Econ 133 –Global Inequality and Growth

Funding the social state

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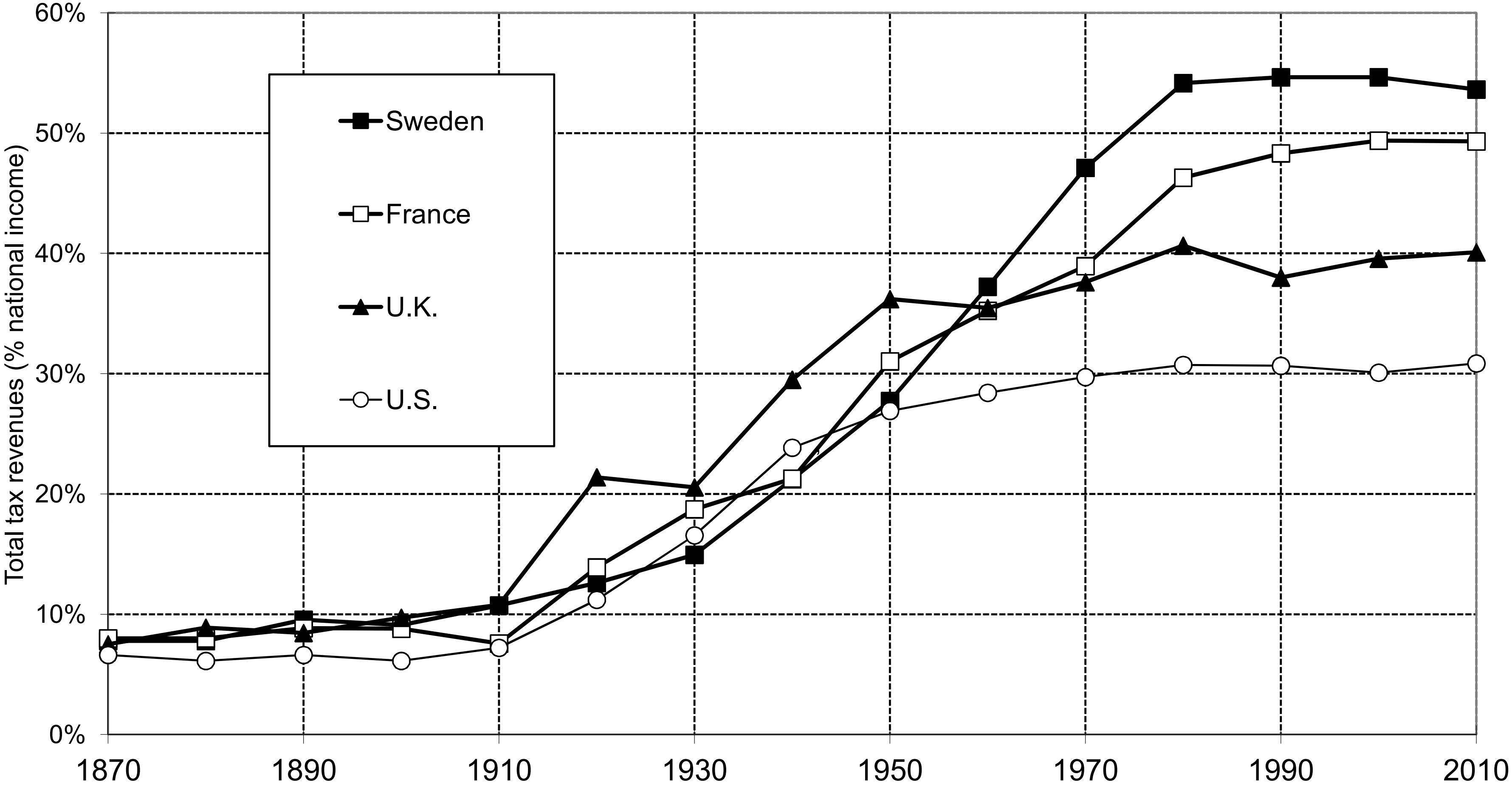
Roadmap

1. The rise of the social state

2. Funding the social state of the 21st century

Figure 13.1. Tax revenues in rich countries, 1870-2010



Total tax revenues were less than 10% of national income in rich countries until 1900-1910; they represent between 30% and 55% of national income in 2000-2010. Sources and series: see piketty.pse.ens.fr/capital21c.

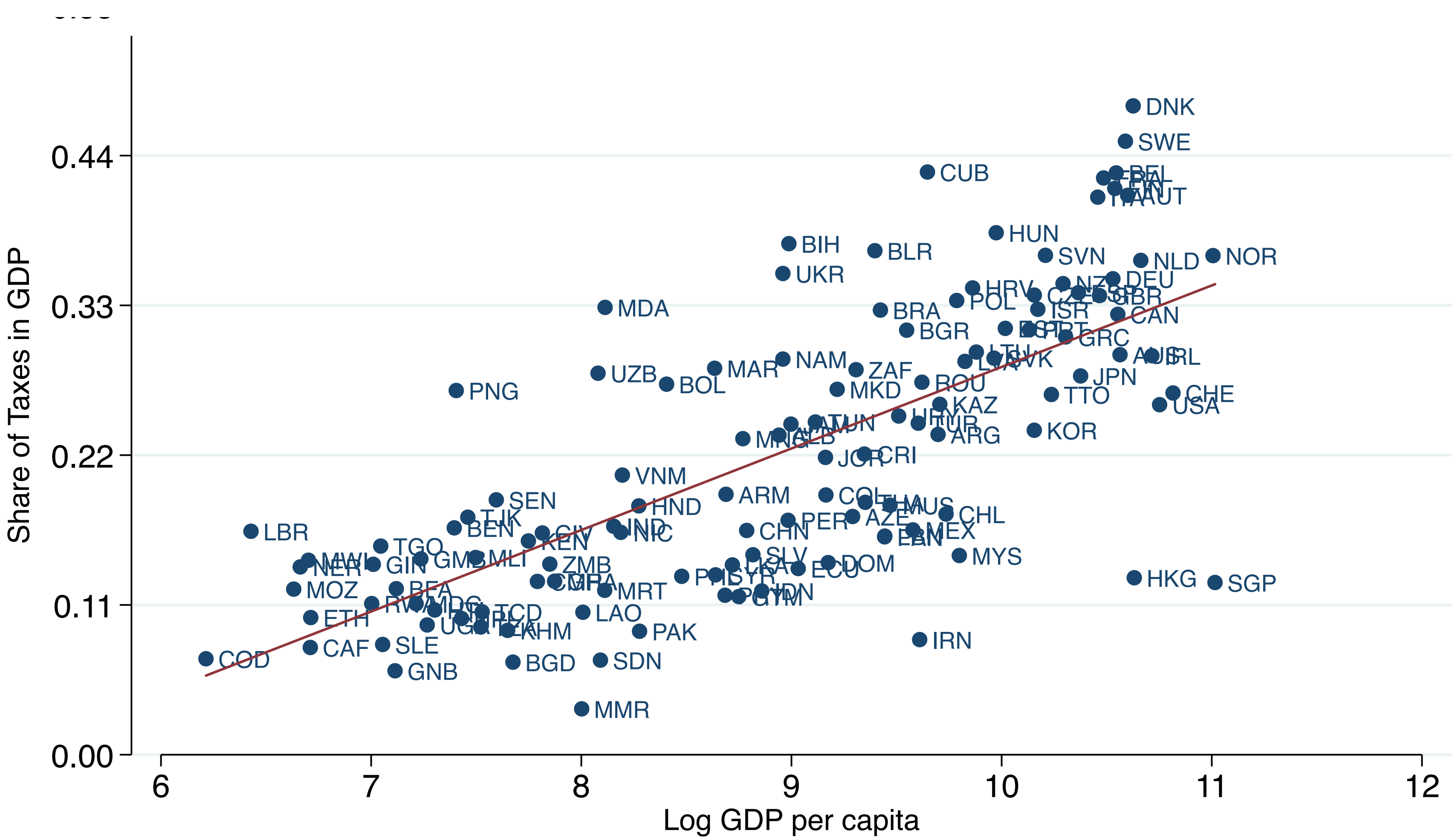
1 The rise of the social state

- During 20th century, big rise of tax revenues in today's rich countries: from 10% to 30-50% of national income

- Part of this jump happens during and just after World Wars

- Previous wars had seen some increase in gov. size (Tilly 1975: "war made the State and the State made war"), but not persistent

- Specificity of mass-mobilization wars: led to development of major new institutions (public pensions, Welfare State) $\rightarrow$ ratchet effect



Share of Taxes in GDP
0.44
0.33
0.22
0.11
0.00
6
7
8
9
10
11
12
Log GDP per capita

Rise of taxes during 20th century corresponds to change in the form of taxation:

- Before 20th century: mostly archaic indirect taxes
- First half of twentieth century: birth of progressive income and wealth taxation
- Expanded with third-party reporting in middle of the 20th century
- Second half: broad-based VAT and Social Security contributions to fund welfare State (education, health & means-tested transfers)

Archaic indirect taxes

Key source of revenue since the Roman Empire. Two main forms:

1. Taxes on trade: for using roads, crossing bridges, arriving in harbor...

2. Taxes on consumption: on goods sold, on salt, on slaves...

Middle-Ages: role of trade fairs where exchanges are concentrated $\rightarrow$ makes it easier for governments to impose sales taxes

Indirect taxes still very high up to late 19th century: 60% of tax revenue in France just before World War I

The birth of progressive taxation

- Before WW1: no or very limited progressive taxation

- Income tax initially highly progressive, high exemption threshold

- Then expanded with lowering of exemption threshold (1941 in the US)

- Expanded information collection from 3rd parties, making successful enforcement possible

- Extra tax on wages with payroll taxes

Why does third-party reporting work?

- In theory, employer and employee could collude to evade taxes
- In practice, such collusion is fragile in modern companies because
  - Accounting and payroll records are widely used within the firm
  - Whistleblowing: a single employee can denounce collusion between employer and employees.

The invention of the VAT

- Invented by French civil servant Maurice Lauré in the 1950s

- Introduced in France in 1954, then Denmark (1967), Germany (1968), Sweden (1969)...

- About 160 countries in total today have a VAT (exceptions: USA, Iraq, Saudi Arabia, Syria, etc.)

- Key property: firms can offset VAT on their purchases against liability on their sales $\rightarrow$ paper trail $\rightarrow$ low evasion

2 Funding the social state of the 21st century

The limits of the VAT

- VAT: exempts saving and big sectors (finance, health, education): VAT base $\approx$ 40% of national income only

- VAT was invented in during post-WW2 decades of low capital stock / low wealth inequality; opposite context today

- What boosts saving: regulations (eg, automatic enrollment in pensions), not tax incentives

The national income tax

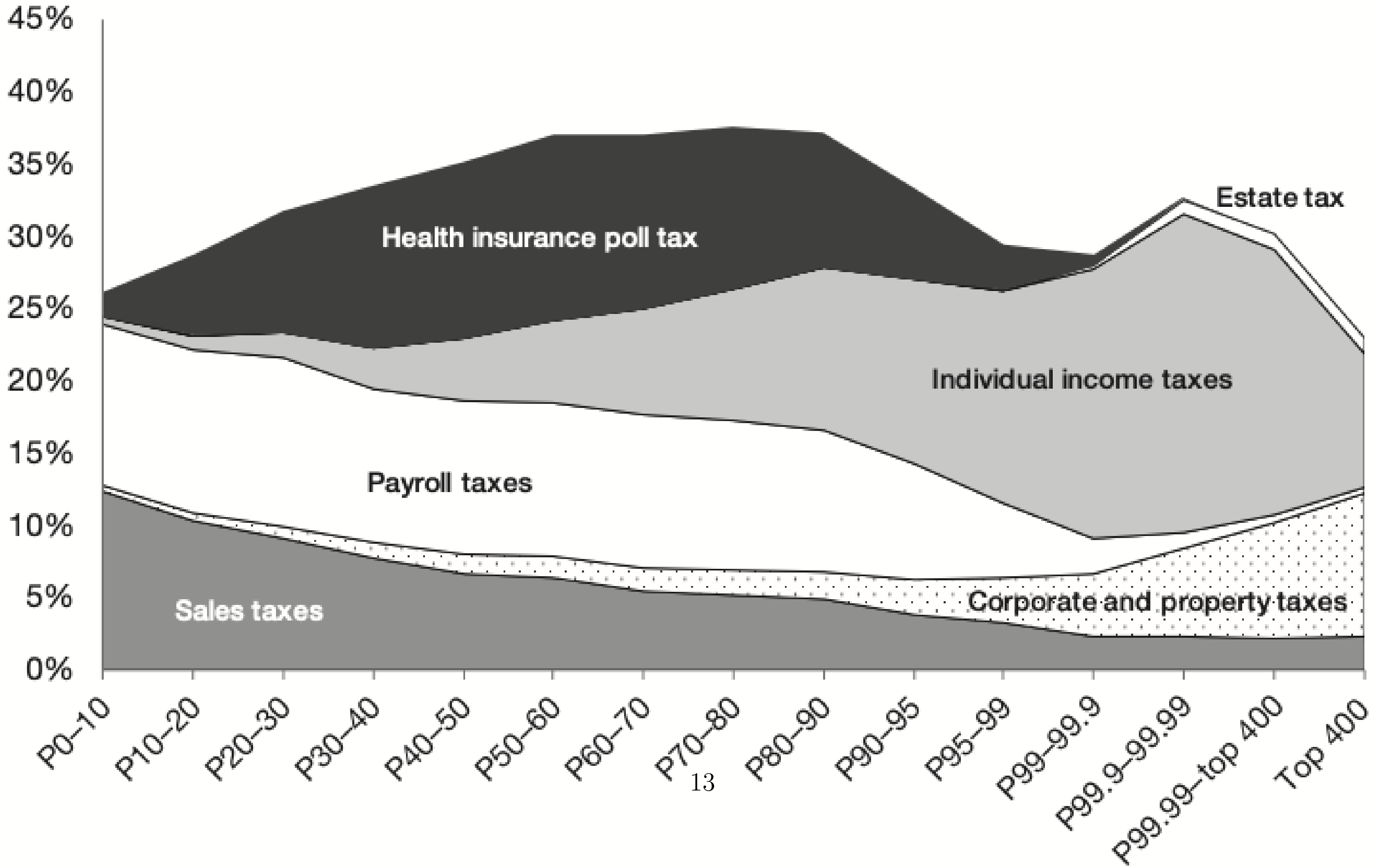
- Base: all labor costs + interest + business profits + foreign dividends ($\approx$ 94% of national income)

- More progressive than payroll taxes (because taxes K) and VAT (because taxes investment)

- 6% rate enough to fund health care for all & abolish private health insurance $\rightarrow$ big tax cut for bottom 90%

- Could be seen as first bracket of a big, progressive income tax

(Tax rates including compulsory health insurance, 2018)



References

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