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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“ Governments avoid taxing the rich when they think it is self-defeating”
Countries tax the rich when people think the state has failed to treat citizens as equals and in so doing privileged the rich.
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.

Debates about tax fairness are primarily debates about what as equals means.
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Debates about tax fairness are primarily debates about what as equals means.
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
Political and economic conditions that make compensatory arguments credible push states to tax the rich.

Absent these conditions, Equal Treatment and Ability to pay arguments dominate with less support for taxing the rich.

Historically, compensatory arguments have come in two forms: (1) offsetting other taxes (19th C, early 20th C) (2) equalizing war sacrifice (20th C).
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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
Universal Male Suffrage and Top Rate of Income Taxation

Scheve & Stasavage

Taxing the Rich
Left Partisanship and Top Rate of Income Taxation

Scheve & Stasavage
Taxing the Rich
Inequality and Top Rate of Income Taxation

Statutory rates and top 0.01% income shares

Rates and shares in Canada
\[ \rho = -0.288 \]
Rates and shares in France
\[ \rho = -0.744 \]
Rates and shares in the Netherlands
\[ \rho = -0.858 \]
Rates and shares in Sweden
\[ \rho = -0.838 \]
Rates and shares in the UK
\[ \rho = -0.896 \]
Rates and shares in the USA
\[ \rho = -0.741 \]
Examining contemporaneous correlations does not answer the question. Absent a compelling identification strategy, can investigate the following hypotheses:

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.
Examining contemporaneous correlations does not answer the question. Absent a compelling identification strategy, can investigate the following hypotheses:

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
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2. We should also expect past top tax rates to be *negatively* correlated with current inequality
Panel Tests of Top Income Tax Rates and Top Income Shares

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

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

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

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

- Results are insensitive to number of lags, top incomes measure, or time periods

Scheve & Stasavage  Taxing the Rich
Panel Tests of Top Inheritance Tax Rates and Top Wealth Shares

- Roine & Waldenstrom compilation of top wealth shares (9 countries)
- Panel granger style test, augmented with country and (sometimes) time fixed effects
- We find some evidence that top inheritance tax rates granger cause wealth inequality
- Little evidence that wealth inequality granger causes top inheritance tax rates
World War I Mass Mobilization and Top Rate of Income Taxation by Political Regime Type

- WWI Democratic Mobilization Countries
- WWI Non-Democratic Mobilization Countries

1913 to 1919

Scheve & Stasavage

Taxing the Rich
Two Econometric Specifications

\[ T_{it} = \alpha + \beta_1 D_{it-1} + \beta_2 W_{it-1} + \gamma X_{it-1} + \eta_i + \theta_t + \varepsilon_{it} \]  
(3)

\[ T_{it} = \alpha + \rho T_{it-1} + \beta_1 D_{it-1} + \beta_2 W_{it-1} + \gamma X_{it-1} + \theta_t + \varepsilon_{it} \]  
(4)

- 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

<table>
<thead>
<tr>
<th></th>
<th>Country Fixed Effects</th>
<th>Lag DV</th>
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<tr>
<td></td>
<td>(1)</td>
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<tr>
<td>Top Income Tax Rate(_{t-1})</td>
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<td>(0.03)</td>
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<td>(6.52)</td>
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<td>Universal Male Suffrage(_{t-1})</td>
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<td></td>
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<td>(6.58)</td>
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<td></td>
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<tr>
<td></td>
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<td>Top Rate_{t-1}</td>
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<td>0.891 0.007</td>
<td>0.097 0.000</td>
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<td>Competitive elections_{t-1}</td>
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<td>0.361 0.097</td>
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<td>Competitive Elections_{t-1} * War Mobilization_{t-1}</td>
<td>22.551 (9.623)</td>
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<td>0.030 0.148</td>
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<tr>
<td>Left Executive_{t-1}</td>
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<td>0.498 (0.938)</td>
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<td>0.690 0.596</td>
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<td>Period Fixed Effects</td>
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Table: War Mobilization, Democracy, and Income Taxation, 1816-2010: Interactions between War Mobilization and Democracy and Partisanship Measures.
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>
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<th>Total Burden of Taxation in the UK</th>
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<tr>
<td>£</td>
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<td>2,000</td>
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<td>5,000</td>
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<td>10,000</td>
</tr>
<tr>
<td>20,000</td>
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<td>50,000</td>
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</table>
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 of Inheritance Taxation (1800-2013)](chart)
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?
Other Alternative Interpretations

- **War politically weakens rich**...but governments where wartime destruction of assets limited (e.g. UK and US) responded to war mobilization just as much as countries where destruction substantial (France)

- **War alters beliefs about efficiency effects or increases discount rate**...but this argument does not anticipate that effect is larger in democracies nor that it included raising top rates immediately after wars as well as during
Did new war-induced inequities change debates about taxation?

- WWI test using database of debates in UK parliament
- Search "income tax"
- Read all debates in 1909, 1914, 1915, 1916, 1917, 1918
- Include in database any speech that makes an argument regarding income taxation
- Coded the primary argument in the speech: Equal Treatment, Ability to Pay, Compensatory, Economic Efficiency, Other
Did new war-induced inequities change fairness debates about taxation?

Scheve & Stasavage  

Equal Treatment  
Ability-to-Pay  
Compensatory  
Economic Efficiency  
Other
Canada WWI Example

- War arrived with Conservative government under Robert Borden
- Initially fought with volunteer army and financed with tariff, increased consumption taxes, and debt
- As war progressed and sacrifices mounted, adopted war profits tax (1916) with progressive scale (1917)
- As late as April 1917, Minister of Finance rejected idea of using income tax but government introduced income tax legislation in July 1917.

Two key characteristics of policy change:
- Followed government’s announcement in May 1917 of conscription
- Adopted in political environment demanding greater sacrifices on the part of the wealthy in response to war sacrifices generally and those related to conscription specifically
General response to conscription by organized labor and the left is to push for “conscription of wealth”.

Borden acknowledges principle in Dec 1916 “the government accepted and acted on the principle that the accumulated wealth of the country should bear its due proportion of contributions and sacrifices in the war”

Liberal platform for fall 1917 election “A fundamental objection to the government’s policy of conscription is that it conscripts human life only, and that it does not attempt to conscript wealth...”

Unionist platform “In order to meet the ever-increasing expenditure for war purposes and to ensure that all share in common service and sacrifice, wealth will be conscripted by adequate taxation of war profits and increase taxation of income”
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
What Happened After Mass Wars?
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...
Did Globalization Lead to Lower Taxes on the Rich?

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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

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Taxing the Rich
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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Conclusions About Taxing the Rich

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Conclusions About Taxing the Rich

The answer to the puzzle of why the poor do not soak the rich more than they do in contemporary democracies may be in part because they don’t think it is fair or at least there is not enough of a consensus to overcome the usual advantage of elites in politics.

The real puzzle is why countries ever did soak the rich and the answer has to do with fairness arguments generated by a specific combination of war technology and conflict not likely to be soon repeated.
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Appendix
Full Schedules of Statutory Income Tax Rates

Full schedules of statutory rates

France, 1925-2010

Germany, 1925-2010

New Zealand, 1900-2010

Sweden, 1875-2010

UK, 1875-2010

USA, 1925-2010

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Taxing the Rich
Democracy and Top Rate of Income Taxation

Competitive Elections and Top Rate of Income Taxation

Scheve & Stasavage

Taxing the Rich
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.
Statutory and Effective Rates (Top 0.01%)