

Democracy, War, and Wealth

Evidence from Two Centuries of Inheritance Taxation

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- 1 Inheritance taxes are often very old taxes - 1694 for the UK with its probate duty
- 2 Inheritance taxes require less capacity to collect relative to an income tax.
- 3 Modern inheritance taxation is widely believed to have had a significant impact on the distribution of wealth

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Democracy and War as Influences on Tax Policy

- **The standard story - expansion of the suffrage** - Scholarly observers from Seligman (1913) to Acemoglu and Robinson (2000) suggest it led to more progressive taxation
- **An alternative story** - mass conscription generates political pressures for an analogous conscription of wealth to maintain equal sacrifice

A First Justification for the Conscription of Wealth

From the statistics of estates passing at death it can be deduced that practically all the material capital of the country is held by persons over twenty years of age; that persons over forty-five, who constitute about one-third of these persons, own about three-fourths of the whole; so that the representative man over forty five holds about six times as much material capital as the representative man between twenty and forty-five. But young men, who excel older men in physical strength, have been forced to give their physical strength in the war, while older men have been exempted. The fact that old men excel young men so greatly in financial strength suggests that the balance might be partly adjusted, and something less unlike equality of sacrifice secured, by a levy whose incidence would in the main fall upon persons exempted from military service. (Arthur Pigou)

Those who have made fortunes out of the war must pay for the war; and Labour will insist upon heavily graduated direct taxation with a raising of the exemption limit. That is what Labour means by the Conscription of Wealth (Labour Party Manifesto, 1918).

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- The format of military force (mass or limited) war is itself likely to depend on prevailing technologies and characteristics of opponents.
- This is an argument above all about taxing capital and the top of the wealth distribution

The Inheritance Taxation Data Set

- 1 No existing long-run, comparative data on inheritance taxation.
- 2 Our data set records key features of inheritance taxation for 19 countries—Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, Korea, the Netherlands, New Zealand, Norway, Sweden, Switzerland, United Kingdom, and United States.
- 3 Data generally collected directly from legislation, or, when available, from secondary sources who have themselves compiled such legislation.
- 4 Focus on top marginal rate for direct descendants
- 5 Additional analyses for specific inheritance sizes

- **Generalized differences-in-differences** with and without time varying control variables and country-specific time trends, OLS estimates with country-clustered standard errors. Estimate 5-year, 10-year, and annual panels

$$T_{it} = \alpha + \beta_1 D_{it-1} + \beta_2 W_{it-1} + \gamma \mathbf{X}_{it-1} + \eta_i + \theta_t + \varepsilon_{it}$$

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- **Lagged Dependent Variable** with and without time varying control variables and country-specific time trends, OLS estimates with panel-corrected standard errors. Estimate 5-year, 10-year, and annual panels

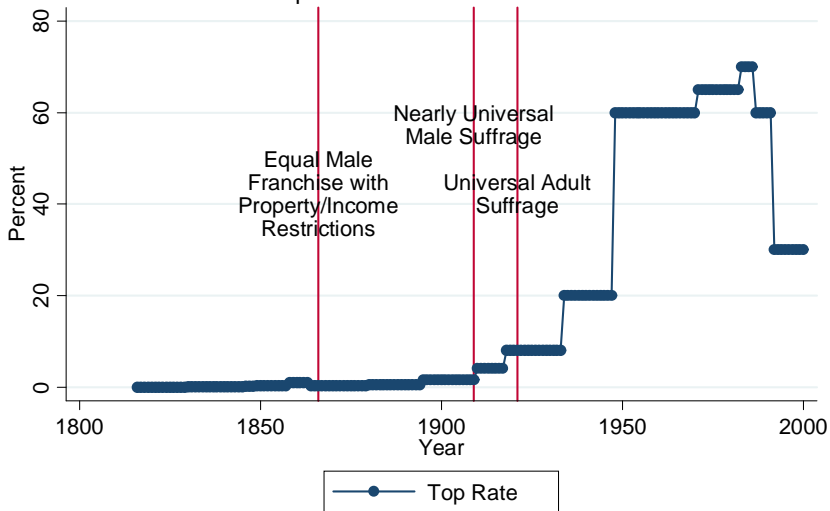
$$T_{it} = \alpha + \rho T_{it-1} + \beta_1 D_{it-1} + \beta_2 W_{it-1} + \gamma \mathbf{X}_{it-1} + \theta_t + \varepsilon_{it}$$

Results for Universal Suffrage

- Differences in Differences coefficient for five year panels 0.93 (3.40)
- Coefficient in LDV model for five year panels 0.75 (1.78)
- Similar results with numerous alternative democracy measures
- Visual inspection of time series provides further support

Inheritance Taxation in Sweden

Top Rate for Direct Descendants

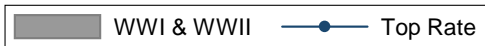
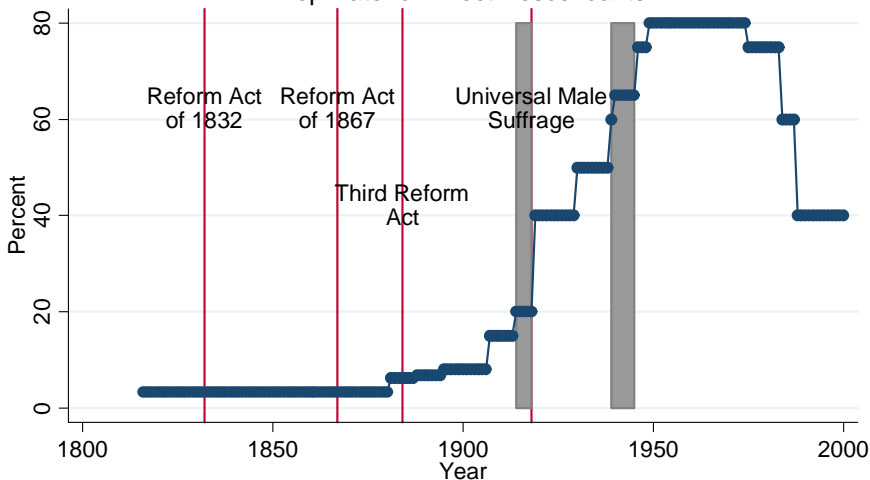


Results for Mass Mobilization

- Differences in Differences coefficient for five year panels 23.3 (6.3)
- Coefficient in LDV model for five year panels 13.6 (3.8)
- Robust to a wide variety of alternative specifications and modelling choices
- No sign of (democracy) \times (mobilization) interaction effects
- Visual inspection of many series also supports

Inheritance Taxation in United Kingdom

Top Rate for Direct Descendants



Interpreting the Mobilization Effect

- **Was it just that WWI and WWII were unprecedentedly expensive?**
- **The ideal counterfactual** - a war that was just as expensive as WWI or WWII but that was not fought with a mass army.
- **Feasible alternative** - Add variable for military spending to our existing specifications
- **Result** - Mobilization variable remains statistically and substantively significant.

Conclusion

When a state seeks to mobilize the great mass of its citizens for war it is more likely to increase taxation of the rich. Much of the twentieth century evolution of progressive taxation may be explained by this simple fact.