP and related magnitudes with the aim of measuring how much output might be increased or reoriented for the war effort (See Tilly 2009). For present purposes the productive capacity is less important than the questions of how much tax to raise and how to distribute tax liabilities. Hence, the present paper is more interested in the capacity to finance spending in which case the "burden" can be shared with income sources that do not derive from GDP, including capital gains which is our present concern.

Fairness

It is already inequitable that wealth and capital gains are taxed so lightly in many jurisdictions. OECD statistics for example show that the OECD average tax on property was 1.9 per cent in GDP in both 1965 and 2018 (OECD, 2020). The average theoretical tax rate applying to capital gains on real property was just 15.7 per cent in 2016 with capital gains on shares subject to various concessions relative to taxes on other earned income (OECD, 2018). The idea of a fair tax is that two people with the same income, the same deductions and so on should be taxed the same no matter the source of that income. Capital gains or personal exertion or any other source of income should be taxed equally. Paul Krugman says, "the low tax rate on capital gains is bad economics, even ignoring who it benefits" (Krugman, 2012). The failure to adequately tax capital gains is an enormous advantage to the rich.

Here the Australian example is used but while the actual numbers will be different in different economies, the qualitative message should be much the same. In Australia the average top 20 per cent of wealth holders enjoyed capital gains of 108 times the capital gains of the lowest 20 per cent of wealth holders. That suggests capital gains will continue to inflate the incomes of the wealthy and so worsen the distribution of income in Australia. The following table examines the incomes of the five quintiles by wealth ownership. Row 1 in Table 1 presents total gross income as defined by the ABS and which excludes capital gains. In the next row capital gains themselves are given. Capital gains for each quintile are calculated by deducting the previous years' net worth from net worth in 2017-18 (the latest figures available)[6] That may mean incorrectly attributing some acquisition of assets to capital gains instead of savings, however, that should not change the orders of magnitude calculated here. The final row in Table 1 is our estimate of the H-S income.

[6] In fact, data limitations meant having to use the difference between 2017-18 and 2015-16 and dividing by two.

Table 1: Household Wealth Quintiles, Incomes received, 2017-18, $.

	Lowest	**Second**	**Third**	**Fourth**	**Highest**	**Ratio highest to lowest**
Total gross income	80,712	138,893	152,217	164,185	270,696	3.4
Capital Gains	3,591.50	22,068	71,704	129,367	389,396	108.4
Total (H-S income)	84,304	160,961	223,921	293,552	660,092	7.8

Source: Author's calculations and ABS (2021a) *Australian National Accounts: Distribution of Household Income, Consumption and Wealth, 2003-04 to 2019-20*, 18 June.

Before discussing the implications of Table 1 it is important to note that wealth and income are poorly correlated. While it may strike the reader as odd in that, for example, the bottom quintile has an apparently reasonably high gross income. Younger households may well enjoy reasonably high incomes. That means when considering the least wealthy we are not necessarily looking at the lowest income earners. Households with new entrants into the labour force are likely to have few assets but may have high incomes. At the other end of the wealth distribution, high wealth households may use companies and other vehicles to hold assets and receive income and may not necessarily pay themselves much of that income.

The important thing about Table 1 is that it shows rather dramatically how capital gains are critical to understanding income and wealth in Australia. Standard measures of income suggest the wealthiest households receive 3.4 times the income of the least wealthy. That seems a rather small degree of inequality. However, as might be expected, there is a large inequality in the distribution of capital gains with the ratio of top to bottom at 108.4 to 1 meaning the top 20 per cent of households receive 108.4 times the capital gains received by the bottom wealth quintile. The effect of capital gains then is to increase the top to bottom comprehensive income ratio which becomes 7.8 to 1, much higher than simple income measures might suggest.

Looking ahead, as net worth outpaces conventional income measures so too will capital gains increase relative to other incomes. That implies that ever higher capital gains will pull the income distribution further apart. For example, if capital gains were twice as high as shown in Table 1 then the top to bottom ratio would blow out from 7.8:1 to 11.9:1. So long as wealth to income ratios are rising then this sort of trend is inevitable.

Of course, as wealth increases it is also possible and perhaps likely that its distribution will be biased even further in favour of the rich. The OECD has noted that the "growth in net wealth levels has … been very uneven across the distribution. On average, wealth levels for the top 10% have grown by 13% in real terms over the past decade, and wealth for the next 50% has increased by 6%. Meanwhile, the bottom 40% saw their average wealth shrink by more than 12%. This resulted in widening wealth gaps, with the wealthiest 10% increasing at the expense of the remaining 90% of households. This development affected most countries…" (OECD 2021).

In its latest *Annual Economic Report* the Bank for International Settlements (BIS, 2021) has examined the effect of monetary policy on the distributions of income and wealth in the major high-income countries. To the extent that lower interest rates encourage economic activity the BIS argues that should be associated with lower inequality that tends to follow higher employment. In relation to wealth, the BIS suggests that lower interest rates may have increased wealth but not worsened the inequality in wealth ownership. Indeed, if housing is a higher proportion of wealth at the bottom of the distribution and if lower interest rates disproportionately affect house prices, then the distribution of wealth may even be improved somewhat.[7] But Table 1 illustrates the problem in thinking that way. Suppose wealth increased across the board but without changing the ratio of the top to bottom wealth holders or any of the other distributional measures. That is likely to mean that the annual capital gains are also doubled. The very unequal distribution of capital gains can greatly worsen the distribution of H-S income compared with conventionally measured income and it all gets so much worse as both wealth and capital gains increase.

One thing is clear; higher levels of wealth generate higher capital gains as wealth gets bigger and higher wealth is likely to be associated with even higher future capital gains. And this greatly worsens the equity of the distribution of comprehensive income. This shows how the BIS fell into a trap by separately considering income and wealth distributions. It is important to appreciate how they interact through the capital gains mechanism.

The exact numbers are uncertain, but these exercises drive home the point that the increase in wealth and associated capital gains will be associated with worsening inequality. Wealth tends to be held by the older people so that higher wealth levels will increase the disparities between young and older households. But even within the older households there will still be large numbers with low incomes and low wealth. Hence there will be in the future, as there is now, a problem associated with a good deal of inequality among older people. Those inequalities will be an issue for future generations to address. But it is important to stress that this is not a young versus old problem as it is often portrayed; it is more correctly a problem of rich v poor or even old rich v old poor. There need only be a higher burden on the working age population if governments chose not to fairly tax wealth and capital gains.

Without wanting to stray too far off topic, it is interesting to also reflect on the fact that while there has been a trend towards lower company tax and lower personal taxes on capital income, it is not national governments but organisations such as the IMF that have led the charge to change course. The IMF has also long opposed the trend towards international tax competition and former IMF director Christine Lagarde (2014) stated that "there would be more revenue for all if countries resisted the temptation to compete with each other on taxes to attract business. By definition, a race to the bottom leaves everybody at the bottom". The IMF pointed out that taxes on capital income are important in "shaping the progressivity of a tax system" (IMF, 2017). It stressed that capital income is distributed more unequally and has been rising relative to other incomes and is now a large share of personal incomes among the rich. It cited American figures that show the highest 400 taxpayers received 60 per cent of their income in capital gains which we take to be realised capital gains.

[7] As it happens, housing for the bottom and second bottom quintiles is 28 and 35 per cent of net worth compared with just 16 per cent for the top quintile. However, it is not clear that price increases for housing have outstripped the prices of other assets.

Revenue implications

Any discussion of capital gains and expanded definitions of income raise the question of taxation and there are important implications for the revenue effort from our discussion to this point. In the US it is more widely recognised that it is the top income earners who escape their fair share of tax through the low or concessional rates on capital gains. As Krugman (2012) says:

> "The main reason the rich pay so little is that most of their income takes the form of capital gains, which are taxed at a maximum rate of 15 percent, far below the maximum on wages and salaries. So the question is whether capital gains — three-quarters of which go to the top 1 percent of the income distribution — warrant such special treatment."

Incidentally, for comparison, the top one per cent of taxpayers in Australia declare 56 per cent of all the capital gains declared to the Australian tax office but declare a much smaller 9.6 per cent of all taxable income. For the top ten per cent the figures are respectively 71 per cent and 21 per cent.[8] This confirms that capital gains overwhelmingly go to the rich and are taxed more lightly than regular income. Anthony Atkinson, Thomas Piketty, and Emmanuel Saez have pointed to the world-wide erosion of the tax base with the gradual removal of capital gains.

> "The erosion of capital income from the progressive income tax base. Early progressive income tax systems included a much larger fraction of capital income than most present progressive income tax systems. Indeed, over time, many sources of capital income, such as interest income or returns on pension funds, have been either taxed separately at flat rates or fully exempted and, hence, have disappeared from the tax base. In all cases, only realized capital gains are included, if at all, in tax statistics and no information on accruing capital gains is available." (cited in Roth 2021)

Of course, in the US and other tax jurisdictions, capital gains attract tax only when they are realised. Part of the reason is obviously practical; measuring capital gains is difficult and many unique assets do not have deep and liquid markets in which market valuations can be used to assess the value of assets and how they change over time. However, the failure to tax capital gains until they are realised gives a large benefit to their beneficiaries. Capital gains are allowed to grow at compound growth rates until they are eventually realised, if at all.[9] It remains very unfair that capital gains are tax free for the most part.

A topic not discussed so far is the implication for tax avoidance. While an important topic in its own right it also reminds us that ordinary definitions of income will miss a good deal because people are deliberately disguising other income as capital gains. That makes the exclusion of

[8] Author's calculations with data from Australian Tax Office (2021).

[9] To appreciate the benefit of taxing capital gains only on realisation, compare two tax regimes, one with an annual 35% tax on capital gains as they accrue and second, taxing them on realisation. An asset worth 100 held for 40 years appreciating at 10 per cent per annum has an after-tax value 2.5 times higher if taxed on realisation rather than on an accrual basis.

capital gains from much macroeconomic analysis so much worse and incidentally hides a lot of the income at the top end of the income distribution (see Advani and Summers, 2020).

An alternative to taxing capital gains on an accrual basis is to tax wealth on a regular basis, a topic taken up in the next section. Before doing that note that there are other policies that may also be worth examining but will not be pursued further in this paper. To begin with economic power and the associated monopoly profits are increasing throughout the world. Those feed into non-labour incomes and often through low or lightly taxed capital gains. Attempts to limit that power through such things as competition policies and price controls should slow down the accumulation of wealth on the part of the rich even if there is little evidence of that to date.

Wealth tax

To the extent they are taxed at all, capital gains are only taxed on realisation. In that way avoidance avenues can take place by simply not realising capital gains. The arguments against taxing gains as they accrue are pragmatic. It would be difficult to measure the value of assets each year to calculate tax liabilities.

If capital gains are difficult to tax because they are difficult to value, then perhaps wealth should be taxed instead. Wealth could be deemed to have a provisional value equal to historic cost plus the general level of inflation since purchase. The existing capital gains tax could then be used to impose additional tax or give credit for any gains on realisation above or below the amounts previously assessed. Atkinson points out that while the increasing inequality due to capital gains suggests that tighter capital gains taxes may be warranted, in fact a good deal of the capital gains have already taken place and dramatically increased the wealth of the wealthy (Atkinson, 2015). Past capital gains can only be captured by a wealth tax of some sort.

A capital tax or wealth tax is the major policy Piketty calls for to address the fundamental problem identified in his book—the tendency for wealth to grow more quickly than the economy generally and so for wealth to be more and more unequally distributed among the population.[10] Piketty suggests that those with “fortunes” worth less than €1 million might pay nothing, while a tax of 1 per cent would apply to “fortunes” between €1 million and €5 million, and 2 per cent to those greater than €5 million. Piketty thought the tax would need to involve international cooperation with respect to rates, definitions and similar so as to avoid countries being played off against each other. A wealth tax as a tax on capital is not related to the rate of return on capital or the way it is invested and so wealth owners will be undeterred from seeking out the best pre-tax return options. Such a tax design would indeed seem to leave the investor with a fixed tax irrespective of the return they might earn.

Stiglitz (2020) has argued that Europe should pursue wealth taxes more aggressively both for the revenue potential but also to address concentrations of family wealth built up through inheritance. That would include annual wealth taxes but also death duties. Stiglitz cites studies that show inherited wealth discourages work on the part of the beneficiaries. That makes sense; people who can live in comfort without working are unlikely to take it up.

[10] See Piketty T (2014). Piketty’s work leads him to the conclusion that everything is dominated by the rule; r > g where r is the rate of return on capital and g is the growth in the economy. If r exceeds g, then the stock of wealth is growing more quickly than the size of the economy.

Mike Truman (2006), the then editor of the journal *Taxation*, put it very well when he said:

> "…the problem with inheritance tax is that we're not paying enough of it…For all its faults in practice, it is in principle a perfect tax. … the tax liability comes at a point where those who did have the money no longer need it, and those who are about to get the money have managed quite well so far without it. Except in a very few cases, there is no problem with liquidating assets in order to get the funds to pay the tax."

Conclusions

This paper has tried to show that the existing analyses of intergenerational issues fail to take account of some of the major trends that will determine the wellbeing of a nation, how that wellbeing is distributed between the rich and poor and the extent to which a nation can "afford" government services in the context of an ageing population. As the introductory public finance textbooks point out, broad definitions of income should be used. That includes the present case when looking at questions such as the future wellbeing people and how that might be affected by the revenue raising efforts of future governments along with trends in government spending. Wealth and increases in wealth, or capital gains, are typically missing in such analysis but are very important in considering whether or not people can "afford" government services.

By including capital gains in a comprehensive measures of income such as the Haig-Simons income measure the distribution of income looks so much worse than when capital gains are ignored. This is likely to be the case in most OECD countries and maybe much worse in some of them. Observers who focus on just the distribution of income or wealth in isolation miss an extremely important joint dynamic that ever increases the income disparities. Given the likely huge increase in income (widely defined) over the next four decades it is ludicrous to suggest there are any social needs national governments cannot "afford" if they want to. Eventually countries are going to have to face the need to tax capital gains more seriously and/or bring accumulated wealth into the tax system. That is not to suggest that taxes must finance all spending but as the distribution of comprehensive measures of income is driven further apart it must become more apparent that many people are waking up with ever-increasing wealth each morning having done nothing to earn it.

The booming wealth and capital gains in the system will profoundly affect the social and economic structures emerging over future decades. But it is incorrect to put the intergenerational problem in terms of the burden an ageing population will impose on future generations. The future generations are going to have to ensure that the rich and very rich old people assist the poor old people in their communities. We have misallocated our worries towards thinking that the problem is one of entitlements to government services when it is not. We can only wonder at the political power behind tax systems that impose most of the burden on ordinary people as they work or consume but very light taxes on wealth and capital income, especially capital gains. It is hard to even imagine a better con on the part of the rich who:

- Take most of their income in a form that is hidden from even the national accounts and does not appear in most distributional analysis.
- Lobby hard to ensure that even when it is taxed on realisation, it is taxed lightly, while

- Traditional definitions mean that half or more again of the income going to the rich is barely noticed at all.
- If capital gains are noticed we are told they are not real income, just market fluctuations, so don't bother your pretty heads about it all.

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