Public Finance Field Exam
August 2020

Directions: Answer both questions, in whatever order you prefer.

1. Wealth Taxation

A. Billionaires' wealth tax

Let us assume (unrealistically) that a new Biden administration imposes a new annual wealth tax on billionaires that works as follows. The tax is based on total net worth including all assets minus all debts of families. If your wealth is below $1 billion, no tax is due. If your wealth is at or above $1 billion, the tax is 1% of your total wealth and is paid on December 31 of the year. A person with $1 billion pays $10 million in taxes, a person with $2 billion pays $20 million in taxes, etc. Let us assume that any family with wealth above $500 million is supposed to file a wealth tax return and that the first year (2021), the tax administration does a dry run by requiring the wealthy to file returns but without imposing a tax. The tax starts in 2022.

a. Assuming you have wealth tax data for 2021 and 2022, explain how you could test for behavioral responses using the $1 billion threshold rule. Would it be possible to use this threshold rule to estimate an elasticity of reported wealth with respect to the "net of tax rate"? Would this elasticity be reliable to infer the overall behavioral response to the tax?

b. Using the taxjusticenow.org online tax calculator, provide an approximate tax revenue estimate (if such a wealth tax were imposed in 2019) and assuming no behavioral responses. By what percentage do you think revenue would fall if we factored in realistic behavioral responses. What would be the most likely mechanism behind such behavioral responses?

c. Bill Gates has been a billionaire in 1987. Assuming the billionaire wealth tax had been in place since 1987 (and that Bill Gates paid it continuously), how much smaller would his wealth be today in 2020 (relative to what it actually is)? What about Mark Zuckerberg who became billionaire in 2008? Be precise on the behavioral assumptions you are making to answer the question. Is it fair to conclude that the wealth tax hits old wealth harder than new wealth?

d. Based on what you know about the growth of billionaires' wealth since the 1980s, do you think such a wealth tax applied since 1980 would have dramatically affected the share of total US wealth going to billionaires? Why or why not?

e. Suppose you were the Treasury Secretary in charge of designing the best possible enforcement for the billionaires' wealth tax. List the most important 3 items to be thinking about.

B. Taxing capital gains better

More realistically, a Biden administration might increase and tighten the taxation of realized capital gains. Specifically, his campaign platform states that, for taxpayers with income above $1 millions, realized capital gains will be taxed at the top ordinary tax rate (currently 37%) instead of the current preferential tax rate of 20%. Biden also proposes to tax unrealized capital gains at death (instead of the current system that provides a step-up of basis to inheritors free of tax and hence exempts from taxation all unrealized capital gains at death). Suppose Joe Biden wins in early November with a democratic majority in congress (both house and senate).

f. Short-run: Explain what behavioral responses in terms of realized capital gains we are likely to see in 2020 (this election year) and 2021 (the first year the new tax is implemented). Is there empirical evidence backing this up based on previous US tax changes?

g. Long-run: Do we expect the tax reform on capital gains to increase or decrease the amount of realized capital gains in the long-run? Explain clearly as there might be competing effects.

h. Suppose you had administrative tax data on realized gains for a number of years before and after the reform, explain at a high level how you would estimate both the short-run and long-run effects of the reform.

2. Other Public Policies in the News

a. Suppose that Vice President Joe Biden is elected president this November with 51% of the vote. Further suppose that Biden's first two actions as president are to raise the corporate tax rate from 21% to 28% and to make it easier for undocumented immigrants to gain citizenship. Since Biden was elected by a majority vote, can we infer that these first two actions are efficient? Why or why not? (Rely on public choice theory in your answer, not on optimal tax or optimal citizenship analysis.)

b. Speaking of Biden's corporate tax policies, he has pledged to assess a 15% alternative minimum tax on the book profit that each large company reports to Wall Street investors. For example, suppose that in 2020, Facebook has $0 in taxable income reported on its corporate income tax return but reports $100 billion in profit in its public financial statements; Biden would assess a $15 billion tax on Facebook.

Is this policy efficient and what do you think its effects would be?

c. During his Democratic presidential primary campaign, Mayor Pete Buttigieg proposed to overhaul 401(k) retirement savings plans so that they would have the following (simplified) features:

   Employers would be required to offer its workers the new type of 401(k), in addition to any old 401(k)s that employers wish to continue offering. Workers would not be defaulted into the new 401(k) but they could actively opt in to it. The new 401(k) would be required to have a generous 2-to-1 match (i.e. every dollar contributed by a worker into her 401(k) would be matched by two dollars contributed by the employer) up to 3% of the worker's pay. The worker's contribution would go into a Rainy Day Account and could be withdrawn at any time and for any reason. In contrast, the employer's contribution would go into a Retirement Account that could not be withdrawn before retirement unless the worker has both low permanent income and also a qualified emergency or life event like disability, unemployment, family medical emergency, or house down payment. The Rainy Day Account would offer no tax advantages, while the Retirement Account would offer the same tax advantages (either Roth or traditional) as do current 401(k)s.

   Discuss Pete's policy. What advantages and disadvantages (from the point of view of the worker) do Pete's new 401(k)s have relative to current 401(k)s? What do you expect its incidence will be? Do you expect that a high share of workers would opt in to using this new 401(k)? What do you like about the policy in terms of promoting desirable savings and what about the policy worries you?

d. Congressional Republicans and President Trump removed the individual mandate from the Affordable Care Act ("ObamaCare"). That is: Americans no longer have to pay a penalty if they do not have health insurance. The individual mandate was a core part of ObamaCare and was partially intended to avoid an unraveling "death spiral" among health care policies offered in the individual (i.e. non-employer) coverage market (which is also known as "the exchanges").

   The share of American adults without health insurance has risen since then, but many Americans continue to get their health insurance in the individual market. How do you interpret this fact that the individual market has not completely unraveled?

e. When the COVID-19 pandemic struck and the United States entered a recession, Congress and President Trump passed a federally funded expansion of unemployment insurance. As a result, unemployment insurance replaced more than the usual 45% of a laid-off worker's lost pay. Does that policy make sense? Why or why not?

f. During his Democratic presidential primary campaign, Mayor Mike Bloomberg proposed a place-based supplement to the Earned Income Tax Credit (EITC). The EITC provides an earnings subsidy equal to 40% of the first approximately $15,000 of household earnings. Under Bloomberg's plan, the residents of certain distressed areas would be eligible for an additional 13 percentage point earnings subsidy up to $15,000 in earnings. What economic factors will determine the incidence of this policy? Why might this policy be desirable or undesirable?