Carried Interest and Inequality

Figure 7: The Top 0.1% in the Private Equity Era

Source: Piketty and Saez, 2003 updated to 2013. Series based on pre-tax cash market income including or excluding realized capital gains, and always excluding government transfers.
overview
(1) U.S. inequality is caused by inequality in labor income, not inequality in capital income

(2) “alpha” income often reported as capital gains income

(3) Treasury/JCT estimates of carried interest reform are low by an order of magnitude

(4) The Obama administration should use executive action to tax carried interest at ordinary rates
capital gains at the top come from alpha
Figure 6: The Top Tenth of the Top One Percent

US Top 0.1% Pre-Tax Income Share and Composition

Source: Piketty and Saez, 2003 updated to 2013. Series based on pre-tax cash market income including or excluding realized capital gains, and always excluding government transfers.
Figure 4: The Top 16,500

The Top 0.01% Income Share, 1913-2014

How many of the top 400 are fund managers? According to Institutional Investor’s Alpha magazine, the top 25 hedge fund managers earned at least $200 million in 2012, with a median of $350 million. Perhaps another 25 made the top 400 AGI.
Figure 7: The Top 0.1% in the Private Equity Era

Source: Piketty and Saez, 2003 updated to 2013. Series based on pre-tax cash market income including or excluding realized capital gains, and always excluding government transfers.
INEQUALITY
LABOR, NOT CAPITAL

• changes in inequality are mostly attributable to the top 0.1%
  • carried interest, founders’ stock, executive compensation
  • not portfolio investments
  • the rich get richer not because their investments do well, but because their compensation is linked to equity
labor is the new capital
carried interest, founders’ stock, and other forms of alpha income are often reported as capital gains income

- exacerbates top-end inequality
- undermines progressivity at the top
- this is not a “second” tax on saved income, but a first and last tax on labor income
revenue
WHAT’S AT STAKE?
TREASURY/JCT ESTIMATES

• Treasury/JCT estimates less than $2 billion per year in revenue
• But Schwarzman alone = $150 million
• Why? Treasury/JCT elasticity model treats carried interest as capital income
  • portfolio investors can defer income indefinitely by holding appreciated positions.
  • fund managers sell when the market dictates because funds have a limited time span, and fund managers care about IRR.
• I estimate $180 billion over ten years
executive action
EXECUTIVE ACTION
TREASURY CAN FIX CARRIED INTEREST UNILATERALLY

• Treasury can do it — it has the legal authority

• Treasury should do it — it’s right from a tax policy perspective

• Treasury should do it now — it’s right from a timing perspective
thank you