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Comments on "Wealth inequality dynamics in Europe and the United States: Understanding the determinants" by Blanchet and Martínez-Toledano

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ABSTRACT

In this paper, Blanchet and Martínez-Toledano collect, expand, and harmonize wealth and income inequality statistics from prior research and public data sets for the U.S. and E.U. It is a huge undertaking. My comments focus on whether the data permit us at this point to draw these conclusions, or whether differences in methodology and data construction require further reconciliation. While I lean toward the latter judgement, I view this paper and the underlying project as a first, constructive step in an ambitious agenda, with many avenues yet to explore.

In this paper, Blanchet and Martínez-Toledano collect, expand, and harmonize wealth and income inequality statistics from prior research and public data sets for the U.S. and E.U. It is a huge undertaking. I commend them for their hard work and contribution to the field in collecting these data.

As a proof of concept for how to use the data, the paper follows the approach in Piketty and Zucman (2014), expanded in Martínez-Toledano (2020), and decomposes the growth in wealth shares across countries into contributions from asset prices, labor and capital income inequality, and a residual attributed to savings rates. With these decompositions, it is then possible to zero out specific components to isolate the key drivers of differences across countries. As a central example, the paper focuses on contrasting the drivers of wealth inequality trends in France and the U.S.

The paper highlights several results. First and most striking, wealth inequality has grown substantially in the U.S., but not in Europe. Second, asset prices, income inequality, and savings rate inequality all contribute to the U.S. trend, with what appear to be roughly similar magnitudes. Third, there is a larger role in Europe for house prices to shape inequality trends, specifically, to offset wealth growth at the top with housing wealth growth for the upper middle groups. Finally, non-financial business assets appear more important for top wealth in Europe than in the U.S.

My comments focus on whether the data permit us at this point to draw these conclusions, or whether differences in methodology and data construction require further reconciliation. While I lean toward the latter judgement, I view this paper and the underlying project as a first, constructive step in an ambitious agenda, with many avenues yet to explore.

1. Missing ingredients?

The paper raises a compelling question: why did the French and American stories of wealth inequality diverge after 1980? In answering this question, the paper examines likely economic explanations, such as differences in inequality and asset price growth. Before focusing on these factors, it is important to rule out more pedestrian explanations based on

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differences in methodology and data source. Neglecting such explanations is like comparing a Chicago hot dog to a *saucisse de Toulouse* without asking how the sausage is made!

Consider how the inequality data are constructed. For the U.S., the paper uses series from Piketty et al. (2018) (henceforth, PSZ), which deploys the capitalization approach of Saez and Zucman (2016) (henceforth, SZ). This methodology allocates wealth components from the U.S. Financial Accounts roughly in proportion to each group's top capital income share within asset class. When measuring the distribution of national income, aggregate income flows from the national accounts are subsequently allocated in proportion to these wealth estimates.[1] In contrast to the U.S. series, the French series, which are drawn from Garbinti et al. (2018) and Garbinti et al. (2021) (henceforth, GGP18 and GGP21), rely much more heavily on household surveys.

Two points immediately follow from this observation. First, these income and wealth series are not independent measures. The methodological link between income and wealth induces a mechanical correlation between income inequality and wealth inequality trends that likely exceeds the correlation due to economic factors. Second, because the French series differ in how much income data are used to impute wealth, we may not need economic stories to rationalize divergent correlations between income and wealth.

Figure 1 presents imputed national income shares for the top 1% in the U.S. from PSZ versus France from GGP18 (Panel A). In Panel B, I plot aggregate income flows for dividends and retained earnings from France and the U.S.[2] Remarkably, it is France—and not the U.S.—that displays the rapid rise in the level and national share of aggregate equity income.

These facts point to a new puzzle: Given macroeconomic forces and globalization, how did wealth inequality in France not go up? My conjecture is that off-balance-sheet (i.e., non-taxable) wealth is hugely important in France, and the E.U. surveys that feed into the French inequality statistics incompletely capture and allocate this wealth. Separately, it may also be the case that "offshore" wealth is more important at the top in France, which would similarly contribute to understated concentration.

If we turn to the details of the French inequality papers, we find ample cause for concern. One wrinkle I find especially worrying is "life insurance," known as *Assurance-vie* in France. In their wealth inequality paper, GGP21 write:

> Before 1998, life insurance income was entirely exempt from income tax. Since 1998, only capital income withdrawn from the account has been taxed...as a result, total life insurance income reported in the tax data corresponds to less than 5% of its counterpart in national accounts. Due to this limitation, we...rely exclusively on our survey-based method to impute life insurance assets. (footnote 32, pp. 632)

But perhaps life insurance assets aren't a big deal? Au contraire:

> It is worth stressing that some of these [non-taxable and therefore imputed from survey] components have increased significantly in recent decades. In particular, life insurance assets did not play an important role until the 1970s, but gradually became a central component of household financial portfolios during the 1980s and 1990s. As a result, these elements are either msising or underreported in income tax returns and the corresponding assets cannot be recovered using the capitalization method. (pp. 632)

As a result of this issue, in the last year of their data, GGP21 are forced to impute from surveys 63% of total household wealth, up from 37% in 1970. In contrast, the majority of top-owned wealth allocated in the U.S. data generates some kind of observable flow on tax returns, at least in the post-TRA86 period.

In a separate paper, Goupille-Lebret and Infante (2018) dig more deeply into the Assurance-vie system. They write:

> Assurance-vie is the most important financial asset owned by French households in 2010 and represents one quarter of total transmission at death. Despite its name, Assurance-vie no longer has insurance features; instead, it is used as a vehicle for wealth accumulation and transmission...in the U.S., the closest equivalent...would be an unlimited Roth IRA with preferential inheritance taxation. (pp. 22)

This extremely generous savings vehicle—which represents 38% of the financial assets owned by households and 23% of observed bequest flows—is also quite popular at the top (Goupille-Lebret and Infante, 2018).

Furthermore, Vermeulen (2018) suggests that many European wealth surveys, including in France, likely undersample the wealthy. That paper's empirical results rely on Forbes estimates for each country and Pareto extrapolation, so are clearly also sensitive to methodological choices. But he also argues that the way European surveys are conducted means they are less well-equipped than the SCF to identify and solicit participation from the ultrarich.

Overall, there is much reason to believe that differences in methodology and how these differences interact with institutions could amplify the true gap between the U.S. and the E.U. In particular, missing equity income held indirectly through businesses, pensions, and insurance; relative reliance on surveys versus tax data; and different tax incentives for income to appear on tax returns likely confound these cross-country comparisons, even after the many commendable efforts to harmonize series.

[1] See Smith et al. (2022), Zwick (2019), and Kopczuk and Zwick (2020) for more details on this approach and its limitations.

[2] These series are drawn from the replication spreadsheets from GGP18 and PSZ. It is possible these concepts are not defined analogously across projects—I admit to being a dilettante when it comes to the French national accounts. So these figures should be taken as suggestive.

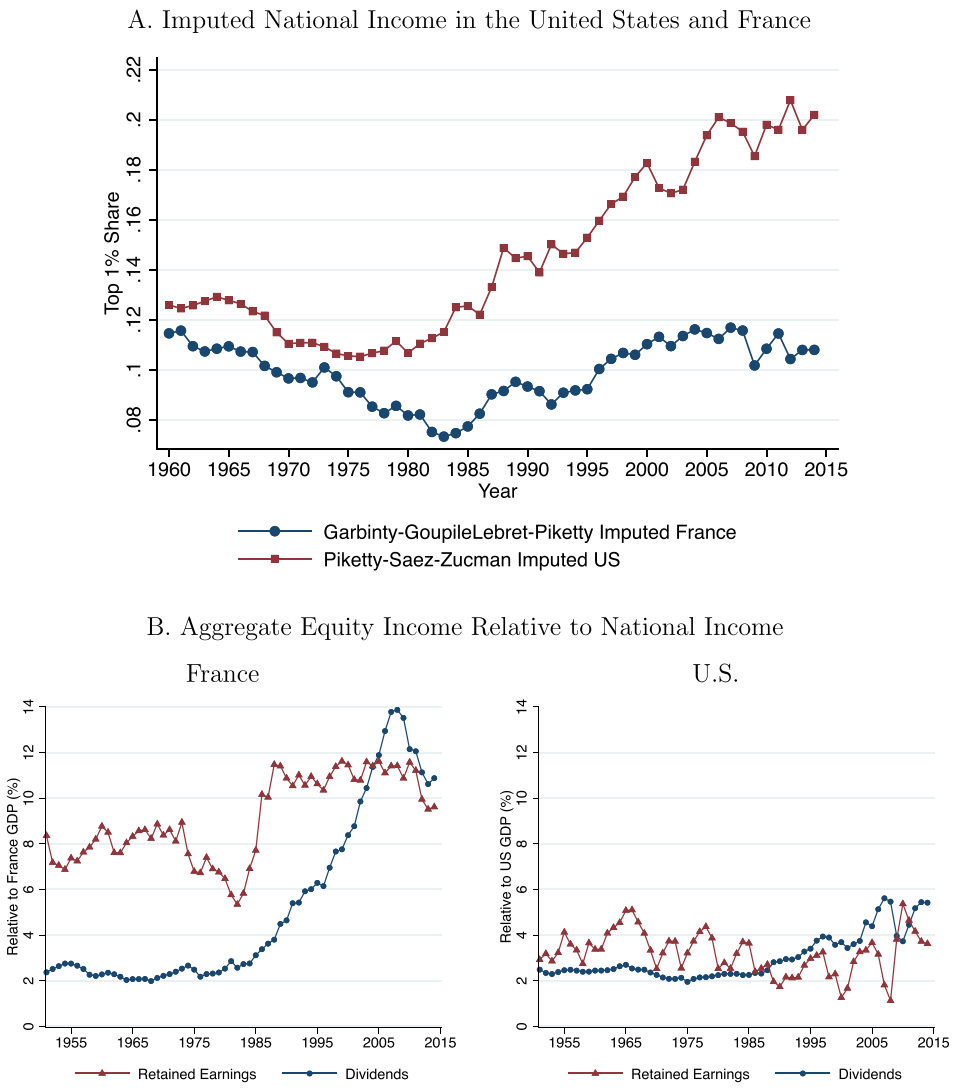

Fig. 1. Why Did Rising Equity Income Amplify Inequality in the U.S. but not France? *Source:* Supplemental spreadsheets from Piketty et al. (2018) and Garbinti et al. (2018).

2. Heterogeneous returns

Another difference between the U.S. and French series is the treatment of heterogeneous returns. The U.S. series from SZ and PSZ rely on the assumption of homogeneous returns within asset class. Kopczuk (2015) and Bricker et al. (2016) were the first to argue that the bias from this assumption was large enough to affect the qualitative conclusions from the capitalized wealth series. Indeed, GGP21 note that an extreme form of heterogeneous returns afflicts attempts to capitalize interest in the French case:

> Because deposits and savings accounts do not yield taxable interests in France, we are able to disentangle bonds from deposits and savings accounts. While bonds are estimated by capitalizing taxable interests...deposits and savings accounts are imputed using our survey-based imputation method. (footnote 28, pp. 631)

Smith et al. (2022) (henceforth, SZZ) show that accounting for heterogeneous returns materially affects top wealth shares and portfolio composition in capitalized wealth estimates. Thus, the gap between the U.S. and French series in the current paper is likely overstated due to the underlying homogeneity assumption in the U.S. data.

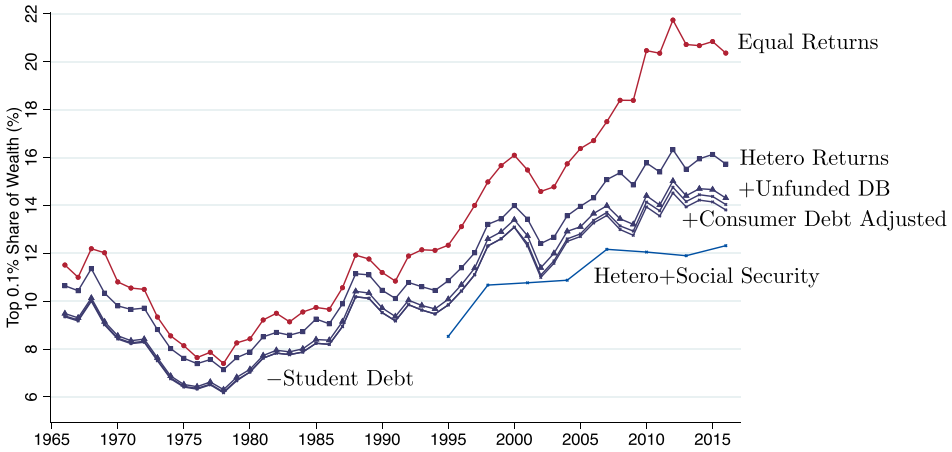

Fig. 2. Top Wealth Shares with Different Methodologies and Wealth Definitions *Source:* Smith et al. (2022).

3. What is wealth?

Finally, it is worth reflecting on why we are assembling these data and for what applications. My reading of the literature is that, when we map these measures to theoretical concepts, we risk neglecting the gaps in empirical definitions.

Figure 2 shows how estimates from SZZ are affected by augmenting the wealth definition in various ways. Quantitative and qualitative conclusions clearly depend on the definition. Different wealth definitions are suited for different questions and these measures might need to be augmented if scholars want to use them in their research.

For instance, if we care about calibrating and testing heterogeneous agent models, several issues emerge. First, unfunded pensions surely resemble wealth to agents and affect savings decisions. When we use these data to study savings, we ought to include pensions, independent of the norms for national accounting and even if their precise valuation is uncertain.

Second, does it make sense to include student debt without considering the human capital asset? When thinking about wealth taxes, the answer is probably yes. But when thinking about the dynamics of how we pay for human capital accumulation, the answer is less clear. Because the U.S. uses student debt to finance higher education, while other countries use progressive taxation, the wealth shares of two college graduates look very different even when the expected stream of cash flows is the same.

Finally, the current norm in the literature is to exclude depreciation and thus allocate national income instead of GDP. But that exclusion makes an implicit assumption about who bears the incidence of depreciation along the wealth and income distributions. Krusell and Smith (2015) show that the treatment of depreciation can affect the conclusions we draw in the $r > g$ debate. More attention should be paid to how depreciation affects distributional income estimates.

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