Two Centuries of Taxing the Rich

Average Top Rates of Income and Inheritance Taxation
1800-2013

- Income Tax
- Inheritance Tax

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Taxing the Rich
Plan of the Talk

1. Review possible answers to the question
2. Show that neither suffrage extensions nor increased inequality led to higher taxation of the rich, but mass warfare did
3. Suggest how we can interpret this war effect
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When Might Governments Tax the Rich?
“Democracies tax the rich more heavily”

“Democracies will tax the rich more heavily when inequality is high”

“Democracies tax the rich more heavily if they are not captured by the rich”

“Governments avoid taxing the rich when they think it is self-defeating”
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Individuals are concerned about their own economic welfare but they also care about fairness.

Fairness in taxation is a notion that is up for grabs.

We argue the key criterion defining tax fairness is that the state should treat people as equals.

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Three Ways to Treat People as Equals

- **Equal Treatment**—Fair that everyone pays the same rate
- **Ability to Pay**—As equals in terms of the utility loss
- **Compensatory Arguments**—People want to tax the rich when they think this compensates for unequal treatment by the state on other dimensions
Sirs when we study in the most general terms the history of our fiscal system, we see that there have always been two vices in our system of taxation, like two weeds in a garden that return continually. It is first a privilege, profiting certain classes, or profiting certain localities, or certain parts of the territory. It is in second place the extension of indirect taxes to the detriment of direct taxes, which is after all a form of privilege. *We see that all the movements that have taken place in our history against the existing tax system have always been dominated by the need to restrain privilege and by the desire to insure a greater role for direct taxes by restricting indirect taxes within a circle that they should not exceed.*
It is a time of danger, when men part willingly with anything in order to avert evils impending on the country they love, and I am perfectly certain that when there are millions of our countrymen volunteering to risk their lives, men who cannot volunteer are not going to grudge a fair share of their possessions.
When Did Governments Tax The Rich in Practice?
Data for Our Analysis

Comparative Income Taxation Database records top marginal rate levied by the national government on individuals in 20 countries, 1800-2013.

Top Rate
- Focus of political debate
- Measures tax burden on the rich—correlated with effective rate on wealthy
- Measures progressivity—correlated with overall progressivity based on full schedules
- Possible to collect for a relatively large number of countries over many years
Income Tax Data

Average Top Rate

Average Top Rate of Income Taxation
1800-2013

Top Rate, Selected Years

Top Rate of Income Taxation
Selected Years

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Taxing the Rich
Left Partisanship and Top Rate of Income Taxation

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Taxing the Rich
World War I and Top Rate of Income Taxation

World War I Mass Mobilization and Top Rate of Income Taxation

- WWI Mobilization Countries
- Non-Mobilization Countries

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Taxing the Rich
World War I Mass Mobilization and Top Rate of Income Taxation

By Political Regime Type

Year

1913 1914 1915 1916 1917 1918 1919

Percent

0 10 20 30 40

WWI Democratic Mobilization Countries

WWI Non-Democratic Mobilization Countries

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Taxing the Rich
Two Econometric Specifications

\[ T_{it} = \alpha + \beta_1 D_{it-1} + \beta_2 W_{it-1} + \gamma X_{it-1} + \eta_i + \theta_t + \varepsilon_{it} \] (1)

\[ T_{it} = \alpha + \rho T_{it-1} + \beta_1 D_{it-1} + \beta_2 W_{it-1} + \gamma X_{it-1} + \theta_t + \varepsilon_{it} \] (2)

- With data in five year intervals, mass mobilized war associated with an increase in Top Rate of 17 (FE) or 15 (LDV) percentage points
- No evidence that suffrage extensions lead to higher taxes on the rich
- All results robust to many alternative specifications
## Estimation Results

**Ordinary Least Squares, 5-year Data**

<table>
<thead>
<tr>
<th></th>
<th>Country Fixed Effects</th>
<th>Lag DV</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>(1)</td>
<td>(2)</td>
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<tr>
<td>**Top Income Tax Rate}_{t-1}</td>
<td>0.79</td>
<td>0.78</td>
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<tr>
<td></td>
<td>(0.03)</td>
<td>(0.03)</td>
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<td>**War Mobilization}_{t-1}</td>
<td>17.35</td>
<td>18.43</td>
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<td></td>
<td>(6.52)</td>
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<td></td>
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<tr>
<td></td>
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<td>0.95</td>
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<td>1.66</td>
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<td></td>
<td>(3.28)</td>
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<td>0.62</td>
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<td>**GDP per capita}_{t-1}</td>
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<td>-0.001</td>
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<td></td>
<td>(0.001)</td>
<td>(0.001)</td>
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<td></td>
<td>0.16</td>
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<td>Country-specific Time Trends</td>
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<td>Country Fixed Effects</td>
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<td>R-squared</td>
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<td>Number of Observations</td>
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</table>

Scheve & Stasavage, *Taxing the Rich*
Do Governments Tax the Rich When Inequality is High?

Examining Contemporaneous Correlations is Insufficient Here

1. If true then past income inequality should be positively correlated with the top tax rate
2. We should also expect past top tax rates to be negatively correlated with current inequality

This argues in favor of conducting a granger style test
Examining Contemporaneous Correlations is Insufficient Here

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Panel Granger Tests of Top Tax Rates and Top Income Shares

- Panel granger style test, augmented with country and time fixed effects

\[ T_{it} = \alpha + \beta T_{it-1} + \gamma I_{it-1} + \eta_i + \theta_t + \varepsilon_{it} \]  
(3)

\[ I_{it} = \alpha + \beta I_{it-1} + \gamma T_{it-1} + \eta_i + \theta_t + \varepsilon_{it} \]  
(4)

- We find that top tax rates granger cause inequality, but not the reverse

- Results are insensitive to number of lags, top incomes measure, or time periods
How Should We Interpret the War Effect?
Did Taxes Just Go Up on Everyone Else in the Same Proportion? **NO**

- Other taxes on the rich also increased: inheritance taxes, war profits, and capital levies.
- Indirect taxes went up but not by the same proportion.
- Overall tax burden in the UK (Shirras & Rostas 1943).
- Evidence from other countries points to the same pattern.

<table>
<thead>
<tr>
<th>£</th>
<th>1913</th>
<th>1918</th>
<th>1937</th>
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<td>10.2</td>
<td>5.6</td>
<td>18.4</td>
</tr>
<tr>
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<td>5.2</td>
<td>16.9</td>
<td>11.8</td>
<td>32.2</td>
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<td>18.0</td>
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</tr>
<tr>
<td>5,000</td>
<td>6.7</td>
<td>36.6</td>
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<td>47.9</td>
<td>80.7</td>
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<tr>
<td>50,000</td>
<td>8.4</td>
<td>50.6</td>
<td>56.7</td>
<td>90.7</td>
</tr>
</tbody>
</table>

*Scheve & Stasavage Taxing the Rich*
Does Limited State Capacity Account for our Democracy Null Result? No

- **Comparative Inheritance Taxation Database** records top marginal inheritance tax rate in nineteen countries, 1800-2013.
- Key feature: an inheritance tax did not require high levels of state capacity to collect.
- Estimation results parallel those for the income tax.

![Average Top Rate](chart.png)

*Scheve & Stasavage: Taxing the Rich*
Did Governments Tax the Rich During War Because They Had To? **NO**

- Maybe there was no alternative? No, it was not the most financially desperate countries that taxed the rich.
- Did it Make Sense to Target the Rich Because of Limited State Capacity? Yes, but why then apply different rates within this group?
In Chapter 6 we review debates in the US, the UK, Canada, and France.

Prior to WWI those on left either referred to ability to pay or to the need to compensate for indirect taxes.

With the advent of WWI the debate shifted. The left argued for taxing the rich to equalize war sacrifice, and the right often conceded this point.
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Frequency of Different Fairness Arguments in UK Parliament (among supporters of taxing the rich)

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Taxes the Rich
What Happened After War’s End?
Did Fears for Economic Growth Lead to Lower Taxes on the Rich?

- Arguments about efficiency costs have been salient throughout 19th and 20th century tax debates.
- Salient in party platforms well before the Thatcher and Reagan revolutions.
- Therefore something else must have changed.
We find no correlation between capital account restrictions and top rate of personal income taxation, contrary to what is commonly found for corporate taxation.

Impact of personal mobility harder to assess, but we believe little evidence for this either.

We do see that country tax policies are interdependent, but interdependence has declined over time. This is inconsistent with the argument...
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The Demise of Compensatory Arguments After War’s End

- External conditions supporting compensatory arguments faded
- The right relied on equal treatment arguments to advocate tax cuts for the rich
- The left, in the absence of credible compensatory arguments, relied on ability to pay considerations or general references to “fairness”

References to Equal Sacrifice, 1844-2000
Arguments opposing progressive taxation on equal treatment grounds will often be persuasive.

Arguments in favor of progressive taxation need to show that it treats people as equals.

Ability to pay - One way to treat people as equals, but many aren’t swayed.

Compensatory arguments - These are the most politically powerful arguments for taxing the rich, but they cannot be invented out of thin air.
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Appendix
Why did mass mobilization wars and their impact on taxation happen in the early 20th century?

- Countries mass mobilize only if they can supply and transport a large army and it is advantageous to do so.
- Railroad and other technologies made mass warfare possible.
- Greater remote delivery of force with precision increasingly making such armies less desirable.
- Refers back to idea that political and economic conditions determine whether compensatory arguments are credible.

Military Size and Mobilization, 1600-2000
### Full Schedules of Statutory Income Tax Rates

<table>
<thead>
<tr>
<th>Country</th>
<th>Year Range</th>
<th>Full Schedules of Statutory Rates</th>
</tr>
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<tbody>
<tr>
<td>France</td>
<td>1925-2010</td>
<td>![France Graph]</td>
</tr>
<tr>
<td>Germany</td>
<td>1925-2010</td>
<td>![Germany Graph]</td>
</tr>
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<td>New Zealand</td>
<td>1900-2010</td>
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<tr>
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<td>1875-2010</td>
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<tr>
<td>UK</td>
<td>1875-2010</td>
<td>![UK Graph]</td>
</tr>
<tr>
<td>USA</td>
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**Scheve & Stasavage**

_Taxing the Rich_