Volatile top income shares in Switzerland? Reassessing the evolution between 1981 and 2009

Reto Foellmi, Isabel Martínez 31 August 2014

Switzerland has had consistently low tax rates and a remarkably stable income distribution, although in the last 20 years the share of top incomes has risen. This column documents that the top 0.01%’s share doubled, meaning Switzerland is similar to European countries in terms of the top 1%’s income share, but closer to the US for higher top incomes. Labour incomes have grown in importance among top income earners. At the same time, however, top incomes have exhibited large and possibly increasing variations over the business cycle.

The evolution of inequality in income and wealth has attracted substantial attention in recent decades. Academics have been trying to capture the relation between distribution and growth patterns – most recently and prominently Piketty (2014) in his widely discussed book Capital in the Twenty-First Century. Research on income distributions has notably focused on the top of the earnings distribution, in particular because changes in the very top incomes account for a large part of overall inequality in quantitative terms. Starting with Piketty (2001), there have been many studies compiling top income shares series based on tax data for many developed and developing countries, many of which are collected in Atkinson and Piketty (2007, 2010).

The main finding of this body of scientific work is that the Anglo-Saxon world – and especially the US – has experienced an increase in top income shares since the 1980s, while top income shares seem to have remained relatively stable in Europe. Subsequent studies have tried to explain the different experiences by differences in top marginal tax rates (Piketty et al. 2014, Saez et al. 2012, Kleven and Schultz 2014) or changes in skill-biased technological change (Mankiw 2013), market size, and firm capitalisation (Gabaix and Landier 2008).

Top income shares in Switzerland have been increasing ...

In Foellmi and Martinez (2013), we study the recent evolution of top incomes in Switzerland, and in contrast to many other country studies we are able to draw on two separate date sources: social security data on labour incomes, and tax data on total income. Unlike most countries, the Swiss social security system has no upper income limit, which allows us to study the entire distribution of labour incomes.

Besides data availability, Switzerland is of particular interest because it is a globalised industrialised country with a large financial sector. Tax competition within Switzerland and the absence of wars have kept tax rates low and have not foreclosed possible wealth accumulation by rich households, unlike in Switzerland’s European neighbours. At the same time, Switzerland has a very equal wage distribution – the ratio between bottom and top deciles is at a similar low level as Northern European countries.

Our results show that over the last 20 years the share of income going to the top income earners has overall been increasing also in Switzerland, while in the long run (1933–2009) the top share has stayed remarkably stable – confirming the conclusion reached by Dell et al. (2007), who studied Swiss top incomes for the period 1933–1995. Furthermore, inequality has risen pronouncedly within the top group – while the top 10% group experienced an increase of 13% over the whole period, the increase for the top 1% was 31% and added up to 117% for the richest 450 tax units belonging to the top 0.01% group.[1] As shown in Figure 1, these patterns mean Switzerland is similar to European countries for the top 1% group, but closer to the US for higher top incomes. Despite the
differing experiences of the top income groups, by the end of the time span covered, all groups have reached shares in total income above any level reached since 1980. These findings hold for both total income measured with tax data and labour income based on social security data.

**Figure 1a.** Top 1% income share in Switzerland and other selected countries

![Graph showing top 1% income share in Switzerland and other selected countries over years](image)

**Figure 1b.** Top 0.01% income share in Switzerland and other selected countries

![Graph showing top 0.01% income share in Switzerland and other selected countries over years](image)

... and have become more volatile

The patterns in Figure 1 also suggest that higher percentiles in the income distribution tend to have more volatile earnings. Top incomes exhibited large variations over the business cycle, which is confirmed by the correlation with the variance of periodical growth rates. This is in line with findings for other countries, suggesting that top incomes have become more cyclical since the 1980s (Saez 2013). Using a panel of 16 countries, Roine et al. (2009) find that growth benefits the top 1% group the most, while Guvenen et al. (2012), who use a large panel of individuals in the US for 1978–2011, find that those belonging to the top 1% and top 0.1% experience, when entering a recession, the largest drop in earnings.

**The increasing importance of employees’ labour incomes**

Comparing the results based on tax data (at the household level) with social security data on top labour incomes (at the individual level) suggests that labour incomes have become more important among top income earners also in Switzerland. This is in line with findings for other developed countries – especially the US, but also European countries like Germany and the Netherlands.

The social security data, which capture all forms of compensation including bonuses and stock
market options, further allow for a decomposition of labour income into wages paid to employees and incomes of the self-employed. This allows a comparison of the growth of top self-employed and employees’ incomes (Figure 2). The increase in top employees’ income share is stunning. For the top 0.01% it more than tripled over the observed period, compared to the top self-employed’s shares, which less than doubled. Figure 2 thereby shows how the distribution of labour earnings in Switzerland has been undergoing remarkable changes since the beginning of the millennium. While up to the mid-1990s the evolution of incomes at the very top was similar for entrepreneurs and employees, the latter have benefitted from a steady increase in their income shares since then. The top incomes of employees rose by more than 55%, whereas the total top incomes rose by only 30%. Taken together, this implies that, while there has been a general increase in earnings inequality at the top as top income shares have been on a steady rise, this increase has been steeper for employees’ incomes than for the self-employed’ incomes and general incomes measured by the tax data.

Figure 2. Growth in different top 1% income shares in Switzerland

If this increase in top employees’ earnings is partly due to more volatile salary components such as stock options and equity pay, the top paid employees like CEOs will also bear part of the firm’s risk. Note, however, that the upward trend still remains, as the declines are sharp but smaller than the increases. This fits an empirical literature demonstrating asymmetric payments for CEOs in up-versus downturns (Bertrand and Mullainathan 2001).

The question must remain open why we observe such a surge only after the mid-1990s. On the one hand, the literature has proposed market-driven explanations such as skill-biased technological change, which has favoured top earners (e.g. Gabaix and Landier 2008). Others have claimed that it is the international institutional setting which matters and which has changed after the Reagan/Thatcher epoch, which was followed by a wave of liberalisations in many spheres (Pontusson 2005).

Related to the latter view is the broad literature considering the effects of tax rates on top incomes. The Swiss case is particularly interesting to study that hypothesis, as both the level and the change in taxes differ a lot between cantons in Switzerland. Cantonal income tax rates have been falling over this period in Switzerland, which is in line with the hypothesis of an inverse correlation between top income shares and top marginal tax rates put forth by Saez et al. (2012) and Piketty et al. (2014). Further research is needed to investigate the hypothesis that falling top marginal tax rates could partially explain the rise of incomes at the very top of the distribution, in particular in a country with an equal primary (wage) distribution like Switzerland.

References


Pontusson, J (2005), Inequality and Prosperity: Social Europe vs. Liberal America, Cornell University Press.


Footnote

1 The finding that the top decile is a heterogeneous income group has been pointed out in previous research by Atkinson and Piketty (2007, 2010) and Roine et al. (2009).