Philipp Genschel in collaboration with Laura Seelkopf (University Bremen)

Florence, 15 March 2015

The comparative political economy of taxation

1. Abstract:

Seed money is requested to start a project on the comparative political economy of taxation. The money serves to collect comparative data on the historical development of tax systems worldwide. The focus is on five taxes: Personal income tax, corporate income tax, general sales tax/ VAT, social security contributions, inheritance tax. Information collected includes (a) introduction dates, (b) statutory rates, and (c) revenues. The data collection covers the time period 1850-2010, and aims for the broadest feasible coverage of countries. The data collection will form the basis for a book project on the global diffusion of modern taxation.

2. Objective

Taxes are the main source of government revenue. Other revenue sources – foreign conquest, tribute payments, the private wealth of the ruler, public entrepreneurship – have generally lost in importance. Where they have not, as in some developing countries which still rely heavily on foreign aid, import duties or resource rents, this is usually considered as a pathological deviation from the norm of taxation, not as a viable alternative.

The modern state is a 'tax state' (Schumpeter 1917). The level and structure of tax revenue determines what a government can and cannot do, how many civil servants it can hire, how many services it can deliver, how modestly or ambitiously it can define its goals, and how effectively it can constitute its authority domestically and internationally. The level and structure of taxation also shapes the society the government governs. It determines who has to pay for the state and who not, who gains and who loses, who is empowered and who is disempowered. Most social conflicts are reflected in and fueled by taxation: rich versus poor, capital versus labor, urban versus rural, men versus women, employed versus transfer recipients, the privileged versus the disenfranchised. To the extent that states are tax states, societies are also 'tax societies'. They are constituted and shaped through taxation.

Given the symptomatic and causal centrality of taxation, it offers an excellent starting point for analyzing social sources and consequences of state change. Our (immodestly ambitious) goal is to write a monograph analysing the diffusion and transformation of the modern state through the lens of taxation. The core of the book will be an attempt to map and explain fundamental differences in the structures and developmental pathways of national tax systems for a global sample of Western and Non-Western states since the 19th century.

The essential prerequisite of our project is comparative time series data on a large enough number of countries for a long enough period of time. A grant from the research council would help us collect this data. The data collection would build on the effort of others such as, for instance, the ICTD Government Revenue Database at Sussex, the Global State Revenues and Expenditures Dataset for autocratic regimes at the German Institute of Global and Area Studies (GIGA), the comparative inheritance taxation data base by Arndt Plagge, Kenneth Scheve and David Stasavage, or the data collection of Thomas Piketty and collaborators. In return, we will make our data available to others at the end of the project. All our data will be published online. A presentation of very preliminary data on introduction dates of major taxes at the Comparative Politics Section of the German Political Science Association (Hamburg, Feb 2015) was well received and led to several data requests.

The project is important for four reasons. First, it provides a descriptive overview of historical trends and regional variation in taxation worldwide. As far as we can see, such a global mapping of developments is missing so far. Second, the project contributes to the analysis of the causes of tax policy choice and reform by systematically comparing developments across different country groups which are usually studied in isolation – advanced capitalist democracies, transformation economies, (least) developed countries. Third, the project provides a basis for advancing our understanding of the consequences of taxation for inequality within and across countries . Finally, the project improves data availability in a relevant area of research.

I will closely collaborate on the data collection and the book project with Laura Seelkopf (University of Bremen). A grant from the research council would help to facilitate regular work meetings in Florence. Laura and I have collaborated on tax issues before, most recently in the context of a special issue of the Review of International Political Economy on 'Revenue Mobilization in the Developing World: Changes, Challenges, and Chances' that is currently under review (provisional publication date is Volume 22, Issue 6, December 2015).

3. Theoretical background and hypotheses

Our project builds on a large body of literature in political economy and fiscal sociology that theorizes the determinants of national tax levels and structures. Empirically, the bulk of the literature focuses on recent tax reforms in advanced capitalist democracies (e.g. Ganghof 2006; Kato 2010; Jensen and Lindstädt 2012). Yet there are also studies analysing long-run historical developments (Brownlee 1996; Kemmerling 2014; Martin, Mehrotra, and Prasad 2009; Steinmo 1993), cross-national tax differences in large samples of advanced democracies (e.g. Messere 1993; Peters 1991; Tanzi 2011) and also increasingly on taxation in non-Western countries (e.g. Bird and Marinez-vazquez 2014; Di John 2006; Cao 2010; Li 2006; Kenny and Winer 2006). In terms of theoretical approach, we can sort the literature very roughly according to whether authors focus on domestic or on international factors, and on whether the factors are broadly economic or political. Here is a brief, non-exhaustive review.

Domestic factors

- Economic: A broad literature discusses the interrelation between processes of economic modernization (industrialization, urbanization, monetization, wealth) and taxation. For instance, German economist Adolph Wagner famously predicted the demand for public goods provision and welfare spending to increase in economic modernization. Richer, more advanced states need more tax revenues (Wagner 1892). Harley Hinrichs conjectured that economic modernization by increasing the general taxability of the society and hence the tax policy options of government, will fuel cross-national tax diversity (Hinrichs 1966). More recent studies build on these ideas to explain the tax problems of less developed countries by their economic backwardness. For instance, large agricultural sectors and informal labour markets are often hypothesized to constrain taxation by forcing governments to overuse easy to collect tax handles such as import duties or corporate taxes (Bird and Marinez-vazquez 2014; Aizenman and Jinjarak 2009; Tanzi and Shome 1993).

- Political: A rich literature analyses the impact of regime differences on taxation. Margaret Levi finds, for instance, that democracies can more easily mobilize taxpayer consent than non-democratic regimes and, hence, tend to generate more revenue (Levi 1989). Her and others' (Aidt and Jensen 2009; Scheve and Stasavage 2012) historical analysis on Western Europe is extended by research on tax differences in contemporary democracies and autocracies (Cheibub 1998; Garcia and von Haldenwang 2015). While research into the effects of different autocratic institutions on taxation is still lacking, there exists a large body that looks at differences within democracies. Sven Steinmo shows how institutional differences between presidential, majoritarian and corporatist democracies shape the evolution of their tax policies and lead to diverging tax structures (Steinmo 1993). Other factors including the party-political composition of the government (Garrett 1998; Garrett and Lange 1991) or state capacity and the effectiveness of the tax administration (Kiser and Schneider 1994) have also been hypothesized to affect the level and structure of taxation.

International factors

- Economic: With the advent of deep economic globalization in the 1980s, there has been an increasing interest in international tax competition as a shaper of the structure, and, in more extreme theories also the level of national taxation (see Keen and Konrad 2014; Genschel and Schwarz 2011 for recent reviews). It is generally assumed that tax competition leads to tax reductions for mobile capital and an increasing divergence of capital taxation in large and small, and core and peripheral states. Historically oriented studies point at international trade as a traditionally important source of tax revenue (Seebohm 1983), which has been gradually replaced by more modern forms of taxation in recent decades (Baunsgaard and Keen 2010). As Laura Seelkopf and collaborators have shown, global trade liberalization and GATT/WTO membership significantly affect the adoption of new tax instruments such as the VAT (Seelkopf, Lierse, and Schmitt under review).
- Political: As Charles Tilly, among others, has argued, interstate war was the most important source of revenue demand and tax innovation up until after World War II (Tilly 1975). Other international factors include policy diffusion via elite discourses (Steinmo 2003), legacies of colonial domination (Frankema and van Waijenburg 2014), or the activities of international organizations. It has been shown, for instance, that the likelihood of a country introducing the VAT increases when neighbouring countries already have it (Keen and Lockwood 2010). International Organizations affect national taxation through common rules and provisions, as for instance the EU (Genschel and Jachtenfuchs 2011), through trade liberalisation as in the WTO (Seelkopf, Lierse, and Schmitt under review; Baunsgaard and Keen 2010), or through the promotion of cross-border policy learning as the OECD (Genschel and Rixen 2015).

At this point, we have not settled on a particular explanatory model or set of independent variables. We are not even sure that this is required at all. Yet, we intend to write a thorough review of the literature during the first year of the project to get a better feel for the debate.

4. Methodology

Our book project is based on a Y-centered rather than an X-centered design (Gerring 2006): We do not start from a specific explanatory model that we then test against the data, but from a specific dependent variable (cross-temporal and cross-national variance in the level and structure of taxation) that we want to map and elucidate by different explanatory models. For this purpose, we rely on a set of mixed methods that combine quantitative analysis of our newly collected data with qualitative case studies (Collier, Brady, and Seawright 2010).

The most important requirement at this point is the collection of data on the dependent variable for a global sample of countries. We intend to use a mix of revenue-based and statutory indicators to measure national tax levels and structures.

Following the bulk of the literature, we focus on two revenue-based measures of the *tax level*:

- The total tax ratio (i.e. the share of total tax revenues in GDP or some alternative measure of national income) indicates the aggregate tax burden on society.
- The ratio of total tax revenues to total government revenues indicates how strongly a state relies on tax revenues as opposed to non-tax sources of revenue. In other words, this ratio measures the extent to which a state is a 'tax state' rather than, say, a 'rentier state' relying on resource rents.

The *tax structure* is operationalized by statutory and revenue-based measures of five key taxes. The taxes include the individual income tax, the corporate income tax, the general sales tax/ VAT, social security contributions, and the inheritance (or death or estate) tax.

- The introduction dates of the five taxes provide a rough measure of tax policy innovation. Of course, a governments' choice to adopt a new tax does not necessarily imply a major change in its tax structure. Not all new taxes are immediately fiscally relevant. However, the introduction of a new tax is usually a very visible signal to tax payers and significantly extends the government's policy arsenal. After all, initially low taxes can always be raised afterwards.
- The nominal (top) rate of the five taxes constitutes a rough indicator of the individual tax burden and the possible distributive impact of a tax. Obviously, the burden and progressivity of a tax also depend on statutory provisions on the tax base and the tax system. However, these provisions are difficult to measure and compare – not only for the academic observer but also for taxpayers. This is why even sophisticated analyses of tax progressivity rely strongly on nominal rates (e.g. Scheve and Stasavage 2010).
- Tax ratios, i.e. the revenues generated by each of the six taxes scaled by GDP or by total tax revenues provide information on a country's tax mix. They indicate the absolute and relative reliance of a government on a particular tax.

Once we have collected the data and identified general trends and time- and space-specific variations in tax level and structure, we combine quantitative and qualitative approaches to explaining them. We will analyze the event data on introduction dates using probit models with cubic splines to account for time dependence (Beck, Katz, and Tucker 1998; Carter and Signorino 2010). Also the analysis of the data on tax ratios and nominal rates requires careful modelling of time and spatial effects (Beck 2007; Bell and Jones 2015; Plümper, Troeger, and Manow 2005; Wilson and Butler 2007). Based on our regression results, we will in a second step select typical cases to illustrate the mechanisms behind our findings, as well as deviant cases to arrive at a more fine-grained understanding of the drivers and conditioning factors of tax policy change (Seawright and Gerring 2008).

As a trial run for the project, we started collecting data on the introduction dates of major taxes, 1840-2013. Table 1 summarizes the data we collected so far. Details about the data collected can be gleaned from the code book in the annex. An article summarizing the first preliminary results is currently under review at the Review of International Political Economy (Seelkopf, Lierse, and Schmitt under review).

Table 1: Number of countries for which introduction dates of major taxes are available

Tax Introduction	Number of Countries
Personal Income Tax	102
Corporate Income Tax	86
Social Security Contributions	83
General Sales Tax	69
Value Added Tax	151
Death/Estate/Inheritance Tax	75
Gift Tax	16

The trial run revealed many practical and conceptual problems of the data collection project. We already started sorting them out. The biggest practical problems so far are data availability and comparability. Availability varies greatly across countries, historical periods, and taxes. Comparability is especially problematic over time. Conceptual problems have emerged around the coding rules. Tricky questions include which entities count as countries (e.g. colonies), how to define the introduction date of a tax (e.g. how long does a tax have to be in use in order to be considered has having been 'truly' introduced), how to disentangle overlapping tax categories (e.g. general sales tax and VAT) or what taxes to include in a certain tax category (e.g. inheritance tax). An issue that also came up in collecting data on introduction dates was termination dates: In order to get a sense of tax developments in individual countries, it is not only important to know when important taxes were introduced but also whether and when they were abolished again. We intend to discuss these and related problems with tax scholars and data collection experts we would like to invite to the EUI in spring 2016. A grant from the research council would help to finance this meeting.

5. Policy Relevance

While this is not a policy-oriented project, it speaks to highly salient problems of tax policy making. The probably most important problem concerns income and wealth inequality. Both the level and the structure of taxation affect inequality in important ways. The tax level defines the upper bound for public goods provision and for poverty alleviation at the low-end of the income and wealth spectrum. The structure of taxation affects the extent to which the rich (who are usually also politically powerful) contribute to public revenues. Taxing the rich is not only a problem in non-democratic regimes, where rulers often use the tax system to distribute rents to elites (Acemoglu and Robinson 2006) but also, perhaps increasingly, in Western democracies (Piketty 2014). Our data and research may help identify factors that are generally associated with high or low tax levels, and/or high or low levels of tax progression and reveal regional, cross-national or intertemporal variation. When does war increase tax levels? When does it decrease them? When does democracy increase tax progressivity? When does it spare the rich from taxation?

6. Work plan: (Timing / Milestones / Events)

Date	Event
Jan 2016	Start of the project
Spring 2016	Invitation of leading tax scholars and data experts
Summer 2016	Archival research: IMF and League of Nations
Autumn 2016 (or spring 2017)	Teach a class on 'The comparative political economy of taxation'
Winter 2016	First draft of literature review (paper 1)
Spring 2017	Start to explore the data, identify gaps, check reliability
Summer 2017	Planning for the follow-on grant submission
Autumn 2017	First draft of paper presenting the data base (paper 2)
Winter 2017	Preparing a grant submission to an external funding agency

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8. Budget

Budget Item	units	unit costs	unit no.	total
Student assistants for data coding (2x40h/month for 24 month)	months	800.00€	48	38,400.00€
Research visit of Laura Seelkopf to EUI (6x one week/ 24 month)	one week mission (d.a. 175 + travel)	1,725.00€	6	10,350.00€

Archival Research 1x League of Nations Archive in Geneva– one week	one week mission CH	2,000.00€	1	2,000.00€
Archival Research 1x IMF Archive in Washington, D.C. – one week	one week mission US	2,860.00€	1	2,860.00€
Expert Consultation (Invitation of 2 Tax Data Experts to the EUI for 2 days each)	two visits	1,000.00€	2	2,000.00€
				55,610.00€

Annex

CODEBOOK

Database on Tax Introduction

Version 13.11.2014

Country

Name of the state. Please be aware that some states are included more than once, if they changed their sovereignty, split, merged etc. (see also start. and endyear). For instance, we include the Czechoslovakia and the Czech Republic. Depending on when a tax was introduced, an entry will be made for either Czechoslovakia or the Czech Republic. Countries can also be included twice, e.g. when they were annexed by a foreign power as in the case of Czechoslovakia under Nazi-German occupation.

Startyear

Year the country became sovereign

StartyearCol

If a country was a colony for some time during the period under investigation, we also include the year the country became a colony. For instance, the startyear for India is 1947, but the startyearcol is 1820. This is important as we also count the date of tax introduction when a tax was introduced under colonial rule. Please be aware that some colonial territories split after independence, e.g. India into India, Bangladesh and Pakistan. Here, we choose to extend India backwards, but not the other two countries to avoid double counts.

nn: not needed, no tax was introduced prior to independence

split: former colony was split into different countries > only one is used as successor state, all others have "split" rather than the year of colonialization

<u>Endyear</u>

Year the country left the world system.

Region

World region. We split the countries according to world region to make sure we have no double-coding of countries. In case you have a document that contains information for countries outside your region, please let the other coder know immediately and agree on who is coding which country/tax.

Other information

Please include here any other information you find on the introduction of the tax and consider relevant. This field/information is nice-to-have, but not must-have. Do not go out of your way to look for additional information, once you have found the introduction date. Only include additional information from the existing source, which you judge to be relevant.

Sources

Please save all sources as pdf-/text-file in the appropriate folder and include their full citation in the Source Book (e.g. Genschel, Philipp (2002). Steuerwettbewerb und Steuerharmonisierung in der Europäischen Union. Frankfurt/New York: Campus Verlag). Include a meaningful shorter version into the dataset (e.g. Genschel 2002), so the sources can always be located. If there is more than one source, please include all of them and separate them in the database by a semicolon ";".

Tax (YYYY/MM)

Please include the date for the respective tax introduction exactly in this format. For instance, code "1992/12" for an introduction in December 1992. In case you have no information on the month, just include the year "1992".

Please include the introduction date for those states that actually existed / were sovereign at the time of introduction and for countries under colonial leadership. For instance, a tax introduced between 1918 and 1992 in Czechoslovakia is only coded for this state. Even if the new successor states Czech Republic and Slovakia continue with the policy, the variable is set missing ".". However, if India introduced a tax while it was under British power, the date of introduction is included.

TaxDummy

A "1" is entered if the respective tax was introduced in the country up until the year 2013, "0" otherwise. It differs from the TaxDate variable in cases when the tax was introduced while some countries were not yet dependent/sovereign states or their predecessors already introduced the tax. Hence, they do not have an entry for the date of introduction but nonetheless, they have the tax policy. For instance, Bangladesh does not have an entry for the introduction of the personal income tax as this happened when it was part of India. However, they had introduced it once on their territory, thus it has been introduced (even if it might have been abandoned since). The same applies to Germany, whose first income tax was introduced in Prussia.

Rate/Other Rate

Again, this information is a nice-to-have, but not must-have (different to the date). In case you find a document that contains it, please include the information on the top or general rate *at the point of introduction*, as well as any other information on reduced rates, exemptions etc.. Otherwise, leave the field blank.

Personal income tax (PIT)

Criteria for data selection: when the country had a **permanent** income tax levied by **the central or federal** government.

Many countries experimented with temporary income taxes at some point before income taxation became a permanent feature of their tax system. Most of these "experiments" were directly related to the financial urgency created by war (Aidt and Jensen 2009). However, we aim to collect the date of introduction when the personal income tax became a permanent feature.

Corporate tax (CIT)

Criteria for data selection: when the country had a **permanent special tax** levied by **the central or federal** government **on the profits made by companies**.

In many Western countries, the corporate tax was introduced later than the personal income tax as it can be regarded as a special form of the income tax. It is a tax levied on the profits made by companies. For instance, in Germany it was introduced in 1920 and different than the personal income tax, it was a proportional tax. Other countries soon followed suit e.g. Austria in 1934, UK in 1937 and France in 1948 (Genschel 2002). NOTE: The UK only officially introduced a "corporate tax" in 1965, as companies and individuals previously paid the same income tax. Yet company profits were subjected to an additional profits tax > hence introduction in 1937.

Social Security Contribution (SSC)

Criteria for data selection: when the country has a **permanent and compulsory social contribution** scheme levied by **the central or federal** government.

Compulsory social security contributions, which are paid to general government, are similar to taxes. However, different than taxes, such contributions include an entitlement to receive a (contingent) future social benefit. These include a) employers' social security contributions, b) employees' social security contributions, and c) social security contributions paid by independent entrepreneurs and non-employed persons.

Sales Tax

Criteria for data selection: when the country had a **permanent tax** levied by **the central or federal** government **on the sales of all (regular) goods and services**.

Prior to the WWI consumption was often only taxed very selectively, for instance only on certain luxury goods such as tea and coffee. A tax on the regular consumption did not exist. For instance, Germany only introduced a sales tax in 1916, France in 1917, Italy in 1919, Belgium in 1921 due to the costs of the war.

Value Added Tax (VAT)

VAT is a particular sales tax, which has become popular since the 1950s. Different than other sales taxes, it taxes only the *value added* at each stage of production. We have already coded all countries that introduced the value added tax until approx. 2006, so you only need to look for those countries that have no information and only for the last decade.

Net Worth/Wealth Tax

It is a tax based on the market value of assets that are owned. These assets include, but are not limited to, cash, bank deposits, shares, fixed assets, private cars, assessed value of real property, pension plans, money funds, owner occupied housing and trusts. An ad valorem tax on real estate and an intangible tax on financial assets are both examples of a wealth tax.

Taxes on Estate, Inheritance and Gift

Both estate (or death duty) and inheritance taxes are taxes levied on the transfer of wealth after a person died. While the estate tax is calculated based on the net value of property owned by a deceased person on the date of death, the inheritance tax is calculated based on who receives a deceased person's property. If there are multiple tax rates and bases, we use the one applied to a single child. Gift taxes by contrast refer to a gratuitous transfer of property made during the transferor's lifetime. Yet, they all refer to taxing the transfer of wealth from one person to the next.

Property Tax

It refers to recurrent taxes on immovable property, which are defined as taxes levied regularly in respect of the ownership of immovable property. Usually, these taxes are levied on land and/or buildings.

NOTES:

- South Korea counted as predecessor for both Koreas
- India counted as predecessor for India, Pakistan, Bangladesh
- Pakistan counts as predecessor for Bangladesh until 1971
- Burundi counted as predecessor for Burundi and Rwanda
- Austria-Hungary counted as predecessor for Austria, Hungary and Czechoslovakia.
- China counted as predecessor of China and Taiwan.
- Startyear for San Marino and Andorra changed from 1992 and 1993 respectively (year they joined the UN) to 1600 and 1278 (years of first constitutions).
- South Africa counts as predecessor of South Africa and Namibia.
- Timor-Leste counted as predecessor of East Timor
- Argentina counts as predecessor of Uruguay up until 1830.

– Prussia counts as predecessor of Germany and is as such named “Germany”.

Endnotes

- Please add here, your comments and questions for each country. For instance, if you find two different dates for the introduction of a tax (both from equally reliable sources), you can specify these findings and your coding decisions in a separate endnote.
- If you cannot find information, include “999” into the field and mark it red, so we can differentiate between missings and non-introduced taxes. This allows us to go back later and try to fill in the missing information.