LECTURE 16: THE CRISIS OF THE TAX STATE IN THE 21ST CENTURY

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Introduction

- We have now analyzed the distribution of wealth and the structure of inequality since the 18th century. Inequalities of wealth are close to regaining or even surpassing their historic highs of the 19th century.

- This begs the question – what is the role for government and the democratic state in shaping the politics of distribution in the 21st century?

- How do we resolve the endemic conflict between capitalist markets and democratic social rights?

Market competition or social rights?

- Increasingly governments have to satisfy two different constituencies: markets and voters.

- This friction is reflected in two competing principles of resource allocation: markets and social rights.

- To give an example of the new constraints facing the democratic state consider the following: in the aftermath of the great depression the US President, Herbert Hoover, raised the top marginal income tax rate to 80 per cent.

- In the aftermath of the great recession, the Obama administration struggled to increase it beyond 35 per cent.

- The financial crisis revealed the importance of central banks (public institutions) and the social state (welfare payments) in mitigating the worst effects of free finance markets.

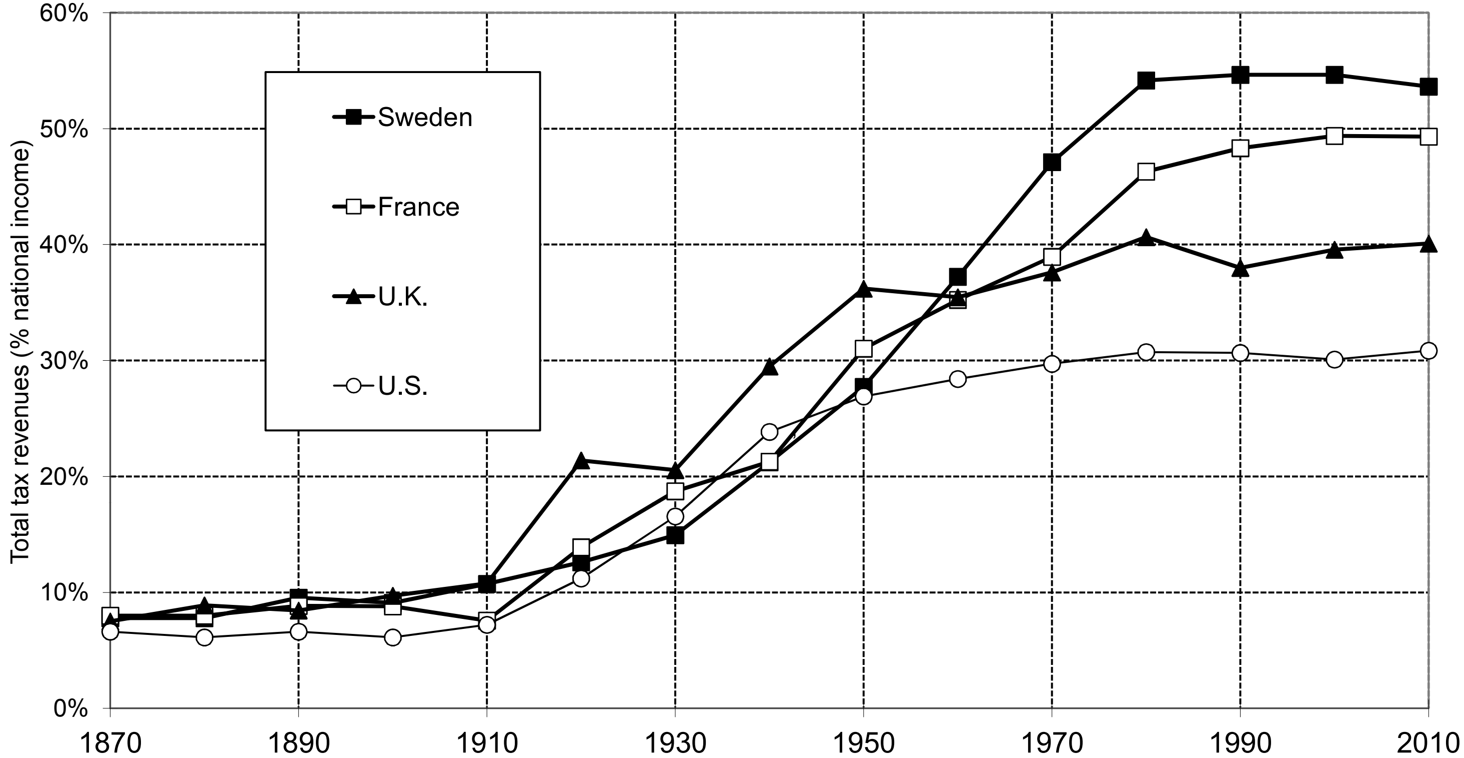
- The capacity to raise tax revenue is the fundamental characteristic of how contemporary democracies manage the boom bust cycles of capitalist markets.

The fiscal state

- The role of the state in the economy has been constantly evolving.
- But contrary to the assumptions of ‘neoliberalism’ the state is not in retreat.
- The state is just as involved in shaping economic outcomes today as it was in the 1970’s.
- Nation-states require new supranational forms of governance to manage global markets,
  - whilst the domestic social state is in constant need of modernization.
- The simplest way to measure the role of the state in the economy (and society) is to look at the total amount of taxes relative to national income.
  - Figure 13.1 shows the trajectory for Sweden, France, Britain and the USA.

The tax state

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.

The fiscal state

- Before WW1 the state had no real role in social life.

- With taxes equivalent to 7-8 per cent of national income, the state could just about manage those “regal” functions of managing a police force and an army.
  - The state existed to maintain social order and defend property rights.

- Between 1920-1980 the share of national income that rich countries began to devote to social spending grew substantially. It increased by more than a factor of 5 in Nordic countries.

- But between 1980-2010 the tax share stabilized almost everywhere.

- The fiscal revolution of the 20th century is now over.

The social state

- Tax revenue has stabilized at around 30 per cent in the USA, 35 per cent in Ireland, 40 per cent in the UK, 45 per cent in Germany, 50 per cent in France and almost 55 per cent in Sweden.

- This growing tax bill has enabled the state to take on broader social and public service functions, which now consume between a third and a quarter of all government expenditure, depending on the country.

- One half of this goes on health and education, whilst the other half goes on replacement incomes and transfer payments.

- Politics is not just about elections. It is about making public policy and public policy regimes vary significantly between countries: liberal, social and coordinated market economies are not the same.

- Trying to explain these differences is a core part of the study '*comparative political economy*'.

Social rights

- Public spending on health and education consumes around 10-15 per cent of national income in most developed market democracies today.
- Primary and secondary education are almost entirely free for everyone in rich democracies (although countries like Ireland heavily subsidize private education as well). Public health insurance is universal in most European countries.
- Replacement income and transfer payments now consume almost 15-20 percent of national income in European countries (because of high unemployment).
- In most developed democracies the state taxes and pays out income to households as replacement income (pensions, unemployment compensation, family and children's allowance).
  - Pensions are the biggest component of this in most countries.
- The growth of the fiscal state over the last century reflects the constitution of the social state. This, in turn, reflects the democratic demand for social rights: education, healthcare, pensions and in some countries – housing.

Modern redistribution

- Modern redistribution is not primarily about transferring income from the rich to the poor but financing democratic public services and replacement incomes for the elderly. It is built around a logic of democratic rights not market competition.

- Democratic questions pertaining to social rights will never be answered by abstract principles and mathematical formulas.

- The only way to deal with democratic questions of social rights is through democratic deliberation. Furthermore, there are very few examples in history where social rights were won without struggle, conflict and political confrontation.

- The political institutions that govern democratic debate and the rules of decision-making will, therefore, play a crucial role in shaping the politics and discourse of what constitutes fair distribution.

- This is not just about comparative differences in electoral rules (majoritarian and proportional systems of representation) but the variation in the relative power resources of interest groups and the persuasive capacity of different social actors.

Conclusion

- The revolution in the public financing of the social state is not likely to be reversed in any rich democratic country.
- There are certainly huge constraints on expenditure and taxation, particularly as it pertains to pensions, but no country is likely to cut social spending back to 20 percent of national income.
- On the contrary, there is pressure on the fiscal state to expand and to invest in various public services such as higher education, training, research, sustainable energy, digital communications and other forms of infrastructural investment.
- This social pressure to expand and invest, however, confronts the market pressure to consolidate public expenditure i.e. austerity.
- Furthermore, the expansion of the fiscal state during the past 50 years was dependent upon one crucial condition that cannot be guaranteed: strong economic and productivity growth. This has slowed down almost everywhere.
- Future debates about the fiscal and social state are likely to revolve around issues of economic growth, structural reform, public sector modernization and the consolidation of social spending. Tax increases don’t win elections.

Class discussion

- The demand to reform the state and improve public services is a very legitimate concern. Taxpayers tend to support public financing when they receive better quality services, and when they have higher levels of trust in government.

- To tease out this fiscal crisis of the state discuss the following:

  - Is higher education a social right?
  - Does it make a difference that it does not impact upon social mobility?
  - What about the right to retirement, does everyone have a right to a pension?
  - Who should pay for all this?