The Economic Consequences of Major Tax Cuts For the Rich

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LSE III
Inequalities Seminar Series
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Tax Cuts for the Rich

- A summary of our findings in Twitter memes:

Tax Cuts for the Rich

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Amy, 2022 Mothman Festival Queen
@cableknitjumper

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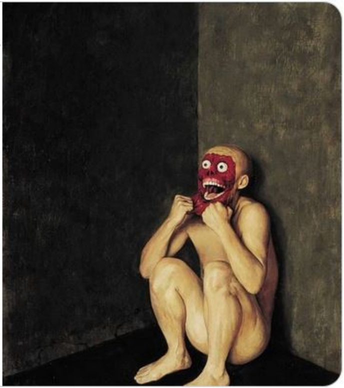
Taxes

Fifty Years of Tax Cuts for Rich Didn't Trickle Down, Study Says

By Craig Stirling
15 December 2020, 16:01 GMT-8

- Paper looks at fiscal policies in 18 countries over 50 years
- Governments shouldn't worry about taxes on rich, author says



5:52 PM · Dec 16, 2020 · Twitter for Android

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Tax Progressivity and Economic Performance

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Nicholas Kaldor 1983, p. 9

However much Ministers may try to revive incentives through tax reductions, they can never hope to achieve the Victorian or Edwardian peaks in fiscal incentives, when income tax was not progressive and it was seven old pence in the pound or 3 percent instead of the present 33 percent. Yet with all those incentives, the economy was stagnating.

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Our Study

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Research Question

What are the economic effects of major tax cuts for the rich?

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  - 2) Hard to make causal claims with observational data (and political science literature tells us reverse causality likely to be an issue).
  - 3) Existing causal evidence limited to effects of single tax reforms (Rubolino and Waldenström, 2020).

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- Indicators:
  - Top Incomes: Top marginal income tax rates, tax burden on the top 1% of wage earners.
  - Capital: Statutory corporate income tax rate, top marginal tax rate on dividends, effective average tax rate on capital.
  - Assets: Top inheritance tax rate, tax revenue from assets (inheritance/estates/net wealth/immovable property, as % of GDP).

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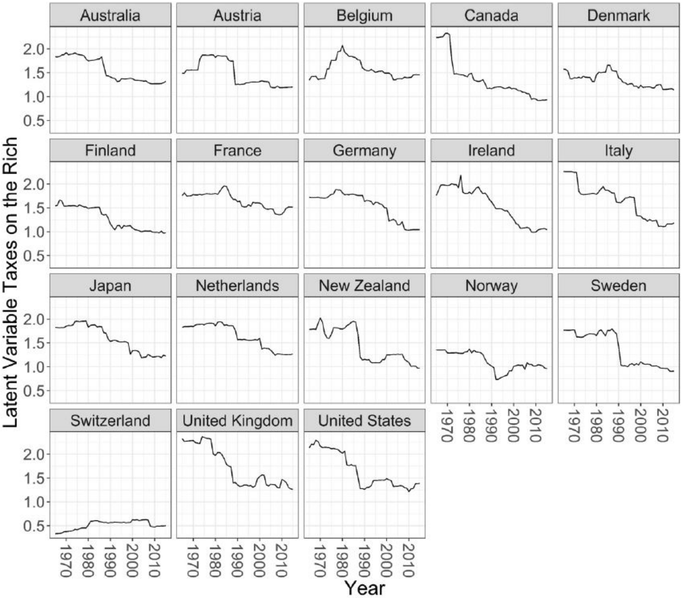
- Advantage: Robust to missing values for some indicators.

Our Comprehensive Measure of Taxes on the Rich



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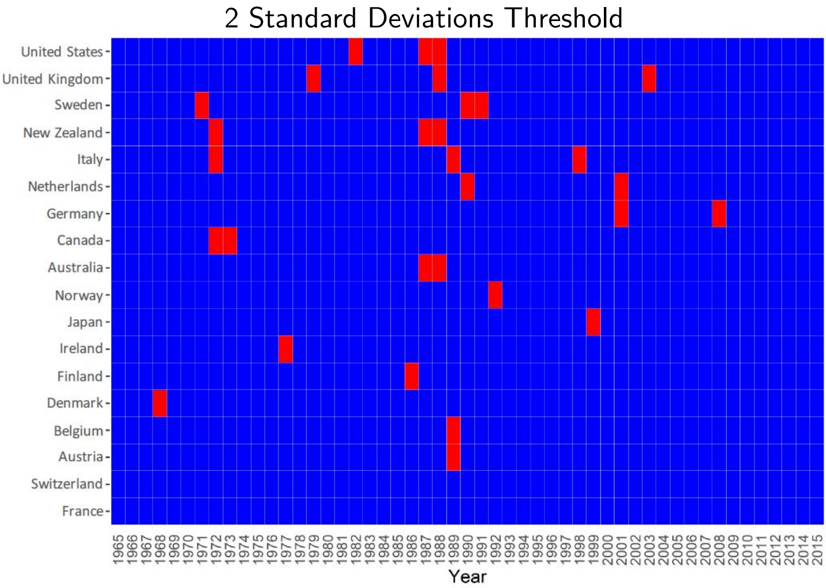
- We code major tax cuts as years in which the index fell by over 2 standard deviations.
- Threshold often used in empirical literature in macroeconomics (Dell' Erba et al., 2015; Fernández-Villaverde et al., 2015) – but we use 1 standard deviation as an alternative threshold as well.

Major Tax Cuts for the Rich in the OECD Since 1965



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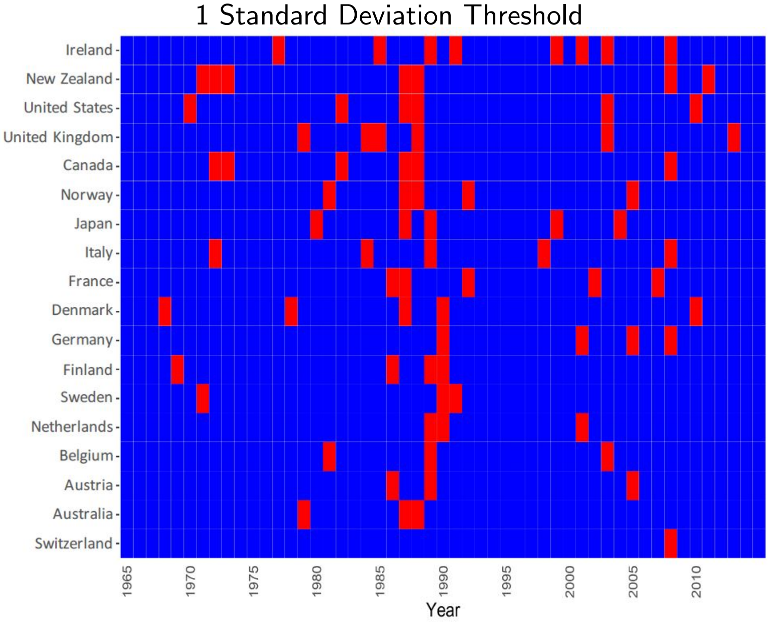

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Empirical Strategy

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- We utilise a new method for causal inference in observational studies, which uses a generalization of the difference-in-differences estimator that implements Mahalanobis distance matching in panel data analysis (Imai et al., 2020).
- Three main ideas:
  - 1) We compare countries (with similar pre-treatment treatment trajectories) that cut taxes on the rich to those that didn't in a given time period. We repeat this for all major reforms.
  - 2) We calculate the difference-in-differences estimator for different lags and leads. Lags allow us to estimate the development of the effect over time. Leads allow us to check whether the parallel trends assumption holds.
  - 3) We use Mahalanobis distance matching to compare countries with similar covariate trajectories.

Data

Data

- Three main dependent variables:
  - Effects of tax cuts for the rich on inequality (top 1% income shares (Alvaredo et al., 2018))
  - Effects of tax cuts for the rich on economic growth (Real GDP pc in 2011 US Dollars, logged values (Feenstra et al., 2015))
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- Block-bootstrap procedure to calculate standard errors (Imai et al., 2020).

Results

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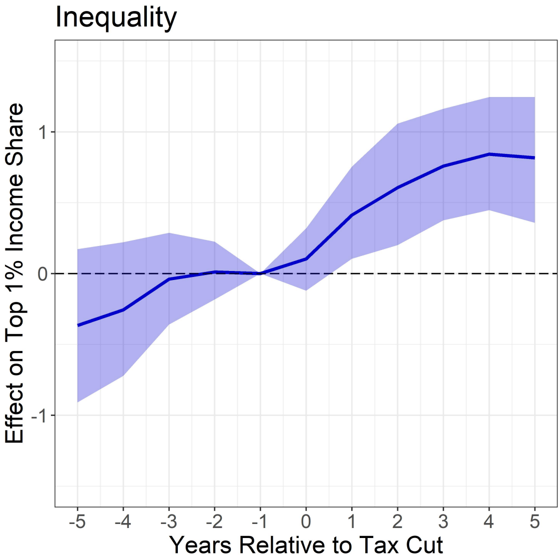
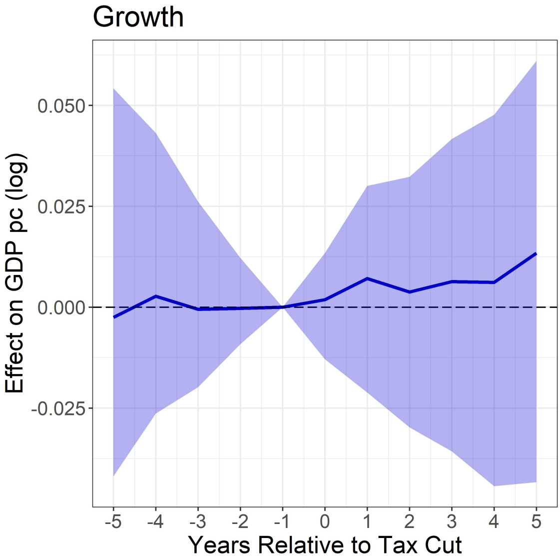

Inequality
Effect on Top 1% Income Share
1
0
-1
-5
-4
-3
-2
-1
0
1
2
3
4
5
Years Relative to Tax Cut

Results


Growth
Effect on GDP pc (log)
0.050
0.025
0.000
-0.025
-5
-4
-3
-2
-1
0
1
2
3
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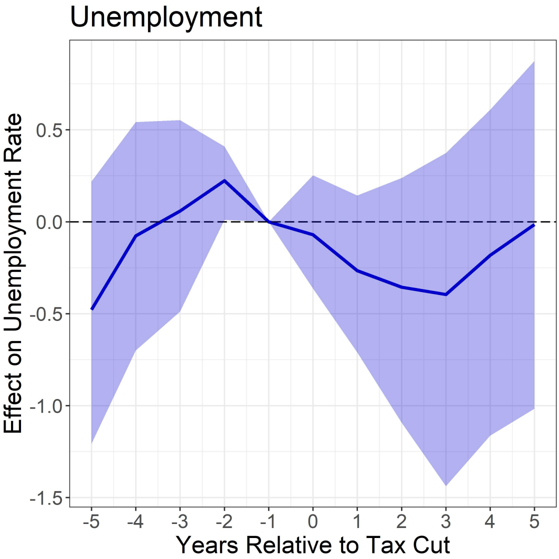
Unemployment
Effect on Unemployment Rate
0.5
0.0
-0.5
-1.0
-1.5
-5
-4
-3
-2
-1
0
1
2
3
4
5
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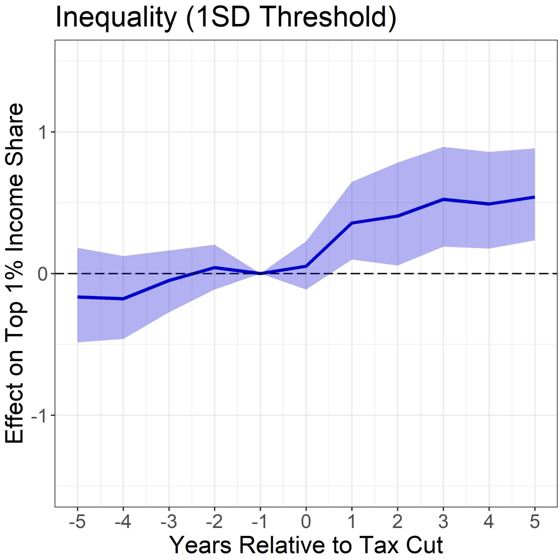

Inequality (1SD Threshold)
Effect on Top 1% Income Share
1
0
-1
-5
-4
-3
-2
-1
0
1
2
3
4
5
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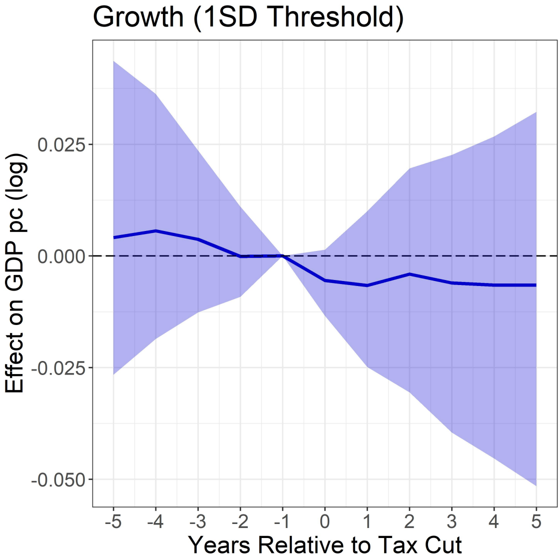

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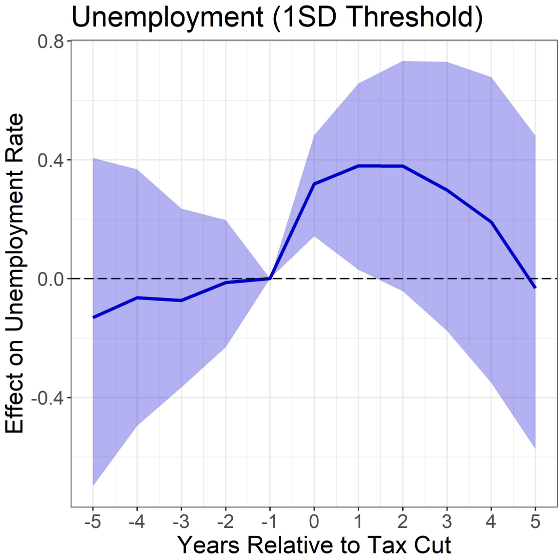
Unemployment (1SD Threshold)
0.8
0.4
0.0
-0.4
Effect on Unemployment Rate
-5
-4
-3
-2
-1
0
1
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Conclusions

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- Growth and unemployment is neither statistically nor substantively significantly different after tax cuts for the rich.
- Main effect: Inequality increases.

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- However, the idea of such 'trickle-down' effects persists – why?
- Survey experiments to shed light on this question – we are currently in the design phase.
- Potential book project on 'The Trickle-Down Myth'.

Thank you for your attention.
Any questions?