

# **Economic History**

*(Master PPD & APE, Paris School of Economics)*

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## **Lecture 7: The rise of the fiscal, social and capital state**

*(check [on line](#) for updated versions)*

# Roadmap of lecture 7

- State formation & government regulation in history
- The rise of the social and fiscal state
- The rise and fall of tax progressivity
- Why doesn't democracy always lead to declining inequality?
- Political beliefs & attitudes toward inequality
- Regulating property: financial transparency & participatory governance
- Organizing democracy: electoral & party systems, nations-states, federations, empires
- History and the dimensions of political conflict

# State formation & government regulation in historical perspective

- **The rise of the fiscal and social state (taxes < 10% of national income Y until WW1, vs. 30-50% Y in all rich countries today) is a crucial evolution that we will address today: from minimal state to educational, developmental and welfare state; major social, economic & political transformation**
- **But: (1) In order to appreciate this transformation, one needs to look into aggregate taxes & spendings.** Tax progressivity or regressivity? Who really benefits from public spendings?
- We have seen many historical examples where the fiscal & social state has been used to reinforce elite domination rather than to reduce inequality. Key question: who controls the state & why?
- Examples. 19<sup>c</sup>: fiscal system used to transfer resources from average taxpayers to property owners (public debt, slave compensation, colonial coercion, etc.) (e.g. UK). 21<sup>c</sup>: very unequal access to higher education spendings (meritocratic myth).

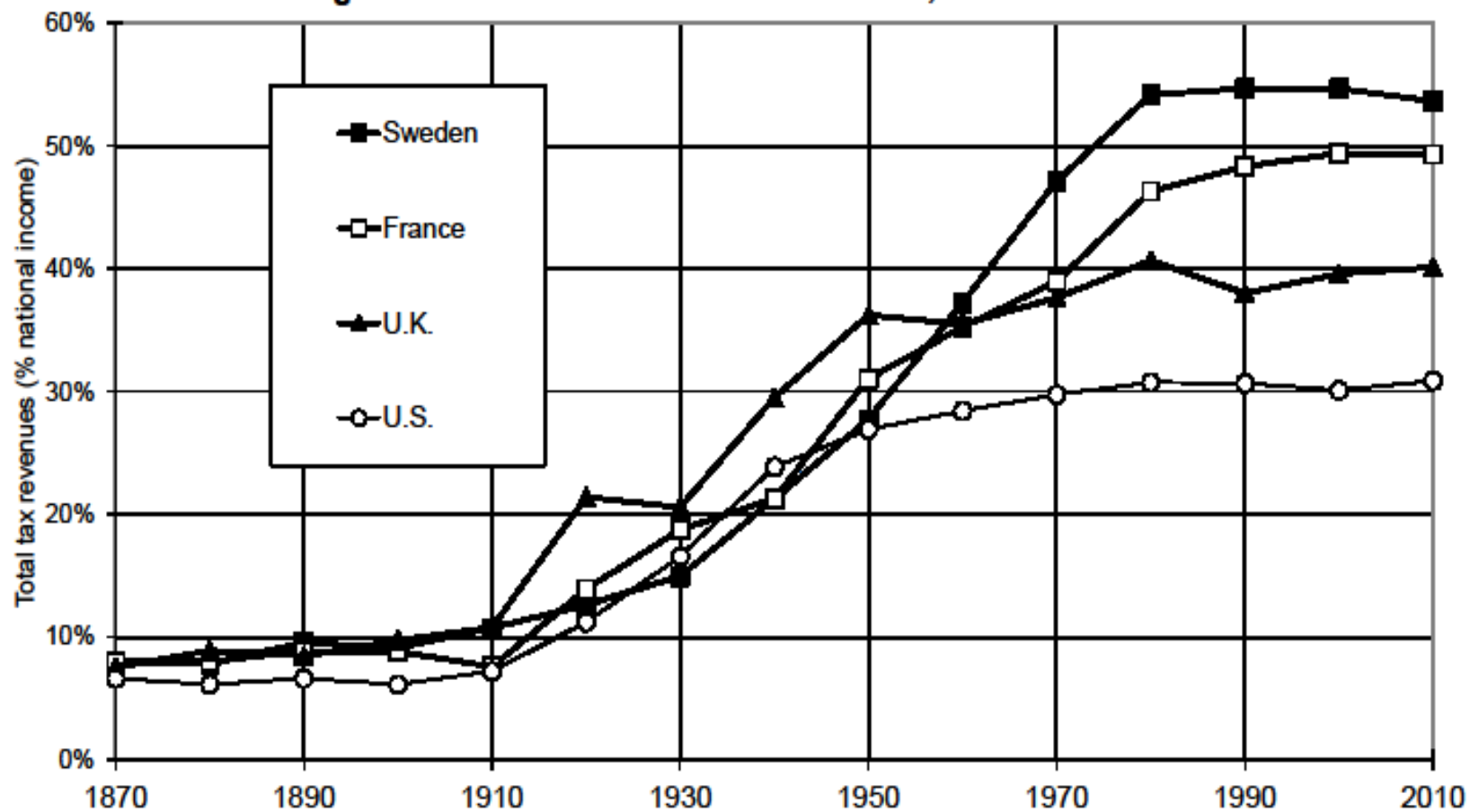
- **(2) The rise of fiscal & social state represents only one aspect of state formation & government regulation.** As we've seen in this course, the general set of laws and rules enforced by govt can be even more important than the fiscal system and public spendings.
  - **Basic civil & political rights:** forced vs free labor, restrictions on mobility, occupational & voting rights (major historical role)
  - **Property regimes:** legal system shapes balance of power between owners & non-owners; public vs private property; workers rights & labor law (co-determination, unions); tenants rights & inheritance; intellectual property rights; monetary regimes & capital controls
- **there are many different complementary ways to evaluate the size & importance of government regulation**
- Exemple: should we look at share of govt tax revenues in national income  $Y$ , or at the share of govt property in national capital  $K$ ?
- China vs Europe: Chinese govt has smaller tax share in  $Y$ , but higher share in  $K$  ownership. Which state is most powerful?

- **Family vs government roles:** conflict about marriage, fertility, gender, education, etc.
- **Political regimes** and the organization of government: electoral & party systems, nations-states, federations, empires  
→ **the capital & democratic state** (the set of legal rules and institutions governing property, labor and political relations between individuals) **encompasses the fiscal & social state** and allows for a broader view of state formation & government regulation
- **During 21<sup>c</sup>, just like in previous centuries, the evolution of fiscal and social institutions will be largely determined by the evolution of legal and political institutions:** financial transparency & participatory governance; international legal systems; democracy vs automatic rules on property or debt; development of supranational (un)democratic institutions?

# The rise of the fiscal and social state

- During 20<sup>c</sup>, huge rise of tax revenues (from 10% to 30-50% of national income  $Y$ ) = rise of the modern fiscal and social state, partly as a response to high inequality generated by free market capitalism
- This rise of the modern fiscal state corresponds both to a change in the form of taxation (from indirect & trade taxes to income taxes and social contributions) and to a change in the type of spending, i.e. the rise of the social state: rise in education, health & welfare spendings (pensions, unemployment insurance)
- Since the 1980s-1990s: stabilisation of  $T/Y$  in all rich countries (regardless of political evolutions), but at different levels (Sweden > France > Germany > UK > US : here politics matters)
- More on the different forms of taxes & spendings: see Lindert, *Growing Public- Social Spending and Economic Growth since the 18<sup>th</sup> Century*, OUP 2004, and [Public economics](#) course

**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](http://piketty.pse.ens.fr/capital21c).

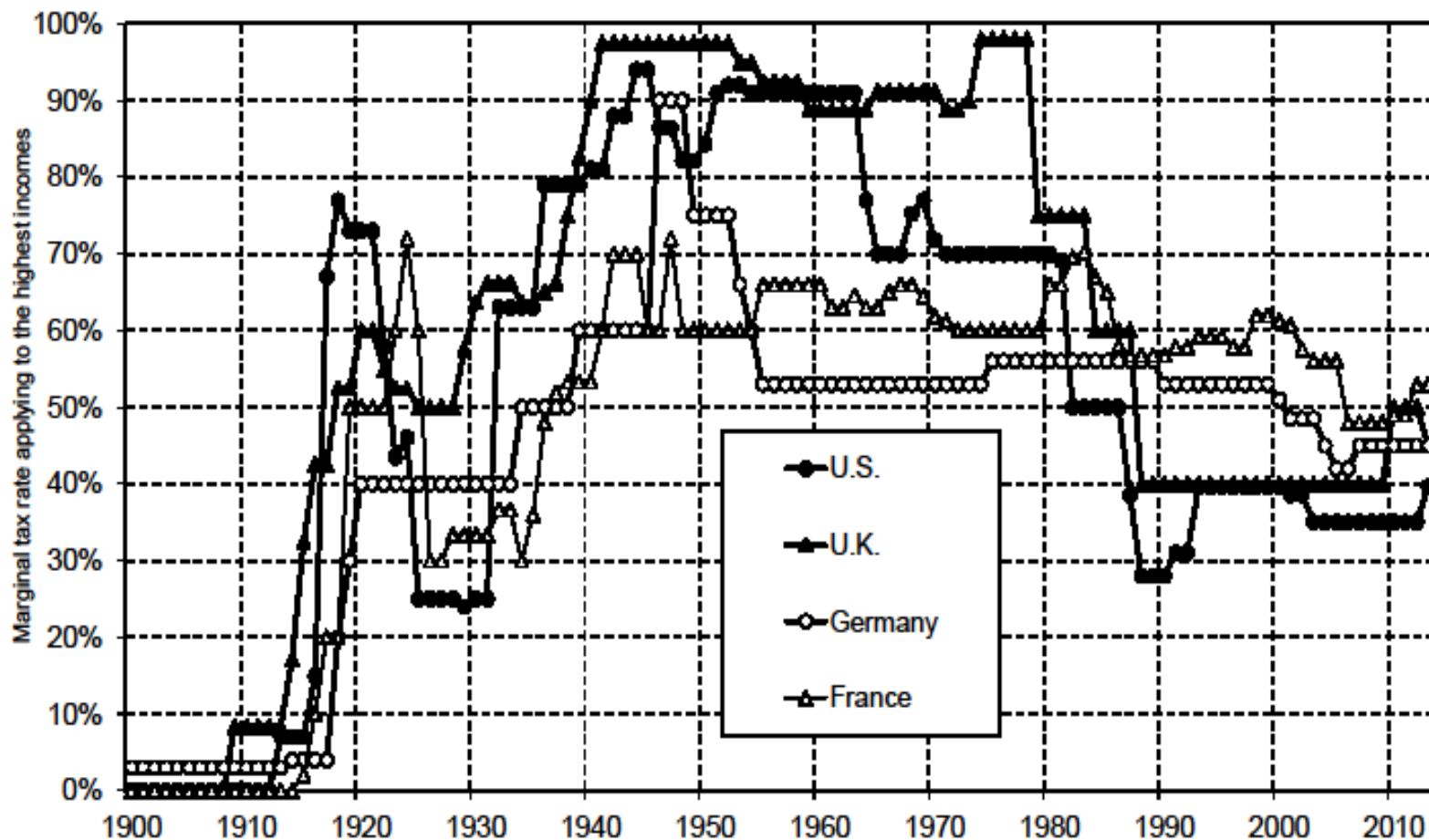
- This « great leap forward » of tax revenues from 10% to 30-50% Y is not going to happen again: during 21<sup>c</sup>, tax revenues are likely to stabilize or to rise a little bit (or maybe to decline if rising tax competition & continuing anti-state ideological shift), not to rise again to 70-80% GDP
- The 21<sup>c</sup> challenge is probably not to make govt bigger (at least in rich countries); this does not mean that nothing can be changed; for a given T/Y, there are many ways to organize the structure of taxes and public spending, and there are many changes in regulatory, property and legal regimes that make an enormous difference; but this explains why the post-2008 legacy is complicated (both markets and govt were accused)



# The rise and fall of tax progressivity

- Tryptic of progressive taxation: income tax, inheritance tax, wealth tax
- **Little or no progressive taxation until WW1**
- **General decline in tax progressivity since 1980s, in spite of the rise (or stabilisation) in total tax burden**
- Progressive income tax: basic pillar for financing public goods and social spendings (together with social contributions)
- Progressive inheritance tax: lower tax revenue than income tax (say,  $<1\% Y$  vs  $10\% Y$ ), but important role to limit perpetuation & concentration of wealth & power in the same families
- **The US invented very steeply progressive taxation of income and inherited wealth in the 1920s-1930s, partly because the US did not want to become as unequal as Europe**
- See [Fisher 1919](#) about the “undemocratic” concentration of wealth (top 2% owned 50% of US wealth at the time: less than in Europe, but already too much according to mainstream US economists of the time)

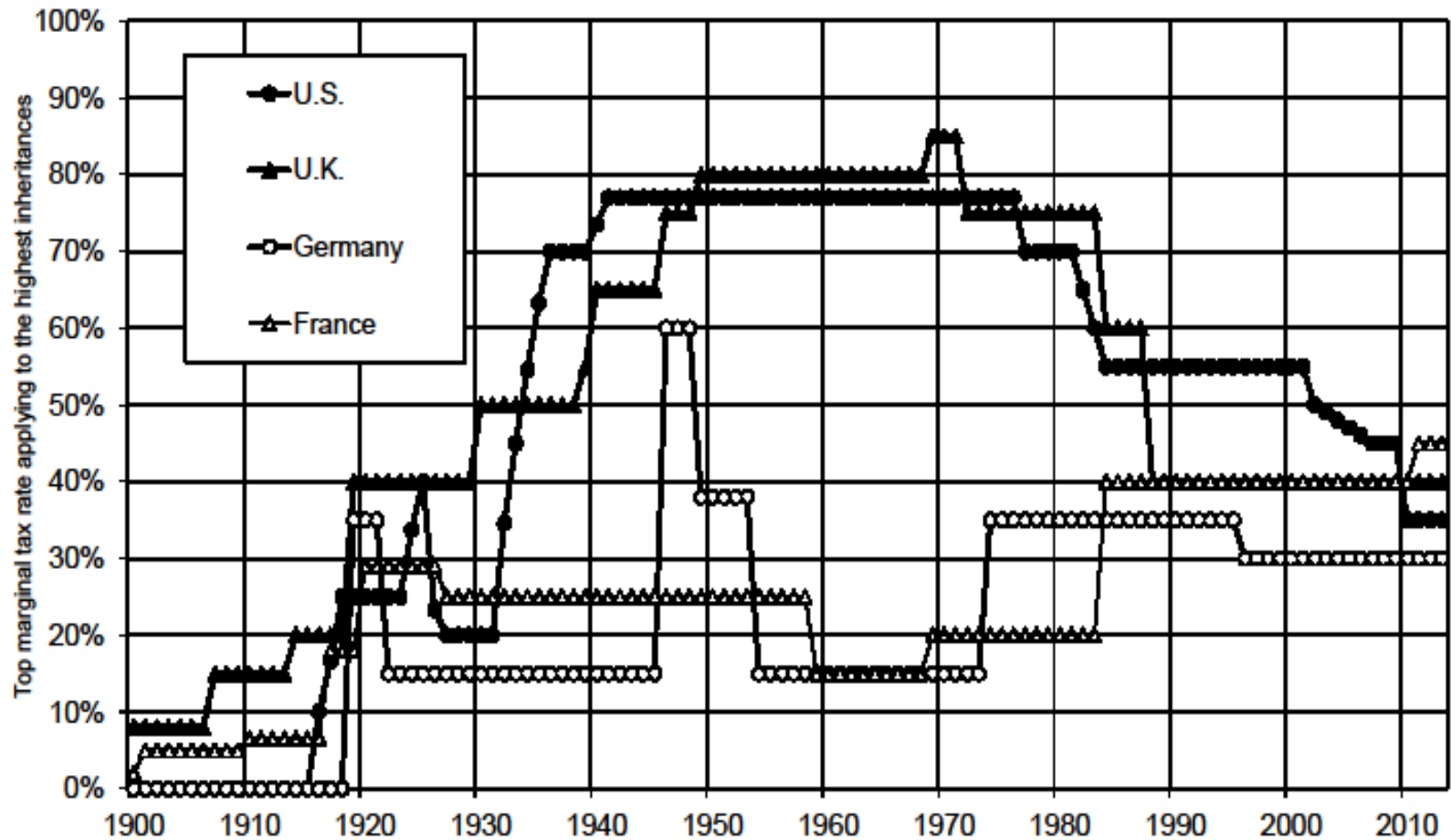
Figure 14.1. Top income tax rates, 1900-2013



The top marginal tax rate of the income tax (applying to the highest incomes) in the U.S. dropped from 70% in 1980 to 28% in 1988. Sources and series: see [piketty.pse.ens.fr/capital21c](http://piketty.pse.ens.fr/capital21c).

- Over 1930-1980 period, top marginal income tax rate = 82% in the US
- Extreme income tax progressivity at the very top is critical not so much to raise revenue, but mostly to keep top labor incomes and rent extraction under control
- Top US & UK inheritance tax rates also reached 70-80% during 1930-1980 period, much more than in Germany and France (where wealth redistribution was largely carried out via other means: destruction, inflation, nationalization)
- Progressive taxation = a US-UK invention
- On the social, political and cultural history of taxation in the US and France, see Huret, *American Tax Resisters*, HUP 2014, and Delalande, *Les batailles de l'impôt – Consentement et résistance de 1789 à nos jours*, 2011
- See also Beckert, *Inherited wealth*, PUP 2008

Figure 14.2. Top inheritance tax rates, 1900-2013



The top marginal tax rate of the inheritance tax (applying to the highest inheritances) in the U.S. dropped from 70% in 1980 to 35% in 2013. Sources and series: see [piketty.pse.ens.fr/capital21c](http://piketty.pse.ens.fr/capital21c).

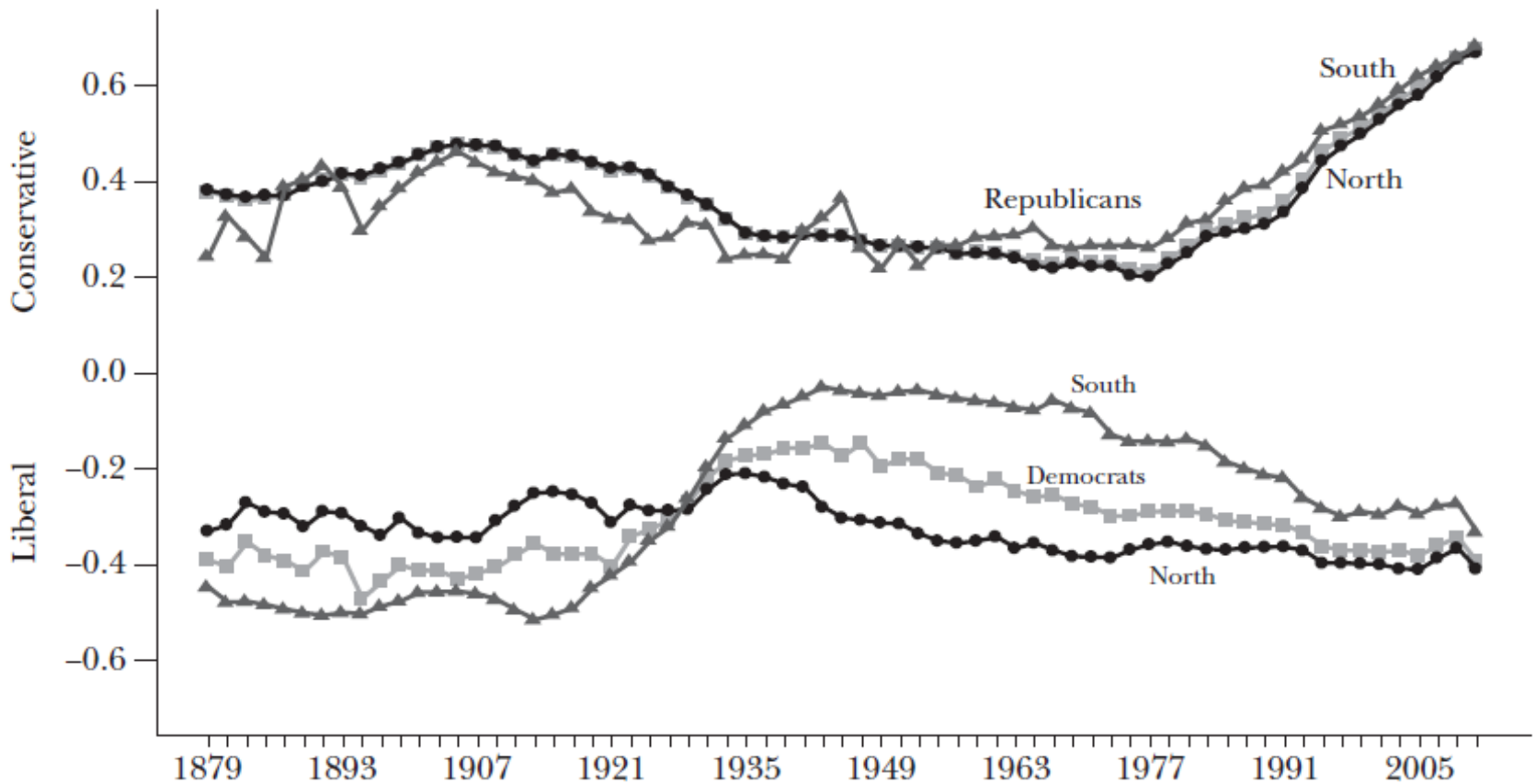
# Why doesn't democracy always lead to declining inequality?

- **In the US, rising inequality since 1980 did not generate a democratic reaction to raise progressive taxation & redistribution. Why?**
- Maybe not so surprising in light of Europe's experience 1870-1914: huge inequality, universal suffrage, but strong & largely successful resistance to fiscal-social reforms by the economic & political elites until the 1914-1945 shocks
- Main response given in recent work by US political scientists: capture of the political process by the wealthy

- See Hacker-Pierson, *Winner-Take-All Politics: How Washington Made the Rich Richer-and Turned Its Back on the Middle Class*, 2010
- Gilens, *Affluence and Influence: Economic Inequality and Political Power in America*, 2012; « Testing Theories of American Politics: Elites, Interest Groups, and Average Citizens », [PoP 2014](#)
- Kuhner, *Capitalism vs Democracy: Money in Politics and the Free Market Constitution*, 2014
- **Bonica-Rosenthal, « Why Hasn't Democracy Slowed Rising Inequality », [JEP 2013](#); « The Wealth Elasticity of Political Contributions by the Forbes 4000 », [WP 2015](#)**
- Maybe work on political contributions & campaign finance more convincing than work on polarization

Figure 1

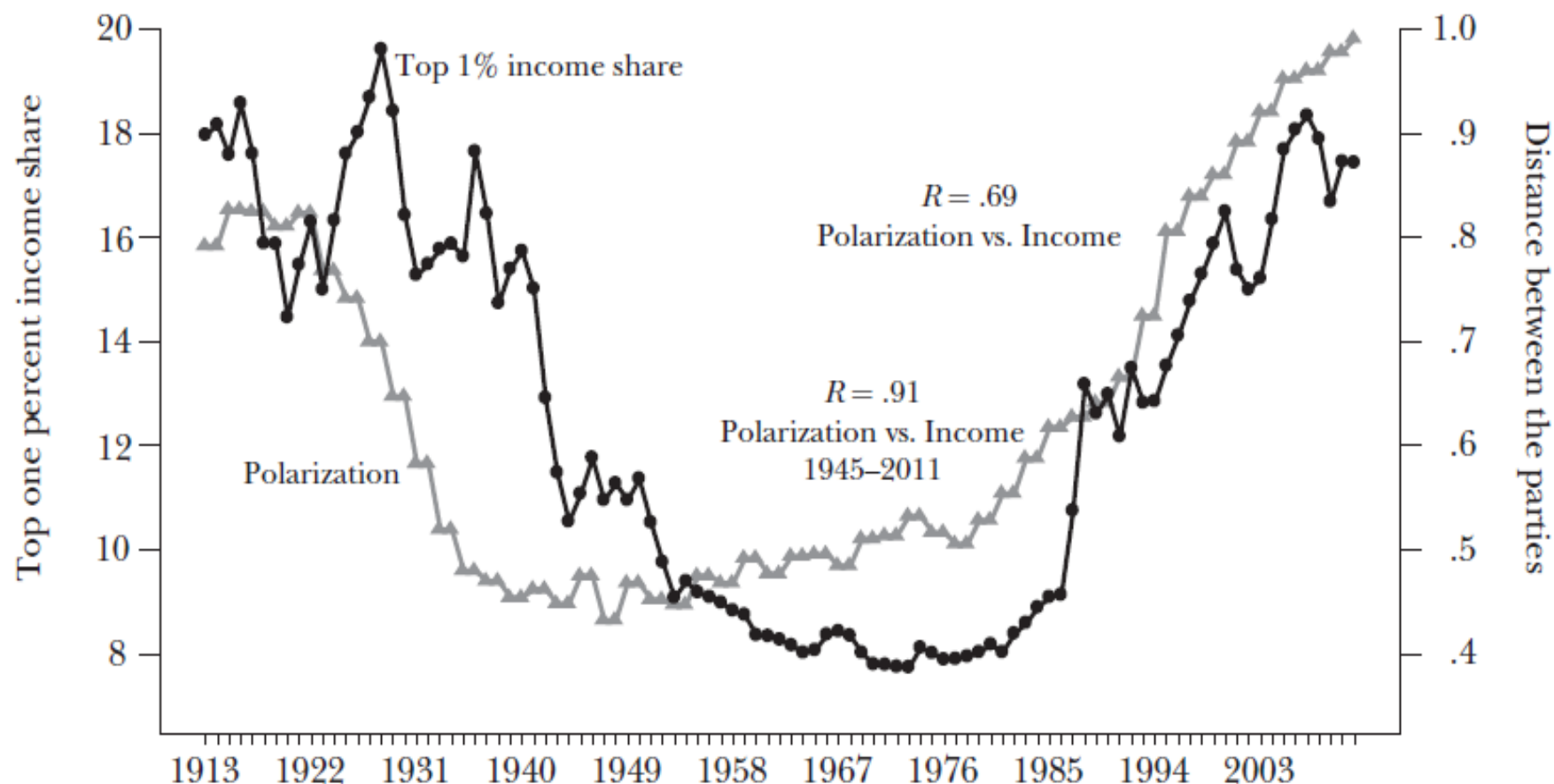
## Party Means on Liberal–Conservative Dimension for the US House of Representatives, 1879–2012



Source: Author's calculations using DW-NOMINATE scores of the liberal–conservative positions of members of Congress, which are based on roll call votes. For methodological details, see Poole and Rosenthal 1997; McCarty, Poole, and Rosenthal 1997; and Poole 2005.

Figure 2

## Top 1 Percent Income Share and Polarization in the US House of Representatives, 1913–2008



Source: Authors calculations using the polarization data described under Figure 1, and data on income from Piketty and Saez (2013).



Figure 4

### Voter Turnout by Household Income and Citizenship, 2008 and 2010

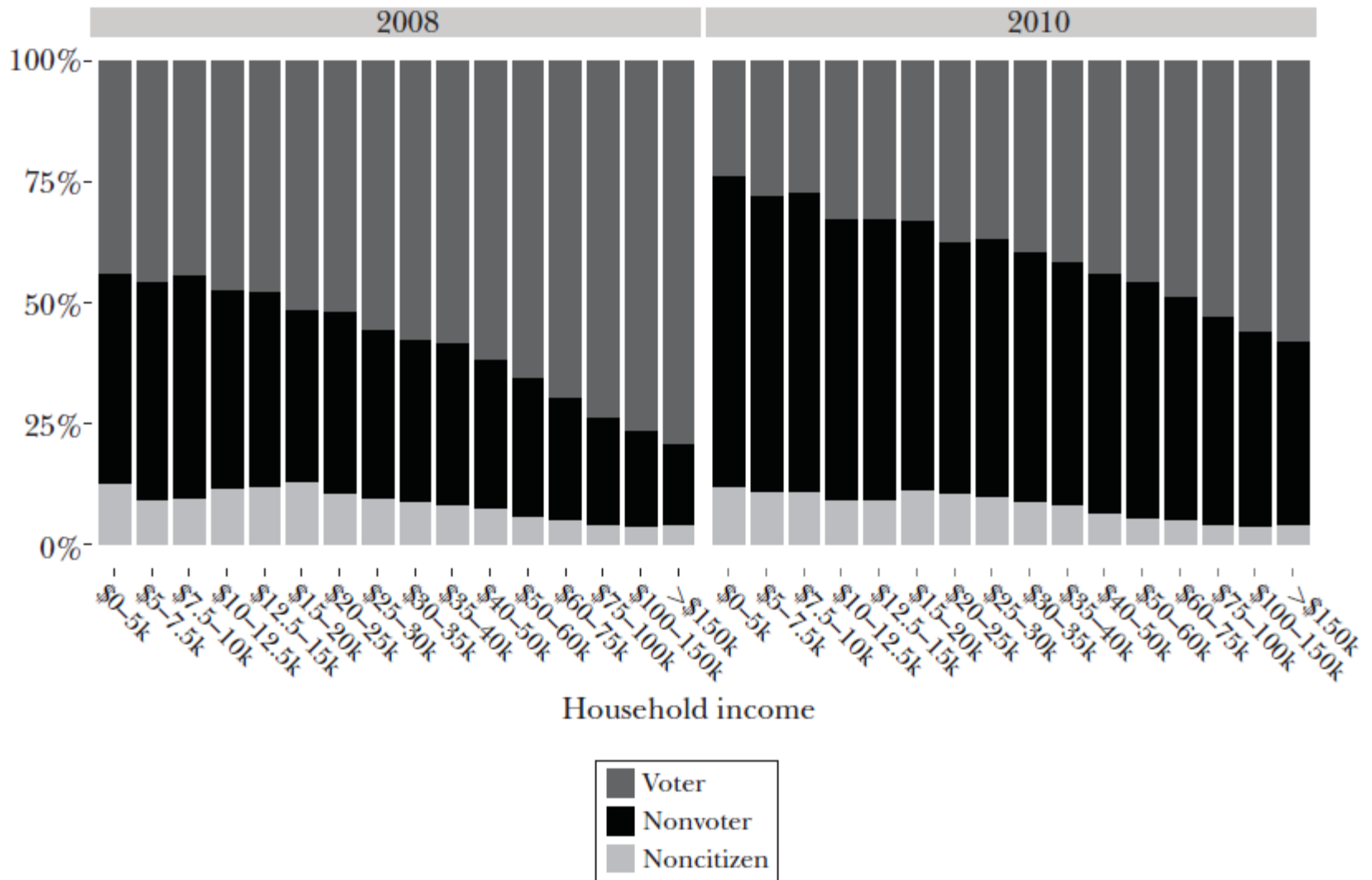


Figure 5

### Concentration of Income and Campaign Contributions in the Top 0.01 Percent of Households and Voting Age Population

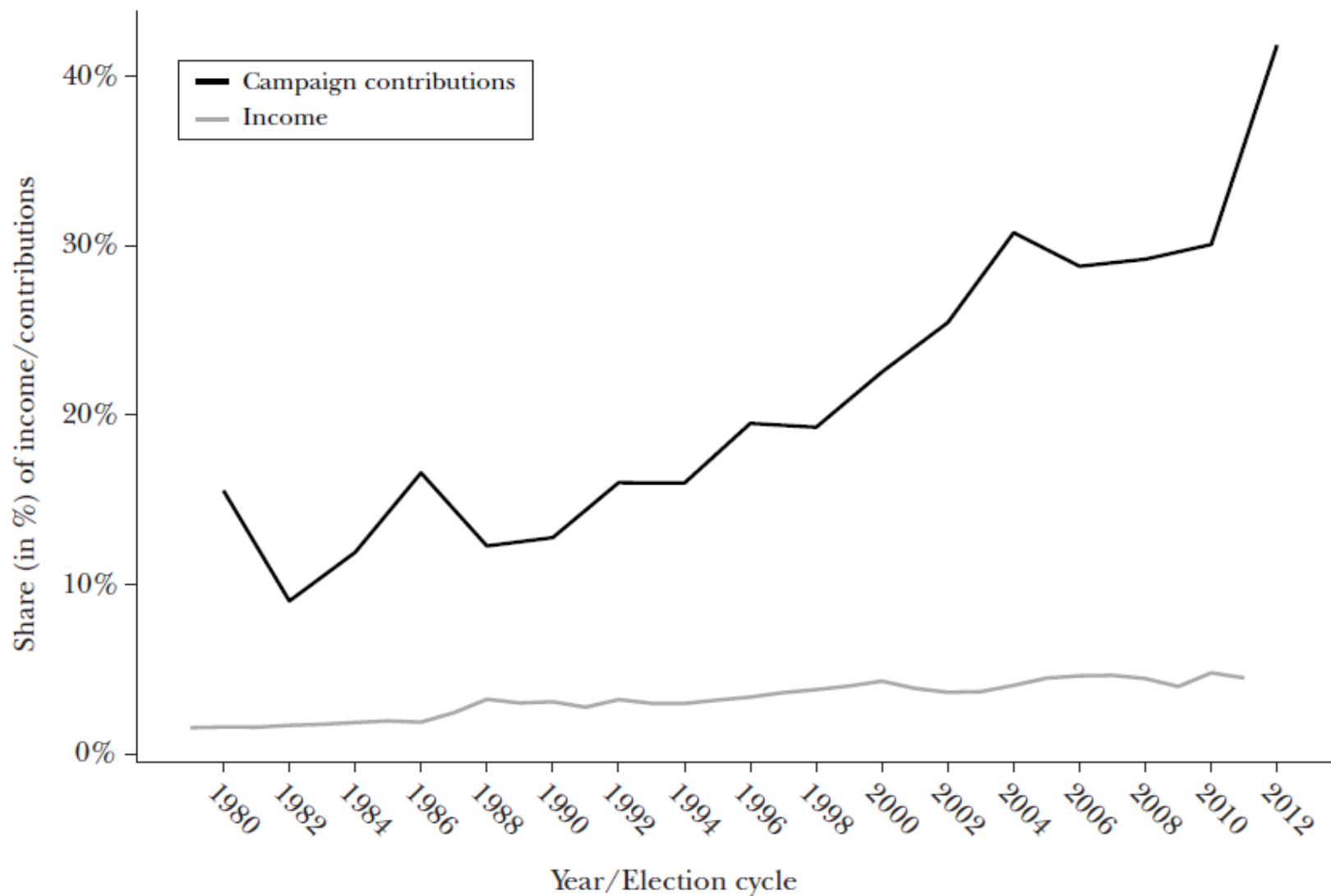
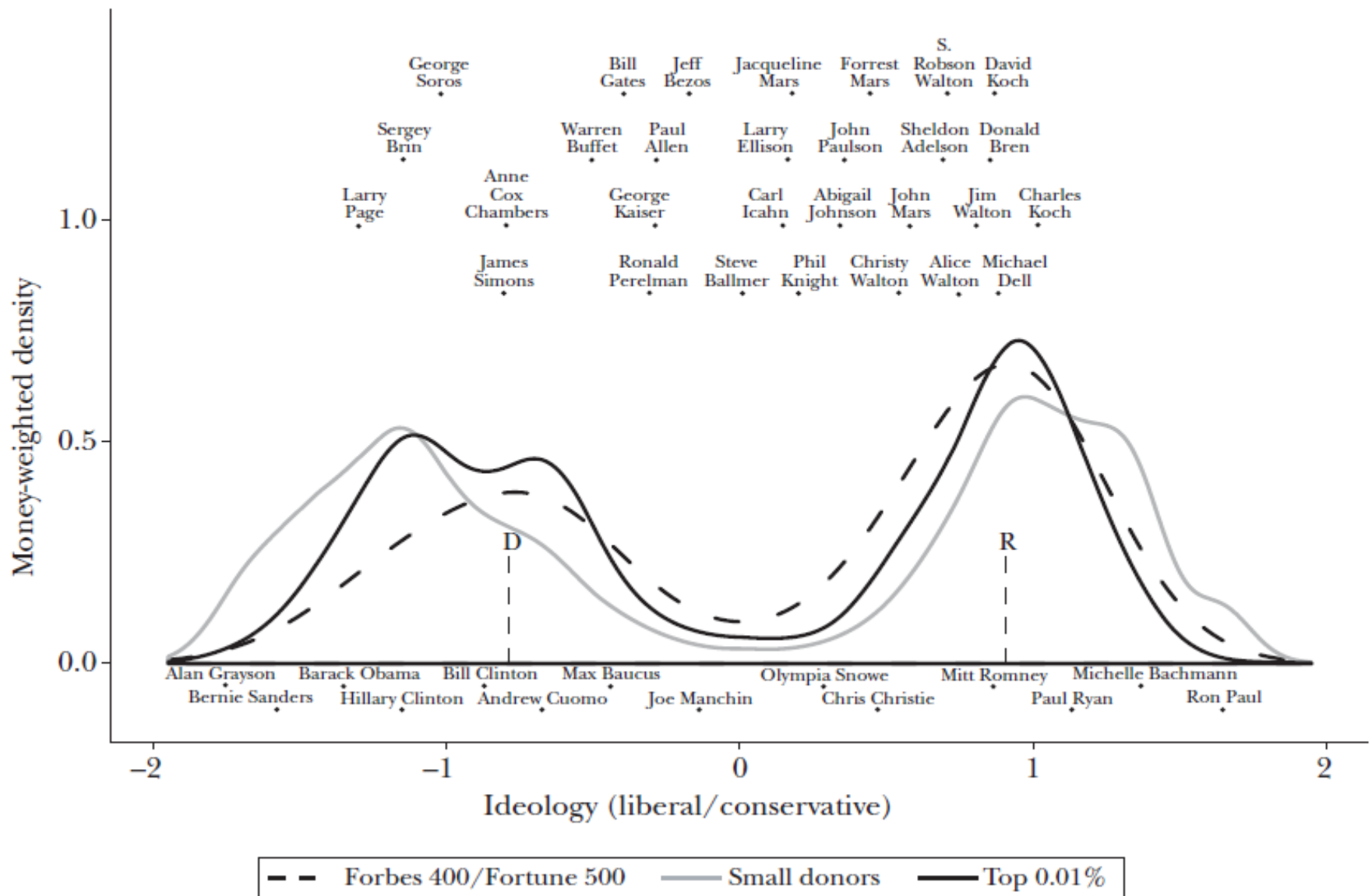


Figure 7

# The Ideological Distribution of Dollars from Small Donors and the Top 0.01 Percent



# Political attitudes toward inequality

- Capture by the wealthy: important but not enough
- Beliefs about inequality involve self-serving beliefs, but also consistent narratives and sincere beliefs, or at least partly sincere beliefs (Arrighi: « power is the grey zone between coercion and consent; it requires moral leadership »; this is true both in international & domestic politics)
- Beliefs systems also involve national identities and trajectories: US 1900-1920 did not want to become like Ancien Régime or Belle Epoque Europe; US 1990-2010 do not want to become like post-Soviet Europe
- See Saez-Stantcheva et al, « How Elastic are Preferences for Redistribution? », [AER 2015](#) : information about inequality can change views, but lack of trust in government can be even more important

# Regulating property: financial transparency & participatory governance

- Progressive taxation and other institutions aimed at limiting the concentration of wealth and power (legal system, workers rights, etc.) should be viewed as complementary, not substitutes
- By producing more transparency, progressive taxation can contribute to more democratic property relations and participatory governance
- Progressive wealth tax: with imperfect k markets, progressive inheritance tax is not enough; also, independantly of inheritance, wealth can be a better indicator of ability to pay than income
- In order to counteract high r for top w, top rates would need quite large (5-10% rather than 2-3%? = a big difference with previous wealth taxes)
- But the main objective behind wealth tax is to deliver international financial transparency and global wealth registration: automatic exchange of information between countries, world registry of financial assets, public statistics on wealth, etc.; critical role for democratic debate

# Organizing democracy: electoral & party systems, nations-states, federations, empires

- Proper fiscal-social policies depends critically of the organization of the political process: electoral systems, party systems, bicameralism, etc.
- Again, critical importance of national learning processes (France: long presidential/parliamentary/bicameralism cycles since 1789)
- Limits of electoral competition: parties, social security funds, monarchy
- With unanimity rule about fiscal decisions in Europe, there's little chance to see a rise in tax progressivity and financial transparency
- Current debates about Euro-zone Parliamentary Chambers: this is only the beginning... here again, there's a lot to learn from historical experiences & non-nationalist perspectives

- Reflections about the limit of nation-states, the need to develop new forms of supranational democratic institutions
  - See Beck-Grande, *Cosmopolitan Europe*, 2007 (*Pour un empire européen*, 2007)
  - See Cooper, *Citizenship between Empire and Nation: Remaking France and French Africa, 1945-1960*, PUP 2014; *Africa and the World – Capitalism, Empire, Nation-State*, HUP 2014
  - **In 1945-1960, a number of African leaders (Senghor, Houphouët-Boigny, etc.) would have preferred a democratic federation with France, including one-man-one-vote representation in a federal Parliament in Paris**
  - **« With small African nation-states we will not be large enough to regulate global capitalist forces and to implement an equitable development strategy »** → long constitutional discussions with France about new « French Union »  
→ but in the end French leaders were afraid to be put in a minority in such a federal Parliament...
- An interesting historical episode to re-visit today's European & global debates regarding federal political union

# History, development & inequality: what have learned from this course?

- Basic idea pursued during this introduction to economic history = how each country deals with inequality & property relations is central for the construction of a legitimate government, state formation, and the development process
- Pb = each country tends to be self-centered (not enough learning from comparative and historical experience)  
+ power of self-serving ideology (without large political or international shocks, elites are very resistant to change)
- Domestic property relations (forced labor, etc.) used to play central role in historical inequality regimes. With globalisation, international property relations have come to play key role. They are particularly complicated to regulate peacefully.
- Learning to live with inequality, beliefs systems about the ideal institutions: **the dimensions of political conflict**



# The dimensions of political conflict

- **Political regime** (organization of government: monarchy, democracy, empires, automatic rules, restraint on govt). *La question du régime politique.*
- **Foreigners** vs citizens (frontiers, national identity, basic civil and political rights, etc.). *La question de l'étranger.*
- **Family** (marriage, children, education, perpetuation of inequality, etc.). *La question de la famille.*
- **Property** (regulation of relations between capital & labor, public vs private property, taxation and public services, etc.). *La question de la propriété.*
- **A complete study of these different dimensions goes well, well beyond the scope of this course.** But preparing this course helped me to think more about these issues. I hope it helped you as well.
- If you want to learn a little bit more about these and other issues, see you again in my [Public economics](#) course.
- **Thank you for your attention !**