

# The American dream (finally) proven?

By [Maxime Parodi](#)

In a recently published short article, Thomas Hirsch and Mark Rank (2015) give us some astonishing figures about American society – numbers that, taken seriously, would lead to a significantly more nuanced view of income inequality in the United States. Indeed, their study suggests that American society is much more fluid than we think. While Americans undoubtedly live in a very unequal society, most of them would experience wealth at some point in their lifetimes. There is, in reality, a high turnover between rich and poor, which would explain why Americans are not very critical of inequality.

According to this study, during their working lives (age 25 to 60), 69.8% of Americans have enjoyed at least one year of household income sufficient to be included among the richest 20%. And 53.1% of Americans have made it – for at least one year – into the richest 10%. An even more exclusive 11.1% of Americans have spent at least one year in the illustrious club of the wealthiest 1%.

But before accepting these outlandish figures, a more serious look needs to be taken of the study by Hirsch and Rank. It turns out that the numbers do not in fact offer a simple description of American society, but are rather the result of a modelling exercise. Behind these figures lie certain assumptions and methods that have been adopted, and which deserve discussion.

In the latest [Note de l'OFCE \(no. 56 of 12 January 2015\)](#), I show that the assumptions made are unrealistic and that the method used does not support the presence of missing data in the biography of the respondents. All in all, the results are

heavily biased in favour of the American dream. It is possible, however, to partially correct this bias, yielding the results in the table below.

**Table. Cumulative percentage by age and averages, after correction for bias, of belonging at least once in one's life to the richest 20%, 10%, 5% or 1% of households**

In %

H* age	Q20		Q10		Q5		Q1	
	Graduate	Non-Graduate	Graduate	Non-Graduate	Graduate	Non-Graduate	Graduate	Non-Graduate
25	7,6	3,4	4,1	1,4	2,4	0,7	0,4	0,1
30	19,1	8,6	10,8	3,8	6,1	1,8	1,0	0,2
35	27,6	12,7	17,2	6,1	10,2	3,0	2,4	0,6
40	33,1	15,5	22,6	8,2	14,5	4,3	4,0	0,9
45	37,2	17,6	26,9	9,9	18,4	5,6	5,4	1,3
50	39,6	18,9	30,8	11,5	21,7	6,6	6,6	1,6
55	41,0	19,7	33,2	12,5	24,3	7,5	7,9	1,9
60	41,3	19,8	34,4	13,0	25,6	7,9	8,7	2,1
<b>Average</b>	31		24		17		5	

Source : Author's calculations.

Basically, the Hirschl & Rank figures are cut in half! Thus, 31% of Americans will have a sufficient household income for at least one year (between age 25 and 60) to be among the richest 20%. And 5% of Americans will have a sufficient household income for one year to be in the richest 1%.

Given the magnitude of this correction, it is clear that the study by Hirschl and Rank distorts reality by suggesting that social destinies in the United States are very chaotic – as if the entire society were at the roulette table. Other articles by Hirschl and Rank further fill out the picture. It is not in fact the first time that these authors have come up with such figures using this method. In 2001, they examined the other end of the income distribution, evaluating the percentage of Americans who have experienced an episode of poverty during their lifetime (Hirschl and Rank, 2001). They again came up with striking figures. For example, 54% of Americans experienced an episode of poverty [\[1\]](#) before age 40. In 2005, they again applied this method to recipients of food stamps (food vouchers), and estimated that 50% of Americans will have

made use of food stamps at least once in their lives (before age 65). This order of magnitude is, yet again, barely credible. A less costly and more direct method would certainly be revealing: it would suffice to ask Americans whether they have ever received food stamps. While some Americans may prefer to hide such an event, this bias of omission will never be as large as that of the preceding survival analyses. Let's be clear: their method is a machine for producing the outlandish.

[\[1\]](#) The poverty threshold adopted here is 1.5 times the value of the basket of goods needed to meet basic needs.

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# On the taxation of household income and capital

By [Henri Sterdyniak](#)

The idea is very widespread that in France unearned income benefits from an especially low level of taxation and that the French system could be made fairer by simply raising this level. In an [OFCE Note](#), we compare the taxation on capital income with that on labour income, and show that most of it is taxed just as highly. The reforms adopted in 2012 further increase the taxation of capital income. So there is little room for manoeuvre. However, there are tax loopholes and a few exceptions, the most notable being the current non-taxation of imputed rent (which benefits households that own their own residence).

The table below compares the marginal tax rates for different types of income. The effective economic tax rates (including the “IS” corporate income tax, non-contributory social charges, the CSG wealth tax, social security taxes) are well above the posted rates. The interest, rental income, dividends and capital gains that are taxed are taxed at approximately the same level as the highest salaries. It is therefore wrong to claim that capital income is taxed at reduced rates. When it is actually taxed, this is at high levels.

Economic tax rate

	Economic tax rate 2011	Economic tax rate 2012
Wages	54.4/57.1*	54.4/57.1*
Interests	62.6	79
Property income	56.1	59.0
Implicit rent	10.0	10.0
Dividends	55.0**/57.1***	58.4**/59.2***
Taxed capital gains	62.8	67.5
Untaxed capital gains	34.43	34.43

\* Beyond 4 times the Social Security ceiling. \*\* Withholding tax. \*\*\* Income rate taxation after 40% allowance.

The official tax rate on capital income increased from 29% in 2008 to 31.3% in 2011 due to a 1.1 percentage point increase in payroll taxes to finance the RSA benefit, a 1 point increase in withholding tax and a 0.2 point increase to fund pensions. The government has financed the expansion of social policy by taxing capital income. This rate will increase to 39.5% (for interest) and to 36.5% for dividends on 2012 income.

Should we advocate a radical reform: submission of all capital income to the tax schedule on personal income? This might be justified for the public image (to show clearly that all income is taxed similarly), but not on purely economic grounds.

With respect to interest income, this would mean ignoring the inflation rate. The 41% bracket would correspond to a levy of 108% on the real income of an investment remunerated at 4% with an inflation rate of 2%. For dividends, one must

not forget that the income in question has already paid the "IS" tax; the 41% bracket (by eliminating the 40% allowance) would correspond to a total tax of 70%. We must make a policy choice between two principles: a single economic tax rate for all income (which paradoxically would lead to preserving a special tax on capital income) or higher taxation on capital income, since this goes mostly to the better-off and is not the fruit of effort (which paradoxically would lead to subjecting it to the same tax schedule as labour income, while forgetting the IS tax and inflation).

The problem lies above all in schemes that allow tax avoidance. For many years, the banks and insurance companies managed to convince the public authorities that it was necessary to make income from household financial capital tax exempt. Two arguments were advanced: to prevent the wealthy from moving their capital abroad; and to promote long-term savings and high-risk savings. Exemptions were thus made for PEA funds, PEP funds, and UCITS mutual funds. Governments are gradually pulling back from these exemptions. Two principles should be reaffirmed: first, all capital income should be subject to taxation, and tax evasion should be combated by European agreements on harmonizing tax systems; and second, it is the responsibility of issuers to convince investors of the value of the investments they offer – the State should not fiscally favour any particular type of investment.

There remains the possibility that wealthy families will succeed in avoiding taxes on capital gains through donations to children (alive or upon their death) or by moving abroad before taxation takes place. Thus, a wealthy shareholder can hold his securities in an ad hoc company that receives his dividends and use the company securities as collateral for loans from the bank, which then provides him the money needed to live. The shareholder thus does not declare this income and then passes on the company

securities to his children, meaning that the dividends and capital gains he has received are never subjected to income tax.

The other black hole in the tax system lies in the non-taxation of imputed rent. It is not fair that two families with the same income pay the same tax if one has inherited an apartment while the other must pay rent: their ability to pay is very different.

Two measures thus appear desirable. One is to eliminate all schemes that help people avoid the taxation of capital gains, and in particular to ensure the payment of tax on any unrealized capital gains in the case of transmission by inheritance or donation or when moving abroad. The second would be gradually to introduce a tax on imputed rent, for example by charging CSG / CRDS tax and social security contributions to homeowners.

Having done this, a policy choice would be needed:

– Either to eliminate the ISF wealth tax, as all income from financial and property capital would clearly be taxed at 60%.

– Or to consider that it is normal for large estates to contribute as such to the running costs of society, regardless of the income the estates provide. With this in mind, the ISF tax would be retained, without comparing the amount of the ISF to the income from the estate, since the purpose of the ISF would be precisely to demand a contribution from the assets themselves.