What determines taxes on the rich in peacetime?

David Hope[1]   Julian Limberg[2]

Panel on "The politics of major tax reform"
LSE International Inequalities Institute
June 15, 2020

[1]Department of Political Economy, King's College London
[2]Department of Political Economy, King's College London

Taxing the Rich

Source: The Independent (2020)

Taxing the Rich

- Large literature on the role that wars play for taxing the rich (Scheve & Stasavage 2016).
- No consensus about drivers of progressive taxation in peacetime:
  - Domestic factors – partisan politics (Osterloh & Debus 2012), veto players (Hallerberg & Basinger 1998; Swank 2016), electoral systems (Hays 2003; Martin & Hertel-Fernandez 2018).
  - International factors – tax competition (Cao 2010, Genschel & Schwarz 2011), learning (Jensen & Lindstädt 2012), diffusion of neoliberal ideas (Swank & Steinmo 2002).
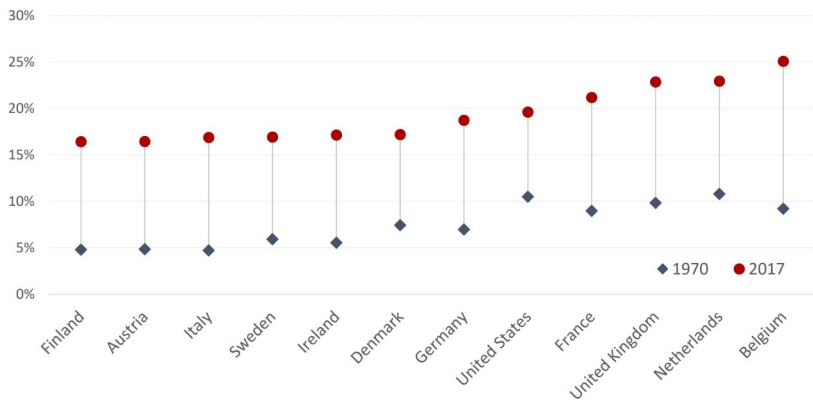
Missing Piece 1

Role of fundamental structural economic changes in the post-war period neglected – rise of the knowledge economy!

Missing Piece 2

No comprehensive approach of how to measure taxes on the rich. Which taxes? Which indicators?

Missing Piece 1: The Rise of the Knowledge Economy

Employment share in knowledge-intensive services, 1970 and 2017

Note: Knowledge-intensive services comprises information and communication, finance and insurance activities, and Professional, scientific, technical, administrative and support service activities.

Source: EU KLEMS, 2009 and 2019 releases. Series combined and smoothed by authors.

Missing Piece 1: The Rise of the Knowledge Economy

- The rise of the knowledge economy is strongly connected to inequality dynamics in the OECD (Iversen & Soskice 2015, Hope & Martelli 2019).
- Two mechanisms for how the rise of the knowledge economy might affect taxes on the rich.
    - Change in redistributive preferences (micro level).
    - Political power of 'superstar' firms in technology and finance (macro level).

Missing Piece 1: The Rise of the Knowledge Economy

- Emerging literature linking the knowledge economy to redistributive preferences.
  - Shift of high skilled workers into knowledge intensive services (and away from sheltered sectors) has reduced demand for redistribution due to heightened concerns about international competitiveness (Wren and Rehm 2014).
  - Individuals in routine task intensive occupations favour greater redistribution than those performing abstract and complex tasks (Thewissen and Rueda 2019).
  - University educated workers are less supportive of redistribution by eroding norms of economic solidarity (Gelepithis and Giani 2020).

- In sum, this literature would expect the shift to the knowledge economy to lead to lower political appetite for redistributive tax policies.

Missing Piece 1: The Rise of the Knowledge Economy

- Finance and technology are particularly knowledge-intensive sectors (Hope and Martelli 2019) and have seen the rise of 'superstar' firms (Song et al. 2019; Autor et al. 2020).
- Big firms in these industries have used their power and resources to extensively lobby national governments on taxes (and other issues), for example:
  - Big US tech companies spent half a billion lobbying Congress in 2010s (Washington Post 2020).
  - The finance, insurance, and real estate industries spent almost $6 billion lobbying Congress between 1998 and 2013 (Makunda 2014)
  - British financial services industry spent £92 million lobbying UK government in 2011 and corporate taxation was slashed shortly afterwards (Guardian 2012).
- In sum, the transition to the knowledge economy has seen greater lobbying from organised interests and businesses to reduce taxes on the rich (see e.g. Hacker and Pierson 2010 for the US).

Missing Piece 2: Measuring Taxes on the Rich

- No consensus which tax to look at:
    - Personal income (top income, capital income)
    - Corporate income
    - Taxes on assets (wealth, inheritance, real estate)
- No consensus which indicator to look at:
    - Top tax rates.
    - Effective tax rates.
    - Public Revenue.
- To overcome this problem, we propose a comprehensive approach using a wide array of taxes and indicators.

Missing Piece 2: Measuring Taxes on the Rich

- No consensus which tax to look at:
  - Personal income (capital income, top incomes)
  - Corporate income
  - Taxes on assets (wealth, inheritance, real estate)
- No consensus which indicator to look at:
  - Top tax rates.
  - Effective tax rates.
  - Public revenue.
- To overcome this problem, we propose a comprehensive approach constructing a new indicator that measures taxes on the rich across countries and over time.

Missing Piece 2: Measuring Taxes on the Rich

- Bayesian latent variable modelling (Merkle & Rosseel, 2018). Models were run with posterior predictives, three MCMC chains and 1000 burnin iterations.
- 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).
- Advantage: Robust to missing values for some indicators.

Missing Piece 2: Measuring Taxes on the Rich
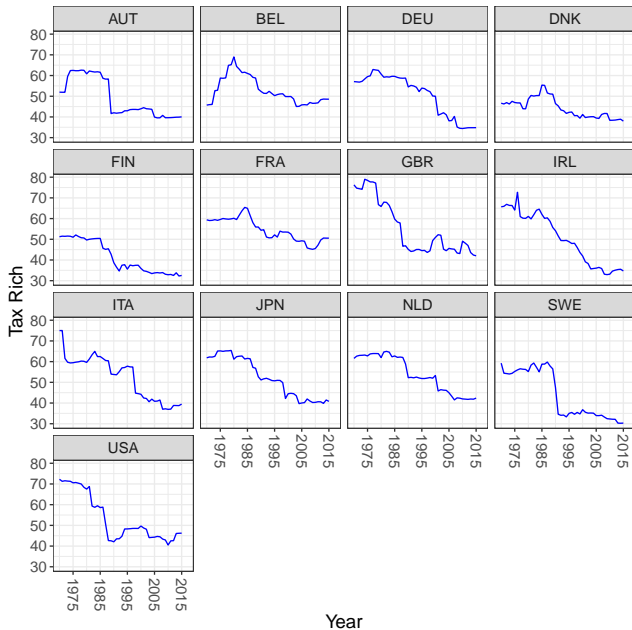
# Missing Piece 2: Measuring Taxes on the Rich
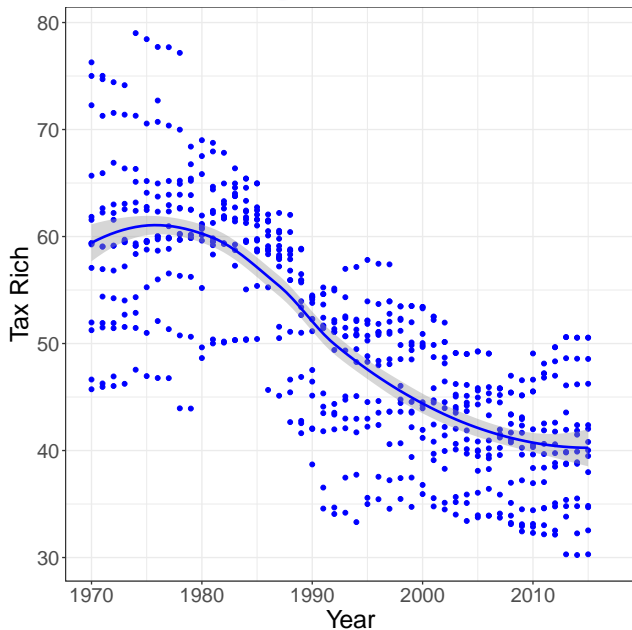
Bringing the Pieces Together: Has the Rise of the Knowledge Economy Led to Lower Taxes on the Rich?

- Data: Panel dataset covering 13 OECD countries from 1970 to 2015.
- DV: New indicator on taxing the rich (author's calculations).
- IV: Share of employment in knowledge intensive services (EU KLEMS, authors' calculations).
- Controls: Covering both domestic and international factors from previous literature:
    - Domestic factors (growth, inflation, leftist government, veto points)
    - International factors (capital account openness, share imports and exports)
- Country fixed effects to control for unobserved unit heterogeneity.
- Panel-corrected standard errors, additional time trends.
- All variables on the right hand side of the equation lagged by one year to avoid simultaneity bias.
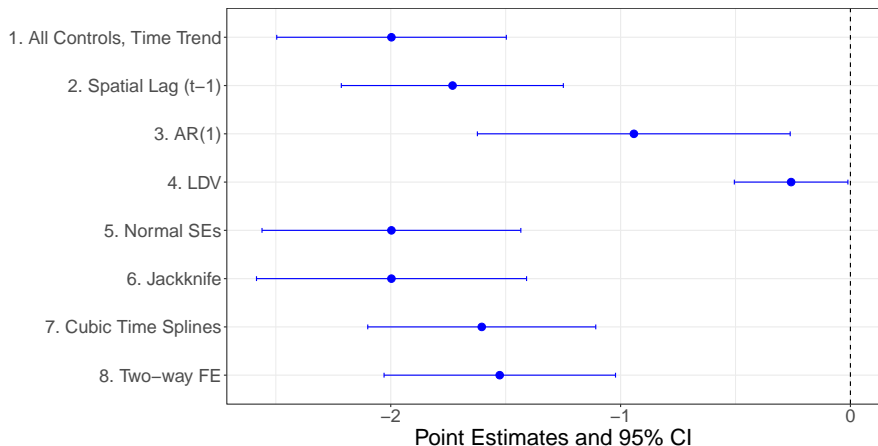
Results 1: Main Models

Effect of Knowledge Economy Employment Share on Taxing the Rich
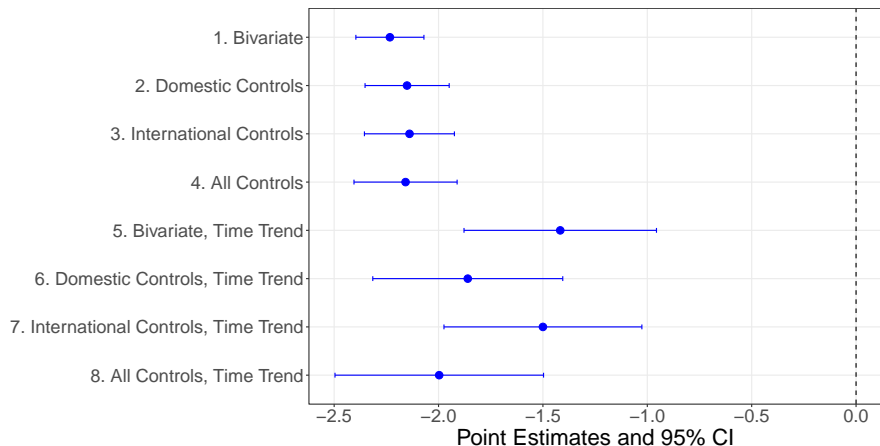
Results 2: Robustness Checks

Effect of Knowledge Economy Employment Share on Taxing the Rich

Conclusion

- Two contributions to help answering the question about the drivers of taxing the rich since the end of WW II.
- First, investigating the effect of fundamental changes in capitalist production systems on taxing the rich.
  - Rise of the knowledge economy as one of the major socio-economic transformations.
  - Bringing changes in domestic production regimes back into the discussion mirrors work on the very origins of progressive taxation in the 19th century (Mares & Queralt 2015, Beramendi, Dinecco & Rogers 2019).
- Second, provide a new, comprehensive measurement for taxing the rich (in total covering 19 countries, 1965-2015).
- Several follow-up questions.
  - Zooming in on the mechanisms – analysing survey data, case studies looking at the effect of big tech companies on tax systems.
  - Using the new dataset to investigate consequences of changing taxes on the rich (e.g. inequality, growth, electoral success).

Thank you for your attention.