

PP 290 – Introduction to Tax Policy

Funding the social state

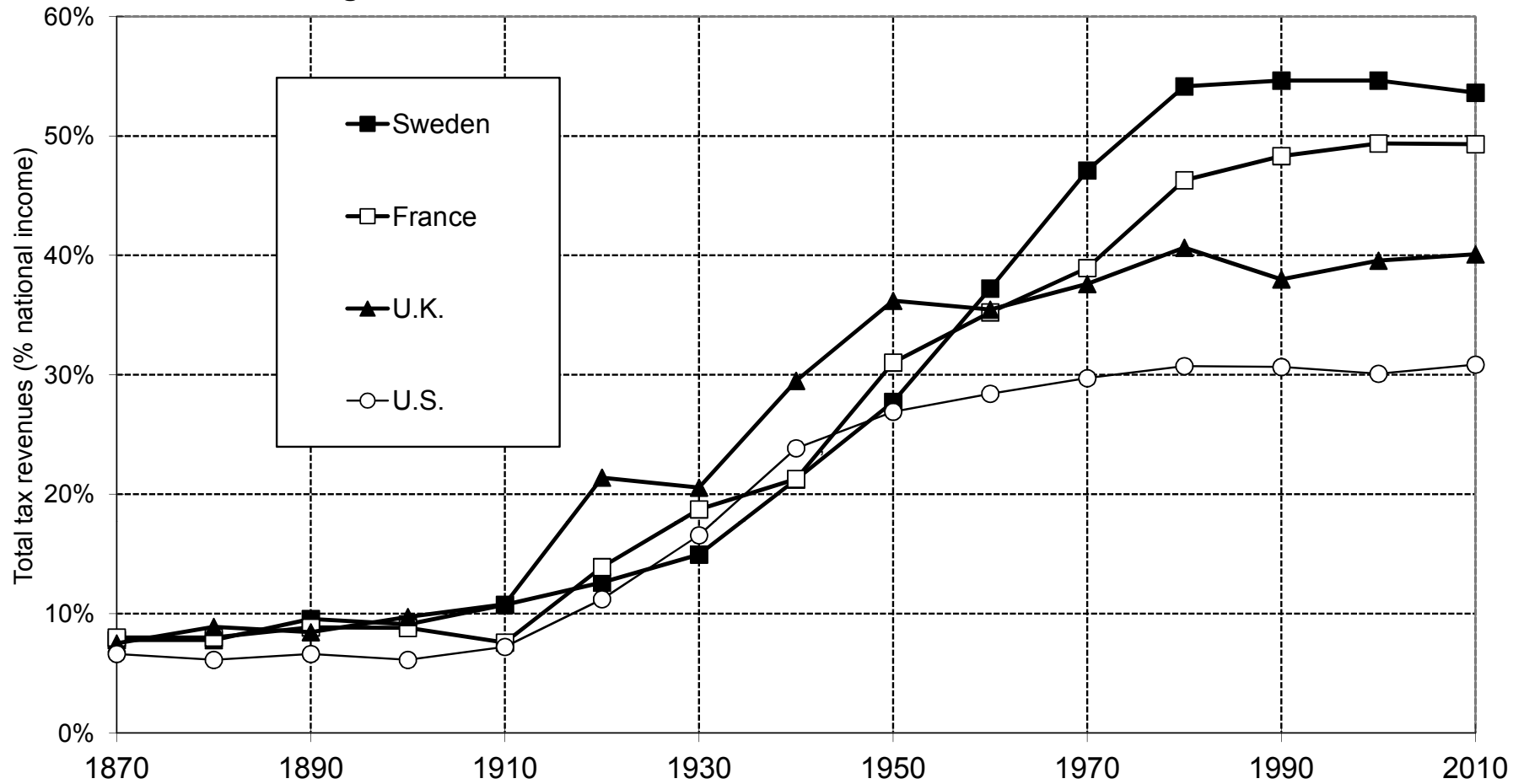
Gabriel Zucman

zucman@berkeley.edu

Roadmap

1. The rise of the social state
2. Funding the social state of the 21st century

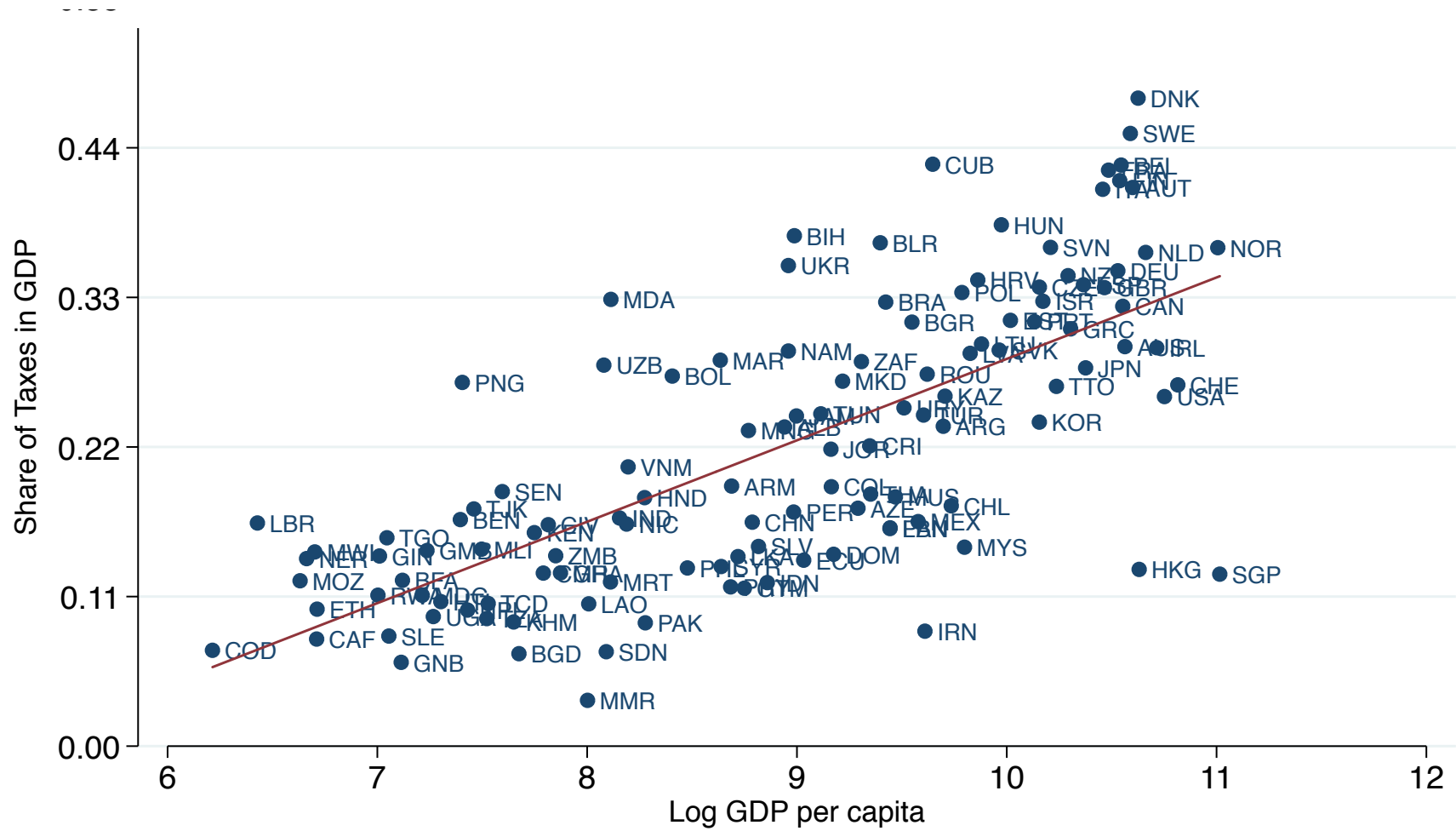
Figure 13.1. Tax revenues in rich countries, 1870-2010



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) → ratchet effect



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 → 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 → paper trail → low evasion

2 Funding the social state of the 21st century

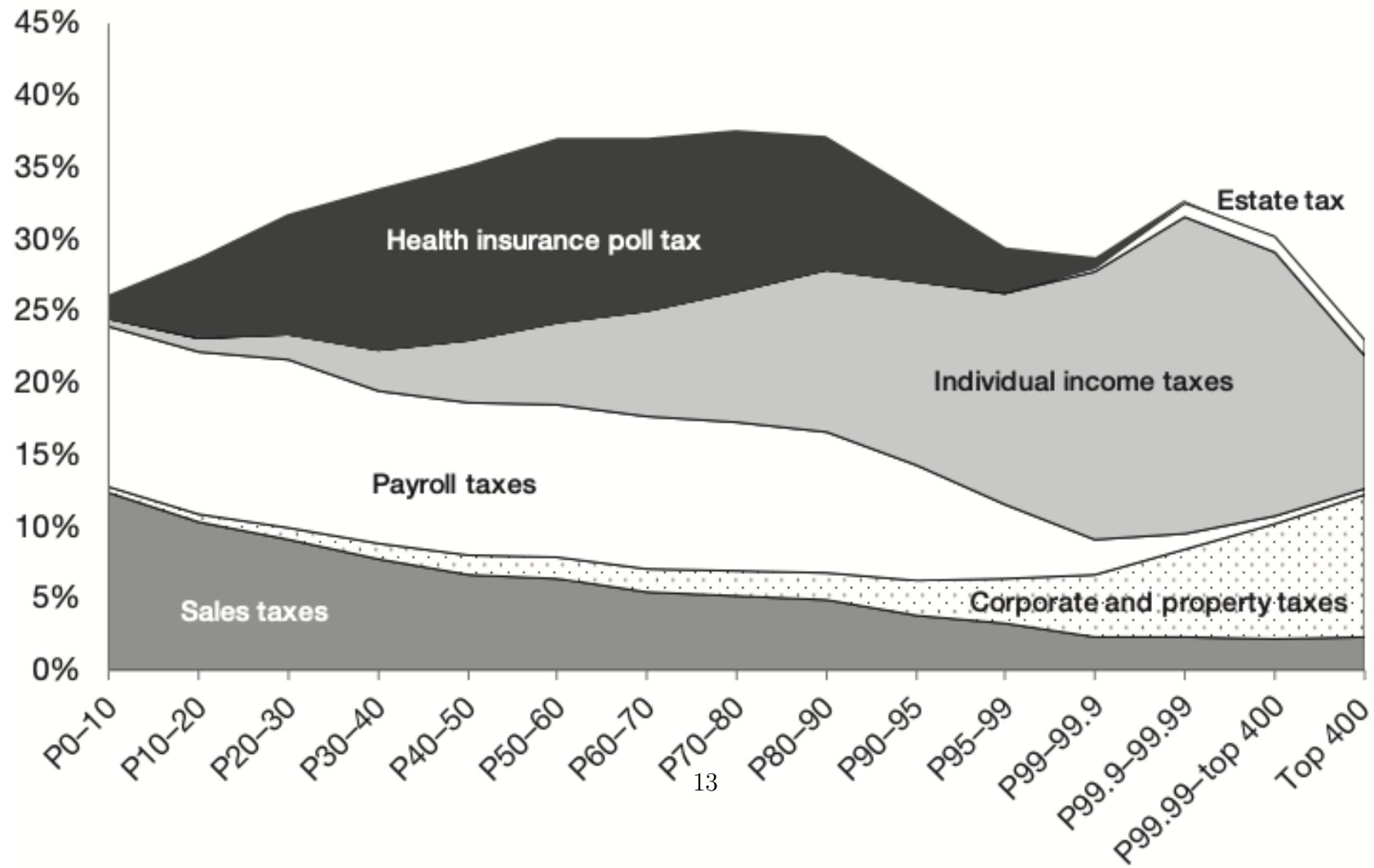
The limits of the VAT

- 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

Kleven, Henrik, Claus Kreiner, and Emmanuel Saez “Why Can Modern Governments Tax So Much? An Agency Model of Firms as Fiscal Intermediaries”, *Economica*, 2016 (web)

Piketty, Thomas, Emmanuel Saez, and Gabriel Zucman, “Distributional National Accounts: Methods and Estimates for the United States,” *Quarterly Journal of Economics*, 2018 (web)

Saez, Emmanuel and Gabriel Zucman, “The Rise of Income and Wealth Inequality in America: Evidence from Distributional Macroeconomic Accounts,” *Journal of Economic Perspectives*, 2020 (web)