

Fiscal Policy and Inequality

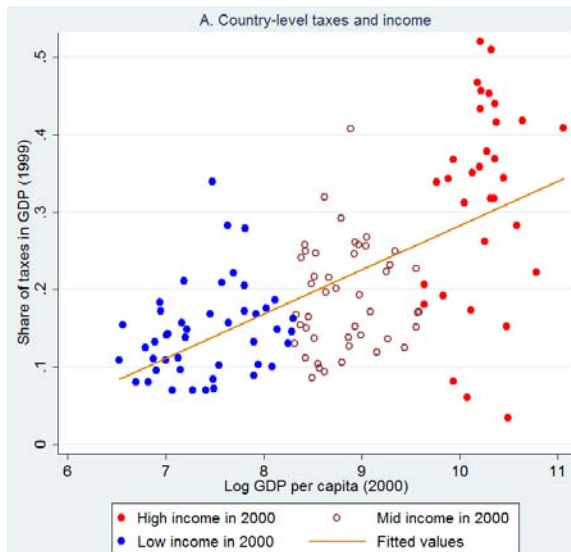
2. Taxation: Introduction

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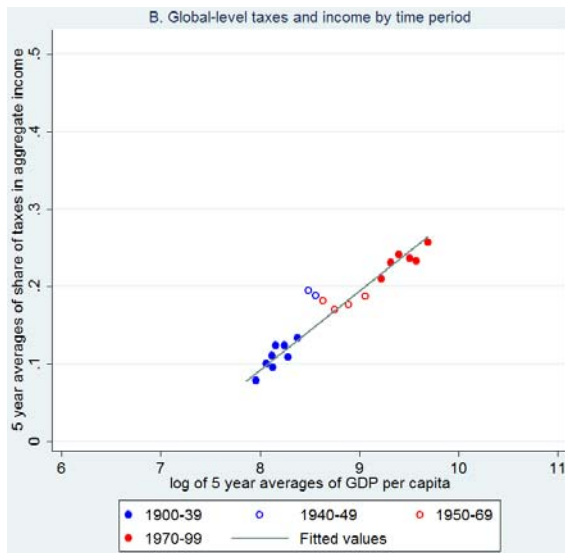
ETH Zurich

September 24, 2018

The size of government (taxes/GDP) across countries

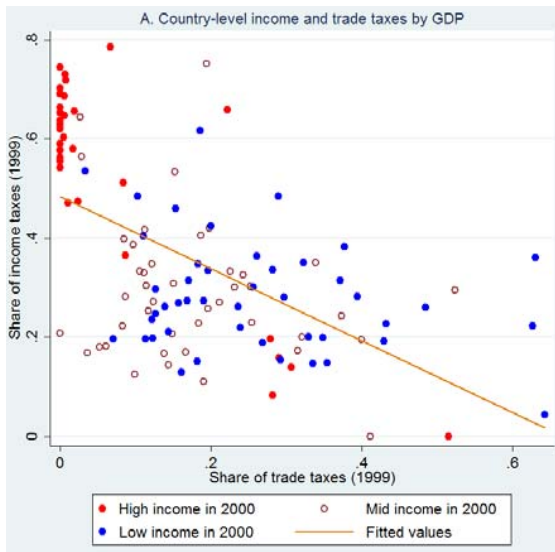


The size of government (taxes/GDP) over time



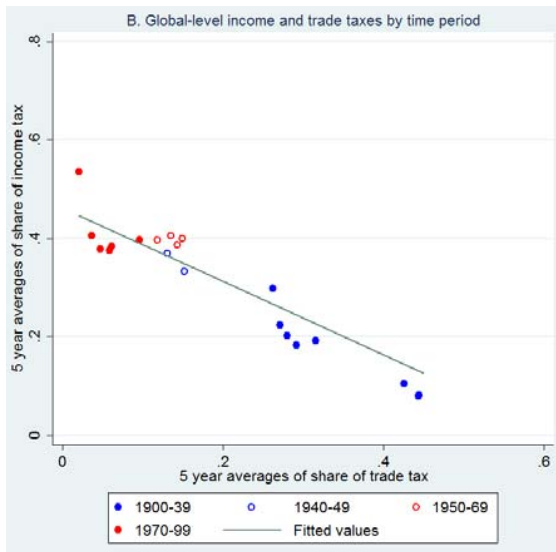
Source: Besley and Persson (2013)

Income vs. Trade taxes across countries



Source: Besley and Persson (2013)

Income vs. Trade taxes over time (18 countries)



Traditional vs. Modern Taxes

▶ **Traditional taxes**

- ▶ Import tariffs and custom duties
- ▶ Property tax
- ▶ Inheritance tax
- ▶ Excise and sales taxes

▶ **Modern taxes**

- ▶ Value-added tax (VAT)
- ▶ Personal and corporate income taxes
- ▶ Payroll tax / social security contributions

Traditional vs. Modern Taxes

▶ **Traditional taxes**

- ▶ Usually rely on self-reporting
 - ▶ Much more room for manipulation and tax evasion and avoidance
 - ▶ Eg, a wealthy individual puts part of his property under his children's name to avoid paying property tax
- ▶ Often more distortionary
 - ▶ Import tariffs are the classical example
 - ▶ Differences between sales tax and VAT

▶ **Modern taxes**

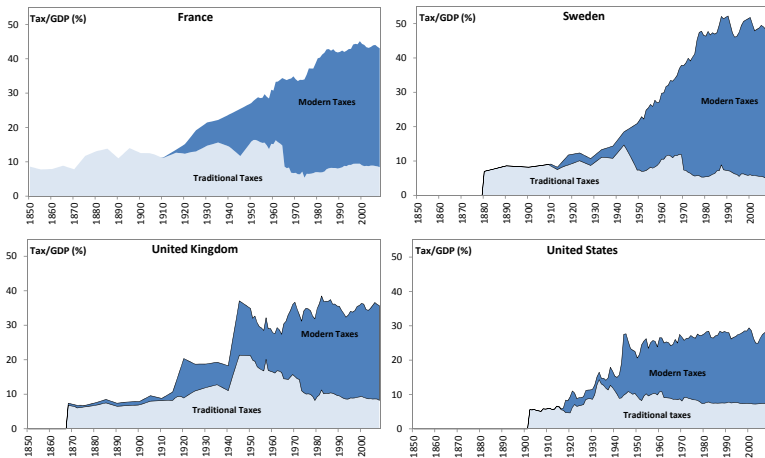
- ▶ Usually rely on third-party reporting
 - ▶ Eg, company reports directly to tax authority the salary of its employees. If employees misreport their income, they will be caught by the tax authority with probability 1.
 - ▶ Exception: income of self-employed individuals

Inflation is a tax

- ▶ In developing countries one of the most important “taxes” is actually inflation
 - ▶ That is, printing new fiat currency
 - ▶ Also called “seignorage” in this context
- ▶ The government can do what it wants with the currency, buying goods and services.
 - ▶ The resulting inflation operates as a tax on everyone in the country, proportional to their wealth.
 - ▶ Tax on savers, subsidy to borrowers.

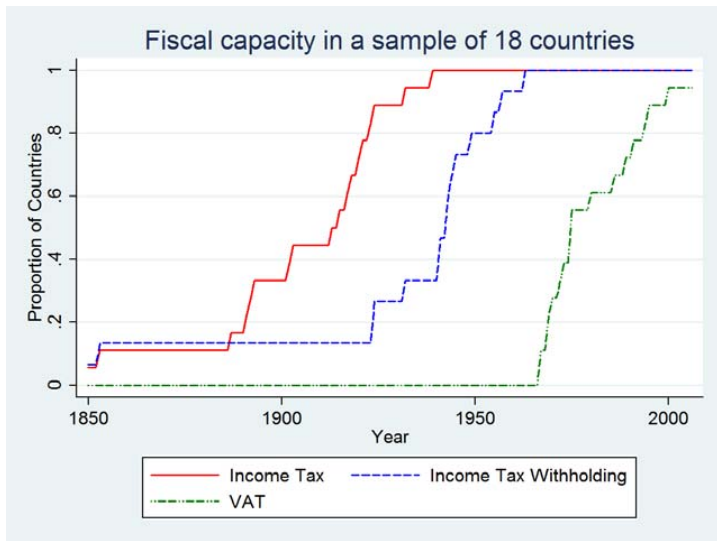
Modern vs. Traditional taxes over time

Figure 2: Tax Take and Tax Structure Over Time

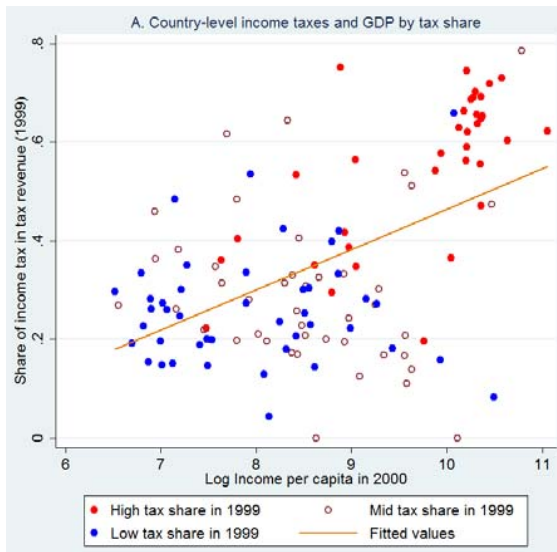


Source: Kleven, Kreiner and Saez (2016)

Introduction of modern taxes over time (18 countries)

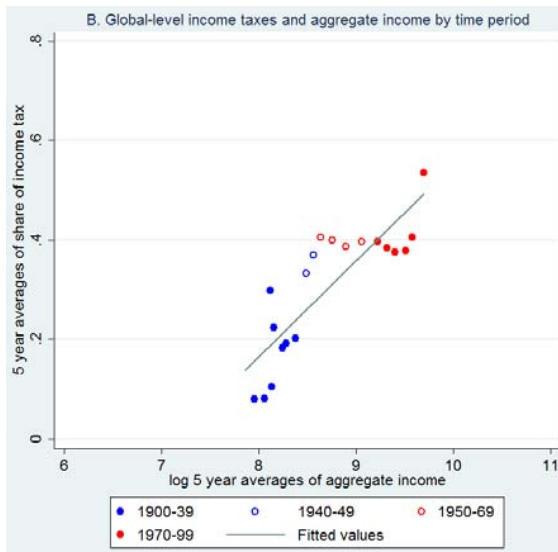


Income taxes and size of govt across countries



Source: Besley and Persson (2013)

Income taxes and size of govt over time (18 countries)

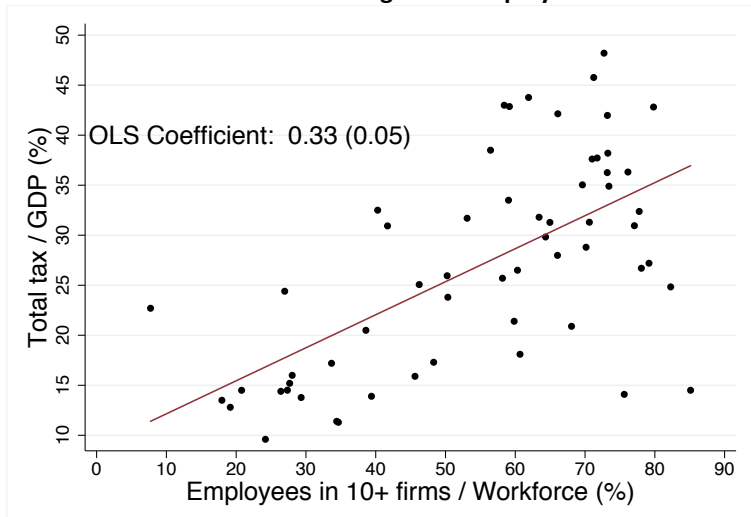


Firms as fiscal intermediaries

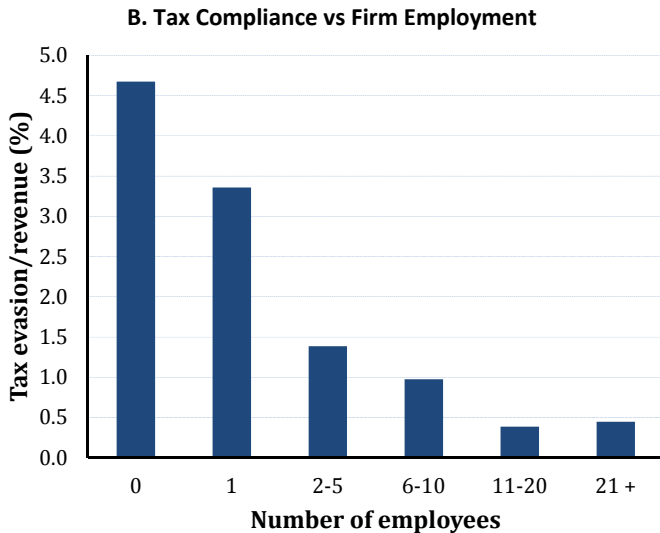
- ▶ In modern tax systems, firms act as fiscal intermediaries by:
 - ▶ Providing third-party information (on employees, business partners, etc)
 - ▶ Collecting and remitting the main taxes (VAT, Inc Tax, CIT)
- ▶ Hence, taxing firms is crucial for an effective tax system:
 - ▶ Allows the state to deal with a smaller number of agents
 - ▶ Lowers the cost of obtaining information
 - ▶ Large firms have an intrinsic interest in keeping good records (Kleven, Kreiner, Saez 2015)
 - ▶ But do they have an interest in telling the truth to the govt?

Firm size and tax compliance (59 countries)

A. Tax Take vs. Average Firm Employment

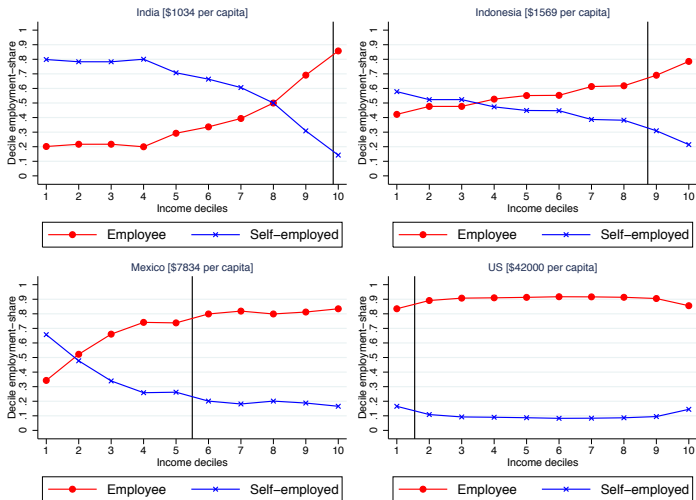


Firm size and tax compliance (Denmark only)



Employees vs. Self-employed, cross country

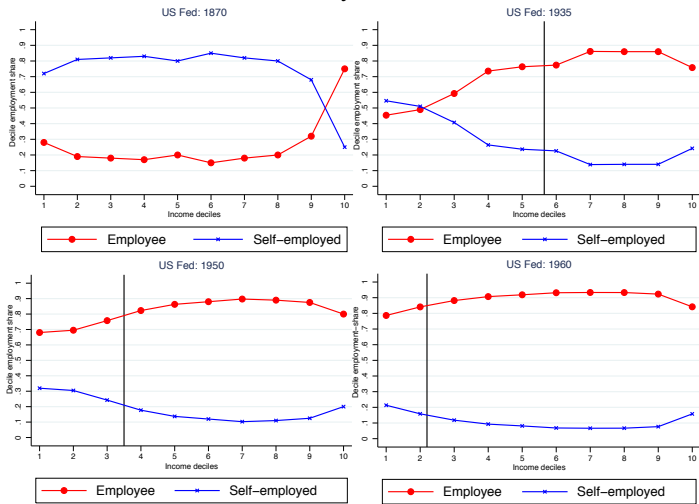
Panel A: cross country



Source: Jensen (2016)

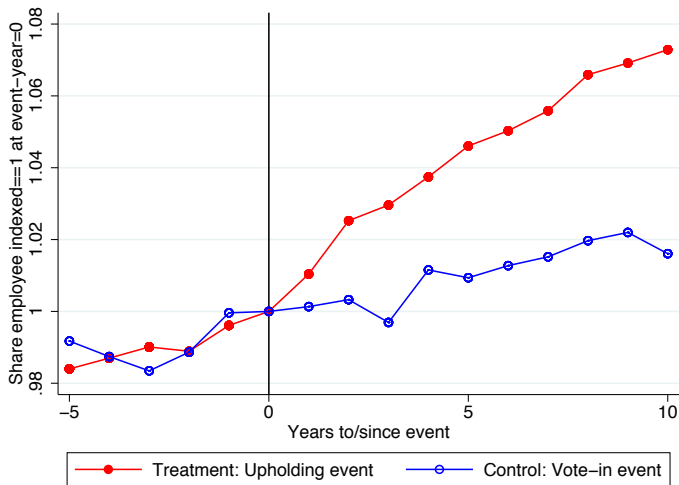
Employees vs. Self-employed, over time (USA)

Panel B: within country over time US 1870-1960



Impact of Infrastructure Development Bonds (USA)

Panel A: Employee-share



Taxes for the future?

- ▶ Land value tax
 - ▶ “Henry George Theorem” says land tax is “free” because expenditures on public goods increase land values.
- ▶ Carbon tax
- ▶ Financial transactions tax
- ▶ Robot tax
 - ▶ If they reduce jobs, could tax them to fund unemployment benefits
- ▶ Progressive global wealth tax
 - ▶ Key policy recommendation of Piketty’s “Capital in the Twenty-First Century”
- ▶ We will come back to these in future lectures.