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Essays on the Politics of Taxation

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Abstract

Taxation is a key activity of any state and a constant point of political struggle. The structure of taxation is continuously changing and evolving, and its size has grown dramatically during the last two hundred years. Many of the cross-national patterns we observe today are the result of centuries old conflicts and challenges, hence we need to take history into account if we want to understand contemporary tax systems. This dissertation is concerned with the evolution of taxation in the last two centuries. During this period modern parliamentary democracy developed and spread, and it is during this period that the contemporary party systems crystallized and the broad lines of conflict between the left and the right emerged. Thus, this period is crucial for our understanding of the effects of political institutions and ideology on policy making.

Because of a lack of comparative information on taxation with a long time scale, previous research has been constrained to a small number of mostly European countries. In this dissertation I present a novel dataset (a collaboration with Thomas Brambor) over government tax revenues covering 31 countries from 1800 to 2012. The dataset is unprecedented in both temporal and geographic scope and includes countries from Europe, North America, South America, as well as Australia, New Zealand, and Japan.

The first paper is concerned with the notion that democracy itself has an impact on taxation by extending influence to previously excluded groups of poor citizens. I present evidence for the argument that the effects of democracy depend on urbanization. Democratization in an urbanized state leads to higher taxes on income and lower taxes on consumption. In contrast, democratization in rural countries is associated with lower taxes on property.

The second paper investigates the influence of ideology on taxation. A puzzle in the literature is why left-wing parties are associated with regressive taxation (e.g., on consumption). I argue that how left-wing governments tax depend on the institutional environment. In countries using majoritarian/plurality electoral systems the left relies more on income tax, and in countries using proportional representation systems the left relies more on consumption tax.

In the third paper I investigate the mechanism behind left-wing tax strategy in more detail by studying reforms of consumption taxation in post-war United Kingdom and Sweden. I find that strategic considerations related to how the political system concentrates power in the United Kingdom affected the Labour Party's attitude towards the value-added tax and its decision not to adopt the tax. The left-wing government in Sweden on the other hand, operating in a different institutional context, decided to introduce a similar tax.

The fourth paper, which is coauthored with Johannes Lindvall, contrasts political investments, of which taxation is one example, with short-term crisis management. We present a game theoretic model in which institutions that concentrate power are better at handling sudden crises but worse at making policy with short-run costs and long-term gains. Power-sharing institutions, on the other hand, are better at resolving inter-temporal dilemmas, but perform worse when faced with sudden crises.

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Contents

1
Introduction

Taxation is not only intimately related to the emergence of the modern state, but is also an ideal policy for a study of the impact of political institutions. This dissertation presents new data and analysis of the emergence of the modern tax state using a novel dataset spanning from 1800 to 2012. Moreover, it uses tax structure to study how democracy and democratic institutions shape the struggle between economic classes over policy. Using a range of methodological approaches, these four papers cast light on different aspects of the politics of taxation, from the long-term effects of democracy to the impact of ideology and left-wing tax strategy to a normative analysis of the performance of political systems.

William H. Riker once claimed that if "[p]olitics [...] is the authoritative allocation of value", then, political science is the study of decision-making (1962, p. 10f). This dissertation is concerned with decision-making with respect to tax policy. Taxation is particularly interesting for at least two reasons. First, no state can exist without revenue; that is, as long as taxation is used to finance the state, decisions about taxation are inevitable. Second, because taxation is by its very nature about allocating value, conflicts will arise concerning how tax obligations will be distributed.

This centrality of revenues – and in particular tax revenue – as a reflection of a society's values was famously stressed by Joseph A. Schumpeter:

> The spirit of a people, its cultural level, its social structure, the deeds its policy may prepare – all this and more is written in its fiscal history, stripped of all phrases. He who

> knows how to listen to its message here discerns the thunder of world history more clearly than anywhere else ([1918]1991 p. 101).

Similarly, the Austrian sociologist Rudolf Goldscheid held that "the budget is the skeleton of the state stripped of all misleading ideologies", pointing out that taxation is crucial to understanding the rise of the modern state.[1] If Schumpeter and Goldscheid are right, much can be gained from studying taxation during the last two centuries, an era that saw dramatic changes not only in the extent of taxation (i.e., taxation grew from being a relatively minor activity in the nineteenth century to representing around half of the economy in modern industrial countries) but also in economic and political organization.

The industrial revolution is one of the largest transformations in human organization since the development of agriculture and sedentary civilization. Apart from profoundly changing the economic structure of societies and leading to an unprecedented increase in human well-being, it also altered the way the state and society interacted. The new economy increased the demands from the state, from providing basic infrastructure to financing ever costlier wars. Industrialization also amplified the process whereby increased dependence of the state on tax revenue was met with increasing demands for representation (Bates and Lien 1985; North and Weingast 1989; Schumpeter 1991). The inclusion of a wider part of society in decision making culminated in modern representative democracy with elected assemblies and accountable executives.

The first question asked in this dissertation pertains to the relationship between tax systems and democracy. It has been claimed that democracy, by including the previously disenfranchised masses in government decision-making, affects the *way* states tax as democracies began to rely on a progressive and redistributive taxation structure. However, the empirical evidence for this hypothesis is mixed. My first paper is concerned with this issue and suggests that the reason for earlier conflicting results is that the poor have been treated as a homogeneous group with identical preferences with respect to taxation. By tying tax preferences to sectors of the economy such as agriculture and manufacturing, I derive more specific testable hypotheses.[2]

Another set of explanations for the variation of taxation around the world focuses on ideology, in particular, the rise of left-wing political

[1] Quoted in Schumpeter [1918]1991, p. 100.
[2] All papers are summarized in section 1.7.

parties during the late nineteenth and early twentieth century. Interestingly, scholars have failed to find a consistent influence of ideology on economic policy in general and on taxation in particular. This unresolved issue is the second puzzle in this dissertation. In Paper 2 and Paper 3, I use insights from the literature on institutions to suggest that the effect of ideology depends on institutional context.

The third part of the dissertation is concerned with what makes taxation different as a policy and what this means for the performance of constitutions. The idea is that not only is taxation a central policy for "stateness" in itself but also belongs to a class of policies commonly referred to as "political investments". Investments are policies with short-run costs but long-run gains. As such, taxation presents the political system with challenges that are very different from other policies. In Paper 4, I and Johannes Lindvall contrast political investments with situations where swift decisive action is needed in a formal model evaluating the relative performance of constitutions that concentrate power compared to constitutions that share power.

Together, the four papers in this dissertation contribute to our understanding of the relationship between taxation and political institutions. It does so in four distinct ways. First, it presents evidence that the influence of democratization is not uniform but depends on the urbanization rate. Second, it argues that the effect of ideology on tax policy is different depending on the institutional context. Third, it extends our theoretical understanding of how different constitutions affect the ability of governments to make investments (of which taxation is a subset) and handle urgent crises. Finally, it presents the first comprehensive data set over government tax revenues from 1800 to today covering 31 countries in Europe, North America, South America, Australia, New Zealand, and Japan.[3]

I have confined my analysis to taxation as a domestic political problem driven by distributive conflict. This means I am not concerned with tax compliance (e.g., Levi 1988; Timmons 2010), the relationship between taxation and economic growth (Auerbach 2006; Widmalm 2001), or international factors such as tax competition (Genschel 2002) or interstate warfare (e.g., Hintze 1970; Scheve and Stasavage 2010; Tilly 1990). My work is also restricted to the nineteenth and twentieth centuries, a time when industrialization and urbanization led to a "threat of concentrated working-class collective action" (Tilly 1990, p. 63) as well as a novel political environment.

[3]The data were collected and compiled together with Thomas Brambor and is described in more detail in section 1.6.

This introductory chapter presents the general scholarly context to which the four papers speak and outlines the common theoretical underpinnings of the papers. I begin by providing a brief overview of taxation and institutions – i.e., what they are and what they mean in the context of the papers. This discussion is followed by a section on previous research. In the subsequent section, I describe the overall empirical strategy, outlining my methodological starting point and how the different methods used in the papers complement each other. The last part of the chapter presents the dataset as well as an empirical exploration of the history of taxation and institutions. The chapter ends with a summary of the contributions made and suggested avenues for future research.

1.1 Taxation and the State: A Short History

Taxation is together with law and order one of the "main attributes of sovereignty and the most visible demonstrations of the power of authority" (Brélaz 2008). As such, it is at the heart of a core concept in comparative politics, states. Max Weber famously defined a state as a "human community that (successfully) claims the monopoly of the legitimate use of physical force within a given territory" (1946, p. 77), but maintaining the monopoly of violence is not free, and the state is often (but not exclusively) financed by taxes.

According to Schumpeter, the modern state evolved from a condition with no clear distinction between the government budget and the private economy of the monarch. Increasing spending pressure as a result of war meant that the private revenue of the monarch could no longer sustain the increasingly larger armies needed to defend the state, forcing the ruler to rely on the aristocracy for additional funds. Since the funds were needed to finance a public good (i.e., defense), the ruler and the nobility had a common interest. However, the increasing demands for revenue were met by calls for influence over how it was spent. Eventually, this agreement developed into what Schumpeter termed a "tax state", where most citizens contributed a share of their income to the state (Schumpeter [1918] 1991).[4]

[4]Extending this narrative, many scholars have linked demand for revenue to democratization (see section 1.3).

Schumpeter's well-known narrative of the development of the tax state in Europe from the Middle Ages suggests a rather linear evolution with war as the ultimate cause; however, the general mechanism of warfare leading to increased government expenditures (and as a consequence, a need for more revenue) goes back much farther. In Ancient Greece, the costs of maintaining large fleets led to a sharp increase in the cost of war, which in turn meant heavier taxation. Recent work even makes explicit comparisons between Athens and the Schumpeterian tax state (Gabrielsen 2013).[5]

Although pre-industrial states were much smaller compared to today's states, the challenges associated with paying for the state were similar. There are many ways to finance government activities:

1. The state might control important **resources** (e.g., diamonds, oil, copper, trading routes) that generate revenue without imposing a direct cost on its citizens.[6]

2. The government can charge **fees** for specific services provided by it, for example, the use of a bridge or a highway system or it might charge a fee for the lawful transfer of property.

3. Most states can also **borrow** money to finance its activities. Importantly, since the loan generally needs to be repaid, this type of revenue is short term and must involve some of the other sources in the long term.

4. Finally, the state can impose a **tax** to fund its activities.[7]

All these types of revenues differ in distributive impact (i.e., who or which groups pay more or less) and how it regulates the relationship between citizens and the state. For example, a fee implies a very different relationship than a tax, as the latter involves more discretion on part of the government (which needs to be complemented by trust on the part of the tax payer).

[5] Section 1.3 provides a brief review of the literature linking taxation to warfare.

[6] However, the use of many of these sources exclusively by the government introduces a number of indirect costs, for example increased prices associated with monopolies.

[7] The state can also choose to privatize a certain activity, by which a service is provided and paid for without the involvement of the state. Throughout history, many activities that we today associated exclusively with the state – such as defense – has been privatized (at least in part) (for examples from the Byzantine empire see Treadgold (1995), ch. 4-5).

This dissertation is concerned with the last of these sources of revenue – taxation – and how decisions regarding taxation are structured by political institutions.[8] The point of departure is that political institutions shape the outcome of the distributive conflicts stemming from the contentious bargaining over taxation.

Before moving on, we have to establish what a tax really is. According to Supreme Court Justice Oliver Wendell Holmes Jr., taxes "are what we pay for civilized society"[9] and Alt (1983) claims that "the answer to the question 'Why have a tax?' is the same as the answer to the question 'Why have a state?' "(p. 185). In other words, taxation is the cost paid by citizens in exchange for a state. A slightly different definition is used by the World Bank (1988): "[Taxes are] unrequited, compulsory payments collected primarily by central governments". This clearly delineates taxation from fees in exchange for specific services and natural resource rents. While succinct and capturing the key elements of what a tax is, this definition hides one of the most important problems tax reform seeks to redress: evasion and avoidance. Noting that including the payment of a tax in its definition effectively ignores compliance, Martin et al. (2009) propose the following definition: "*Taxation* consists of the obligation to contribute money or goods to the state in exchange for nothing in particular" (p. 3, emphasis in original).[10]

Throughout history, states have taxed a variety of things, from beards and musical events to oars and champagne. A fairly common way to categorize different taxes is to begin by distinguishing between direct and indirect taxes. Direct taxes are levied on a person's income or wealth paid directly by the taxpayer, whereas indirect taxes are levied on goods and services. Direct taxes include taxes on income, land, corporations, and profits and indirect taxes include tariffs, excise, and broad-based consumption taxes.[11]

To continue the discussion of these categories of taxation and how they are related to politics, I have to introduce the concept of distributive impact. To understand the preferences of voters and political parties as well as the challenges associated with investment

[8] *Non-tax revenue* is also an important topic in itself. For a recent study of its role in early modern Sweden, see Nilsson (2017).

[9] In *Compania General de Tabacos de Filipinas v. Collector of Internal Revenue* (1929) , p. 100

[10] The empirical definition used when assembling the data is similar in spirit, but more detailed. See section 1.6.

[11] Section 1.6 shows how revenue from these different taxes have changed over time.

dilemmas, it is essential to understand how taxes affect different groups of citizens

Distributive impact describes how heavily the tax falls on citizens depending on their income or wealth. Progressive taxes are used to reduce the tax incidence of people with lower ability to pay and by extension require higher income individuals to pay a larger percentage of their income; regressive taxes, on the other hand, have the opposite effect – the relative tax burden decreases as one's ability to pay increases. The distributive impact of a tax is also called its "incidence". It is common to distinguish between "statutory incidence", indicating who is legally obliged to pay the tax, and "economic incidence", indicating who *really* pays the tax, or more specifically "[t]he change in the distribution of real income induced by the tax" (Rosen and Gayer 2008, p. 304). For example, a tax on the sale of a good might be legally paid by the firm selling it, but if the tax induced the firm to raise the price of the good, the ultimate payer of the tax is the consumer. Exactly how much of the tax is absorbed by the firm and how much is passed on to the consumer is of course an empirical question. By "incidence", I mean "economic incidence".

To simplify theoretical analysis, it is common to make assumptions about the incidence of different types of taxes. Direct taxes on income and property are regularly assumed to fall on income earners and property holders, respectively, and are classified as "progressive", while indirect taxes on consumption are assumed to be passed on to consumers and are considered "regressive". Although incidence is often assumed, there is empirical evidence in support of consumption taxes being regressive and income taxes being mainly progressive (Joumard, Pisu and Bloch 2012; Prasad and Deng 2009). The progressivity/regressivity of taxation has always been politically contentious since the concepts describe who pays for the state and is related to what is considered "fair" and "just" taxation.

With the rise of democracy, the incidence of the tax system became linked to the distributive basis for ideological differences between political parties. These differences are related to changes in social cleavages as a result of industrialization and are particularly interesting during the period this thesis considers (1800-2012). During this period, the new urban working class emerged as a political force, represented by left-wing parties and trade unions. These two groups are the main actors in the second and third paper, where I focus on left-wing governments. I elaborate more on the relationship between economic and political change and how this is related to preferences and representation – and ultimately tax policy – in section 1.4.

In sum, the distributive influence of different taxes affects the preferences of voters and is a main point of conflict between political parties. The outcome of these conflicts is guided by political institutions.

1.2 Political Institutions

My focus is on how democracy and different kinds of democracy affect the way distributive conflicts are resolved. The main theme follows the early insights of Knut Wicksell. Wicksell noted that how the state is financed is closely connected to how the state is ruled and that there are great gains to be had by analyzing them together (I elaborate more on this approach to the politics of taxation in section 1.4). How a state is ruled is commonly codified in a constitution. These codified laws are *formal political institutions*. Electoral institutions are those laws regulating how voter preferences are aggregated and turned into tax policy. Douglass C. North defined institutions as follows:

> Institutions are the humanly devised constraints that structure political, economic and social interaction. They consist of both informal constraints (sanctions, taboos, customs, traditions, and codes of conduct), and formal rules (constitutions, laws, property rights). (1991, p. 97).

Although informal institutions are important (they have been studied extensively in the literature on the politics of taxation),[12] I focus on formal institutions.[13] There is of course almost as many types of democracy as there are democratic states. Moreover, the types of democracies are constantly changing and what is meant by the very concept "democracy" constantly changes. The last issue is of less concern since I restrict myself to the period between 1800 and 2012

[12] For a recent attempt to assess the relative importance of informal institutions in the context of explaining tax compliance, see Zhang et al. (2016).

[13] Importantly, while I treat institutions as exogenous and concern myself with how they moderate the impact of ideology, they are also themselves the result of political, strategic choice. That is, actors deciding whether to democratize, and what institutions to employ, take the expected effects of these institutions into account (Acemoglu and Robinson 2000; Ahmed 2013; Boix 1999; Leemann and Mares 2014).

and to modern representative democracies.

Democracy as a method of governing a state is a key concept in all four papers. The first paper is concerned with the impact of democratization and the other three papers focus on variation within democracies. My argument focuses on how democracy extends influence to previously disenfranchised groups. Defining and classifying regime types has been a central part of political science since Plato's four (and later six) types of political regimes.[14] Plato's work and later refinements by Aristotle remained the starting point for analysis of political systems well into the nineteenth century (Almond 1996).

What a "democracy" really is has been an issue of continuous discussion within the discipline, and the definition used often varies depending on the question asked. One influential definition is from Robert A. Dahl, who proposes five criteria for a maximal/ideal democracy: effective participation, voting equality, enlightened understanding, control of the agenda, and inclusion of adults (1998, ch. 4). In real world large-scale democracies, Dahl instead talks about "polyarchy", which has six minimum requirements: elected officials; free, fair, and frequent elections; freedom of expression; access to alternative sources of information; associational autonomy; and inclusive citizenship (ibid. p. 85).

While Dahl's definition covered a range of factors important for a working democracy, others have gone in the opposite direction, defining democracy with a minimum number of conditions. For example, Joseph A. Schumpeter defines democracy as "that institutional arrangement for arriving at political decisions in which individuals acquire the power to decide by means of a competitive struggle for the people's vote" ([1943] 2003 p. 269). Similarly, democracy, according to Przeworski et al. (2000), is "a regime in which those who govern are selected through contested elections" (p. 15). In their empirical operationalization, they further emphasize that the executive office and legislature are filled in competitive elections whose results are respected and that they are free to rule without responding to some other body or person (such as a monarch). To be classified as a democracy, this process must be repeated and power must be peacefully transferred according to the outcome of competitive elections.

[14] The first four were timocracy, oligarchy, democracy, and tyranny, and the later expansion consisted of monarchy, tyranny, aristocracy, oligarchy, democracy, ochlocracy.

Boix, Miller, and Rosato 2012 have a related approach, but they are more directly influenced by Dahl. They focus on contestation *and* participation. For a country to be democratic, they believe an executive should "directly or indirectly [be] elected in popular elections" and should be "responsible either directly to voters or to a legislature" and the legislature (or executive) should be "chosen in free and fair elections." As for participation, to be democratic the franchise needs to be expanded to a majority of adult men, a factor not emphasized by Schumpeter (ibid. p. 1530).[15] These last concepts are dichotomous, but democracy is also frequently conceptualized and measured on a continuous scale (e.g., Polity (1995) and Freedom House (2016)).[16]

In sum, there are different ways to think about what democracy is, both theoretically and empirically. Since the key aspect of democracy in my argument is the inclusion of previously excluded groups, it is important that the definition includes participation. For this reason, I used the Boix, Miller, and Rosato 2012 definition (and data) in the first two papers.[17]

There is considerable institutional variation *within* the group of democratic countries. Although my focus is on one institution (the electoral system), I will briefly present some of the more important differences between modern representative democracies.

- The first is whether the head of government is elected in separate elections (like most presidents), or if he/she is appointed by the parliament. The first system is called *presidentialism* and the latter *parliamentarism*.

- Another distinguishing feature is the degree of centralization within a country. Some states consist of a *federation* of smaller units, often represented nationally in a separate assembly (e.g., the United States Senate or the German *Bundesrat*). Other countries are centralized, *unitary* states.

[15] Excluding female suffrage runs the risk of bias if women have different preferences than men (see Lott and Kenny (1999)). In the first paper, I use an alternative definition of democracy where full male *and* female suffrage is required as a robustness test. For more details, see Paper 1.

[16] For longer reviews of different empirical measures see Boix, Miller and Rosato (2012), Hadenius and Teorell (2005), and Munck and Verkuilen (2002).

[17] Empirically, I am restricted by data availability. Many indices measuring democracy do not cover the time period from 1800. See Paper 1 for more details.

- Some countries have two assemblies, usually referred to as an "upper" and a "lower" house. This feature is called *bicameralism*. Examples of upper houses include not only the Senate and the *Bundesrat* (representing territorial units) but also the *Seanad Éireann* in the Republic of Ireland (a unitary state). The important factor is that this is an additional body with influence over policy.

- Another key institutional feature is whether there is *judicial review* performed by an independent constitutional court.

- A final distinguishing feature is the type of electoral system used. The two main families are *majoritarian* and *proportional representation* systems.

Due to space limitations, I have just mentioned these institutions very briefly. For longer theoretical and empirical treatments, see Lijphart (2012), Persson and Tabellini (2003), and Powell (2000).

The institutional dimensions just mentioned are often used to categorize democratic states. For example, Lijphart (2012) distinguishes between "consensus" and "majoritarian" democracies, and Powell (2000) divides democracies based on how well they fulfill the proportional and majoritarian "visions". A key element in these and similar categorizations is the electoral system, an institution playing an especially important role in my argument in Papers 2 and 3 (but also in Paper 4 although in somewhat different role).

The term "electoral system" is broad and sometimes refers to slightly different things. For example, it might include how political parties internally select candidates, how the executive is selected, and elections at different levels of government. I use a rather narrow conception roughly equal to what Rae (1967) and Cox (1997) mean by "electoral law": the methods used for translating votes to seats in elections for the main legislative assembly (these include district magnitude, electoral thresholds, and electoral formula). The reason I restrict myself to this particular election is that assemblies are at the core of political power in democratic societies. Moreover, one of the key functions of the parliament is to make decisions pertaining to the budget. Indeed, one of the first tasks for parliaments historically was to approve new taxes.[18]

[18] See Burns and Kamali (2003) for an overview over the historical evolution of parliaments.

A key function of electoral systems is how votes are translated into seats. The results of this is often interpreted in terms of proportionality – i.e., how the distribution of votes among parties/candidates corresponds to the distribution of seats. The electoral formula, the district magnitude, and electoral thresholds all affect the proportionality of representation.[19] I follow earlier literature in distinguishing between two main types: majoritary/plurality (winner-take-all) and proportional representation systems (PR), what has been called "the most fundamental dividing line in the classification of electoral systems" (Lijphart 1999, p. 144) (see also Colomer (2004), ch. 1; Persson and Tabellini (2003); Powell (2000); and Rae (1967)). For example, Lijphart (1999) holds that "[m]ost electoral formulas fit the two large categories of PR and plurality-majority, but a few fall in between" (p. 149) (Lijphart found only a couple of elections, both in Japan, that do not fit in these two main categories.) While there are differences between them (e.g., simple majority versus plurality and varying district magnitude), the important differences are *between* the two broad categories rather than *within* them (Rae 1967).

The typical form of majoritarian system is single-member district plurality. In this system, the nation is divided into a number of geographical districts electing one candidate. The candidate with a plurality of the votes wins the seat.[20] The votes cast for other candidates are thus not represented.

The type of electoral system is strongly linked to the number of political parties. In an early analysis of electoral systems, Maurice Duverger 1954 predicted that plurality rule in single-member districts would lead to two party systems while proportional representation (PR) in multi-member districts would result in multi-party systems. Single-member plurality is associated with two-party competition for two reasons. The first is strategy on part of political parties and voters; the latter do not want to waste their votes on candidates with a small or no chance of winning a seat and the former have no incentive to field candidates that are not competitive. The second reason is that

[19] There are ways of summarizing several aspects of electoral systems into one measure, for example, Lijphart's effective threshold. However, countries generally fall into roughly the same three groups as they would if one were to focus only on the electoral formula: majority/plurality, PR, and mixed systems (see for example Table 2.1 in Powell 2000).

[20] In countries using a "majoritarian formula" instead of a plurality, it is common to have a run-off election between the two top candidates if no candidate reaches an absolute majority in the first round such as in French and American primary elections.

the formula translating votes to seats limits the number of feasible candidates. More specifically, the district magnitude sets an upper limit on the number of parties/candidates. This limit is the number of seats in the district plus 1 (Cox 1997). This means that PR does not deterministically lead to multi-party systems; it just allows it. Another important result reported in Cox (1997) is that the effects generally operate on the district level. This means, for example, that more than two parties may be viable *nationally* in a single-member plurality system if a party has strong regional support.

In PR systems, seats are allocated in proportion to votes received.[21] The district magnitude has the opposite effect here compared to plurality rule: the larger the district, the higher the proportionality.

The important aspect in my theoretical framework is how the electoral system affects the concentration of power and opposition influence. The difference between the two systems with respect to this aspect is stark: majority/plurality systems concentrate power in the majority, excluding minorities from influence, whereas PR leads to broad representation of diverse groups, who often rule in coalitions. For example, in Lijphart's (1999) analysis, over 43% of the governments in plurality-majority systems were *manufactured*[22] majorities, compared to only 9.4% in PR systems. Moreover, 57.9% of governments in PR systems were natural minorities. As Powell (2000) (ch. 2) points out, even without strategic voting, majoritarian/plurality rules in single-member districts manufactures legislative majorities, often with large disproportionalities between number of votes and number of seats. This is elaborated upon in Paper 2 and Paper 3. The next section reviews earlier literature on taxation and its relation to modernization, economic growth, interstate warfare, and democracy.

[21]The most common type of PR is a system where voters cast ballots for party lists. But there is also the so-called mixed-member PR and the single transferable vote. Moreover, there are many different mathematical formulas that are used to allocate votes to parties. The interested reader is referred to Lijphart (1999) (ch. 8) for a brief overview.

[22]Majorities that are a direct result of how the electoral system transform votes to seats.

1.3

Taxation: Causes and Effects

Taxation – and public finance more broadly – is a central component in many of the earliest treatises on statecraft, from Pseudo-Aristotle's *Oikonomikos* and Kautilya's *Arthashastra* in the fourth and second century BCE, respectively, to Ibn Khaldûn's *The Muqaddimah* in the fourteenth century CE. Later works include Francesco Guiccardini's *La Decima Scalata* in sixteenth century Florence and Adam Smith's *The Wealth of Nations* in eighteenth century Scotland. The more immediate predecessors are the late nineteenth and early twentieth century economist Knut Wicksell and his intellectual successors Erik Lindahl, Richard Musgrave, and James M. Buchanan, but also the fiscal sociology tradition with key contributions by Rudolf Goldscheid and Joseph A. Schumpeter. Lately, this topic has generated renewed interest (e.g., Martin, Mehrotra and Prasad (2009); Monson and Scheidel (2015); Yun-Casalilla and O'Brien (2012)).

The link between taxation and the development of modern states has attracted researchers from sociology, economic history, economics, and political science. In this overview, I have divided contemporary research into four main camps, relating taxation to modernization, economic growth, interstate warfare, and democratization. However, many of the topics and authors cross the artificial boundaries set up here, and the categorization is made more for presentational purposes than to reflect clearly defined intellectual borders.

TAXATION AND MODERNIZATION

How taxation and institutions are related have long been studied by sociologists, economists, and political scientists. One of the earliest empirical investigations of the determinants of tax structure was Hinrichs (1966). Building on social mobilization theory (e.g., Deutsch 1961), Hinrichs proposed that countries go through different stages of taxation during the course of economic development. Direct taxes on land dominate at very low levels, but with modernization countries shift to taxes on trade up to a certain level where the most modern states go back to a revenue system that relies mainly on direct taxes (in particular on income). Importantly, economic development does not lead deterministically to one particular tax system; modernization makes more tax tools available for the state, leading to greater variability of tax systems among developed states. Richard Musgrave describes this change in tax systems as follows: “If the availability of tax handles places a constraint on total expenditures in low income countries, it may be expected to do so even more with regard to the tax structure mix. This constraint again loosens as per capita income rises, and in high income countries the composition of the revenue structure becomes a free policy choice” (1969 p. 147). Hinrichs argues that the observed variability is a function of the rather opaque concept of “cultural-political” preferences (1966 p. 39.).

Modernization is also related to administrative capacity, another important factor in determining tax policy choice. Aidt and Jensen (2009) argue that an effective income tax can only be implemented if a certain level of tax collection technology is reached, and this technology in turn is a function of the level of education, urbanization, and the existence of an updated census. Similarly, Coşgel and Miceli (2009) posit that the evolution of tax collection methods can be traced to changes in bureaucratic capacity, costs of measuring the tax base, costs of monitoring, and the variance in the tax base. Others have tied economic development and tax systems together by highlighting low fiscal capacity as a key impediment for economic growth. Investing in tax capacity is a crucial challenge for developing countries (Besley and Persson 2011, especially chapter 2). Importantly, solving the investment dilemma depends on how political institutions shape the distribution of power in the future (ibid.).[23]

TAXATION AND ECONOMIC GROWTH

Another dimension of the politics of taxation is concerned with how taxation is related to incentives, economic growth, and compliance. If taxes are too high, people will choose to produce less or try harder to avoid/evade paying the taxes they owe. This observation is one of the oldest – and most recurrent – in the historical literature on taxation.

Writing at the dawn of the industrial revolution, Adam Smith stressed that “[e]very tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible, over and above what it brings into the public treasury of the state” ([1776] 1904, p. 311). Raising tax rates above a certain point reduces tax revenues since it also decreases productive activity and encourages

[23] The fourth paper of the dissertation concerns a related problem when considering different democratic institutions, but finds that there is a trade-off between investments and crisis management.

avoidance and evasion.[24] And a couple of centuries later, Schumpeter argued that "the tax state must not demand from the people so much that they lose financial interest in production or at any rate cease to use their best energies for it" and "there exists a level beyond which further tax increases mean not an increase but a decrease of yield" ([1918]1991, p. 112-113). In short, it has long been recognized that "just the right amount" is key to a sound tax policy. Importantly, Schumpeter linked this to constitutions when he argued that a broader *political* base allows for a broader *tax* base (ibid.).

The point that taxation affects overall output has spurred an enormous wealth of research in optimal taxation (for early contributions see Ramsey 1927 and Mirrlees 1971). This tradition usually analyzes taxation with the goal of maximizing social welfare. A common omission in optimal taxation theory is administrative costs, an important issue in real world tax policy reform. This means, for example, that while in (some) theories different goods should be taxed at differentiated rates according to their demand elasticities (e.g., Ramsey 1927), a real world optimal consumption tax involves fewer rates since administrative costs increase with the number of different rates (Slemrod 1990). Even more problematic is that optimal taxation theory in general ignores the political process behind tax policy and does not consider the possibility that political actors may maximize something else than social welfare (Slemrod 1990; Wicksell [1896] 1958). Since political actors not only are interested in taxing efficiently but also are concerned with the distributive impact of taxes and how the revenue is spent, it is unrealistic to expect these actors to implement optimal taxes from the point of view of aggregate social welfare. This is especially important in democracies where tax policy is usually the result of struggle and compromise between different groups typically represented by political parties rather than the enlightened decision of a benevolent social planner. In short, taxation is just another tool politicians use to win elections. There is evidence of this view in recent work on consumption taxation. For example, James (2015) argues that although the modern value-added tax (VAT) was introduced mainly with reference to efficiency, the real VATs actually introduced were far from the theoretical constructs in the optimal taxation literature and more the result of political conflict and compromise. For example, although the (modern) theoretical ideal prescribes one (or a few) uniform rate over all goods and services, real

[24] This relationship is known to most social scientists as "the Laffer curve", named after the American economist Arthur Laffer (Wanniski 1978), but was pointed out already by Ibn Khaldun in the 14th century.

world VATs are characterized by differentiated rates and exemptions (ibid.).

TAXATION AND WAR

While only indirectly related to institutions, this overview would be incomplete without mentioning the impact of interstate warfare. The argument is that war provides a way out of the vicious circle of low tax revenue and low state capacity through the extreme demands war puts on the treasury. As mentioned before, Schumpeter saw war as the main driver behind the evolution from the domain state of medieval Europe to the modern tax state. A version of this argument is that war was an urgent factor forcing rulers to make representative concessions in exchange for taxation, setting in motion the "taxation for representation" dynamic that ended in democracy (Tilly 1990).[25]

Important contributions stress the importance of war or war pressure as factors leading to increased levels of taxation as well as inducing governments to invest in new types of taxes (Besley and Persson 2009; Herbst 2000 ch.4; Hintze 1970; Karaman and Pamuk 2013; Scheve and Stasavage 2010; Tilly 1990).[26]

However, it is not necessarily warfare itself that provides the shock to which the state responds with tax reform. Based on a comparative historical case study of England, Japan, and China, He (2013) argues that severe fiscal crises, which could be but does not have to be connected to warfare, led to the centralization and modernization of fiscal systems. Which taxes were centralized depended on the economic structure at that time and place. Moreover, centralization made it possible for the state to leverage long-term loans to finance further reforms of the revenue system.[27]

However, war (or a crisis) is by no means a sufficient or even necessary condition. Schumpeter (rather dramatically) pointed out with respect to the New Deal in the United States that "irrespective of the war, a tremendous transfer of wealth has actually been effected, a transfer that quantitatively is comparable with that effected by Lenin"

[25]The link between taxation and democratization is discussed in more detail in the next section.

[26]The affinity between warfare and government revenue was even emphasized by Thucydides in *History of the Peloponnesian War*. For an excellent analysis of the relationship between war and state finances in Thucydides, see Kallet-Marx (1993) and Kallet (2002).

[27]It has also been claimed that economic crises have been a catalyst for reform in more recent times (see for example Drazen and Grilli (1990)).

(Schumpeter 1947 p. 382). Many countries also introduced the income tax when there was no war. For example, when Sweden introduced an income tax in 1810, it was the influence of peasants that was crucial (Åkerman 1967).[28] Another powerful critique of the link between taxation and warfare is that this view has mainly been informed by the European experience. Centeno (1997), for example, has questioned the validity of the argument in Latin America. A further issue is path dependency. Morgan and Prasad (2009) argue that warfare tends to amplify existing patterns of taxation rather than changing the system completely. That is, war leads to an expansion of existing taxes, not the implementation of new ones. Finally, there are other ways to finance war. For example, tying tax payments directly to the war effort through allotment systems (or similar methods) turns the tax into a fee and resistance to taxation can be reduced.

TAXATION AND DEMOCRACY

The slogan "no taxation without representation" is commonly associated with the complaints of American colonists in the mid eighteenth century, leading up to the American Revolution.[29] The notion that expansion of taxation led to democratization is widespread in explanations of the rise of the modern state in Europe (see North and Weingast (1989) and Schumpeter [1918] (1991)). This literature points to the fact that increased levels of taxation led to rising demands for representation that in turn led to democracy (important contributions include Bates and Lien (1985), Herb (2005), Moore (2004), and Ross (2004), but see also Boucoyannis (2015) for a different view).

A related idea is that of the "resource curse": an abundance of natural resources impedes democratization since it allows the state to operate without having to resort to taxation (Ross (1999,2001)). A version of this argument is that democracy in itself reflects a commitment

[28]This was possible because the fourth estate – the peasants – needed to approve the new constitution. And without a new constitution Sweden could not negotiate a peace with Russia (since the king had recently been deposed in a coup d'etat). That is, the peasants had a unique opportunity where they actually had influence, and they took it. The tax was removed only a couple of years later, although it did yield significant revenue (Åkerman 1967). Importantly, the tax was not introduced because of revenue needs associated with war, but because of peasant influence and their tax preferences.

[29]Importantly, it was not taxation itself that sparked the protest known as the Boston Tea Party, but *unjust* taxation. Specifically, the British Parliament had recently passed a tax exemption for the East India Company, an exemption unavailable for the American colonists (Thorndike 2013, p. 2).

to redistribution. The existing political elite in a nondemocratic society wants to prevent a possible revolution from the lower classes but cannot use redistribution as appeasement since the promise of redistribution is not credible over time. An extension of political rights changes the equilibrium distribution of power and therefore serves as a commitment device leading to more redistribution and a lower risk of unrest (Acemoglu and Robinson 2000; Boix 2003). However, democracy might not be stable if the level of inequality (and thus redistribution) is so high that the former elite mounts a coup (Acemoglu and Robinson 2001, 2006). This rendering of the argument has been criticized by scholars who claim that intra-elite competition is the main determinant of democratization (Ansell and Samuels 2014).

Some of the models of democratization mentioned above, in particular Acemoglu and Robinson (2006) and Boix (2003), are based on the anticipated impact of democracy on taxation. That is, the behavior of the elite in non-democracies is contingent on what they expect the effect of democracy on taxation will be. This expectation is based on the notion that demand for redistribution is a main determinant of tax policy (Alt 1983). One of the most influential theories linking institutions to tax policy posits that democracy leads to redistribution. The argument is based on the median voter theorem (Black 1948; Downs 1957; Hotelling 1929) and the distribution of income among voters. In a democracy, the median voter sets the tax rate, and if the income of the median voter is lower than the mean income, the rate will be redistributive. This means that for a given inequality of income, extending suffrage to the poorer segments of society will lower the income of the median voter and thus increase redistribution (Meltzer and Richard 1981; Romer 1975). While theoretically straightforward, the empirical evidence is mixed, with some reporting results in support of the theory and others rejecting it (Ansell and Samuels 2010; Lee 2005; Lindert 2004; Mares and Queralt 2015; Mueller and Stratmann 2003; Scheve and Stasavage 2010). In my first paper, I build on this literature, arguing that the effect of democratization on redistribution depends on the tax preferences of the previously disenfranchised, preferences that vary depending on urbanization.

Within democracies, scholars have highlighted several important institutional features for tax policy outcomes. For example, proportional representation (PR) electoral systems have been linked to larger governments and more redistribution (Austen-Smith 2000; Iversen and Soskice 2006; Persson and Tabellini 2003; Steinmo and Tolbert 1998). However, recent evidence suggests that this is a modern development, reporting a negative effect of PR in the time before the Second World War (Aidt and Jensen 2009). The impact of electoral systems is also closely connected to geography since district size and formula have different effects depending on the spatial distribution of voters (Rodden 2010, 2011). Earlier research emphasizes the distinction between presidential and parliamentarian systems (Hettich and Winer 1999), where presidential countries are associated with smaller governments and less redistribution than parliamentarian countries (Persson and Tabellini 2003).

While political institutions certainly matter, the input side of politics (e.g., the ideology of political parties) also plays a role. Scholars have explored a range of topics such as the impact of ideology on the size of government, unemployment, and welfare spending (e.g., Cameron 1978; Hibbs 1977; Hicks and Swank 1992). Among the findings are that left parties are associated with larger governments (Tavits 2004), more redistribution (Bradley et al. 2003; Iversen and Soskice 2006), and (under some conditions) higher taxes on labor (Beramendi and Rueda 2007; Cusack and Beramendi 2006). While this suggests that partisanship matters, others find that government ideology has no impact (see Imbeau, Pétry and Lamari 2001 for a meta study). There is also recent historical research questioning the relationship between the left and redistribution. For example, Scheve and Stasavage (2010) found that mass warfare was an important determinant of tax progressivity during the First World War in Europe, but they found no effect of left party influence. Others have shown that, contrary to expectation, the first income taxes were adopted by conservatives in political systems with very limited suffrage (Mares and Queralt 2015). Since tax systems are strongly path dependent (Morgan and Prasad 2009), this exemplifies the potential of historical research to contribute to these debates.

Focusing mainly on the post Second World War era, several scholars emphasize the co-development of taxation and the welfare state (Beramendi and Rueda 2007; Bradley et al. 2003; Cusack and Beramendi 2006; Ganghof 2006; Kato 2003; Kemmerling 2009; Steinmo 1993). However, the nature of this relationship is contested. Some argue that an efficient tax system (in terms of generating revenue) facilitated a large state (e.g., Kato 2003), whereas others claim that spending pressure caused the state to increase revenue capacity (e.g., Ganghof 2006).

Somewhat ignored is the fact that the effect of democracy, especially considering franchise, depends on the underlying distribution of preferences. These preferences vary both between countries and within countries over time, making it problematic to assume a uniform effect of democracy on tax structure. The structure of the economy also matters for how we should think about political parties (Lipset and Rokkan 1967). For example, farmers were an important force in nineteenth century Scandinavia, and this group does not necessarily share the tax preferences of the urban working class (Baldwin 1990). Moreover, how these cleavages affect policy is different in democracies and non-democracies (Olper 2001; Thomson 2016). As I will argue in the next section, it is important to be clear about the distributive impact of different taxes and then link these to the preferences of the previously disenfranchised. In Paper 1, I conclude that the influence of democracy on tax structure depends on the geographic distribution of voters.[30]

The impact of ideology is not uniform either. How a party achieves its goals depends on the actions of other parties and how the rules of the game (i.e., political institutions) shape their interaction. Earlier research on the influence of ideology is either undertheorized or based on several assumptions not made explicit. In this dissertation, I clarify the connection between preferences for equality and different approaches to redistribution, and present quantitative (Paper 1 and 2) and qualitative evidence (Paper 3) to support my argument.

1.4

Taxation and Constitutions: How the Papers Fit Together

My theoretical starting point is that rule by the many or rule by the few matters. Moreover, how the state is ruled affects its *goals*. Or more specifically, the rules of government (i.e., its political institutions) determine how those in power secure their power and how they interact with other groups, which by extension relates to how ruling groups design and implement policies.

Analyzing the state as an agent is common when focusing on compliance where the state and citizens engage in contracting and bargaining. For example, Levi (1988) assumes that the ruler or the state has

[30] The general point that geography matters is not novel – see, e.g., Baldwin (1990), Lipset and Rokkan (1967), Rodden (2010), and Thomson (2016).

its own utility function with one argument, revenue maximization. This perspective is also common in the optimal taxation and welfare economics literatures. However, I follow the approach advocated by Knut Wicksell by treating the state as an arena where different groups compete for power, groups that do not see the welfare of the society in general as their goal: "[T]he members of the representative body are [...] precisely as interested in the general welfare as are their constituents, neither more nor less" (Wicksell [1896] (1958), p. 87). From this viewpoint, political institutions define the context in which the competing preferences of these groups are translated into policy. Moreover, the relevant bargaining is *not* between the ruler and the people, but between different representatives *of* the people. This approach sees politics and political conflict as the main input variable, and political institutions as the process whereby these conflicts are resolved. In the end, this conflict produces observable tax policy. In this section, I outline some intellectual forerunners and discuss important definitions and assumptions. In particular, I flesh out who the relevant actors are, what their preferences are, and what institutional contexts regulate their interaction.

Following Wicksell, the starting point tying the papers together is that taxation and political institutions are inextricably linked. Wicksell is famous for two ideas in the second essay of his *Finanztheoretische Untersuchungen*: taxation and expenditure should not be separated and the near unanimity rule. The first claim has been interpreted mainly in normative terms and influenced James Buchanan's work on fiscal constitutions.[31] The second claim – the near unanimity rule – can be interpreted both normatively and positively. Wicksell, writing at a time when suffrage was severely limited in Sweden, states explicitly that he expects an expanded franchise to lead to heavier taxes on the rich because of increased influence of the poor, and uses this as an argument that the rich should reform the public finance process so that taxation is tied to expenditure.

The modern research in this tradition was sparked by the seminal papers by Romer (1975) and Meltzer and Richard (1981). Their models are in a sense refinements of the intuitive notion that democracy leads to redistributive taxation. However, their iteration of the argument is

[31] The two main intellectual heirs to Wicksell are James M. Buchanan and Richard A. Musgrave, affiliated with the approaches *public choice* and *public finance* respectively. For a concise summary of these two approaches, see Buchanan and Musgrave (1999).

constrained in that it is wedded to the median voter theorem as the main political mechanism translating preferences into policies, thereby ignoring real world institutions. But, as Powell (2000) has shown, real world democratic constitutions vary considerably in their ability to represent the median voter.

The papers in this dissertation are part of the same tradition, acknowledging the central importance of formal political institutions with respect to taxation. In terms of theoretical structure, they are more specific than Wicksell, but they are not wedded to a specific model translating preferences to policy (such as the Meltzer and Richard (1981) model). Instead, the papers emphasize the diversity of institutions in the real world and how these institutions have real effects on tax systems. The papers are also concerned with a specific, although fairly long, period (1800-2012), where factors such as industrialization, urbanization, and mass party democracy driven by modern ideologies are central.[32] As mentioned above, this is critical when discussing terms such as "ideology", "political parties", and "democracy". Moreover, as was pointed out by Tilly (1990, ch. 2), the threat of collective action by the new industrial working class presented new challenges and opportunities for rulers.

On a general level, all papers in this dissertation use the same underlying model of politics. This model assumes that voters prefer policies that align with their economic self-interests and act accordingly. Voters are represented by political parties. How elections are won – and by extension how voters' preferences are represented – and how policy is made is determined by formal political institutions. It is important to note that there is a distinction between parties' preferences with respect to taxation and their ultimate goals. It is common to identify three key goals motivating parties: policy, office, and votes (Müller and Strøm 1999). My theoretical argument is on a lower level of abstraction, making it difficult to distinguish between these three motivations. Any behavior seemingly in line with a party being policy motivated can equally be the result of a party seeking office or votes. Moreover, parties might seek votes to gain office in order to affect policy. For example, if a party has a preference for income taxation it can be consistent with the party being motivated by policy but it can also be consistent with the notion that policy is just an instrument to achieve the goal of attaining votes and/or office. For my argument it is not necessary to make any assumptions regarding the ultimate goal of parties, the important factor

[32] Paper 1 is concerned with the entire period from 1800 to 2012, Paper 2 focuses on 1870-1945, and Paper 3 is concerned with the post Second World War era.

is that parties have divergent preferences over taxation and that these preferences are linked to those of the voters (for a discussion about different goals behind party behavior in general, see Müller and Strøm (1999)).[33]

All four papers assume that actors behave rationally. Rational behavior can be seen as "behavior that shows [...] goal-directedness to a particularly high degree and in a particularly consistent manner" (Harsanyi 1977, p. 17). More specifically, an agent is rational if he can rank actions based on the utility they yield, that he chooses the action yielding the highest utility, and that if he prefers A over B and B over C, then he prefers A over C. Rationality as internal consistency of choice is used by classics such as Arrow (1951) but also by contemporary textbooks like McCarty and Meirowitz (2007), usually referred to as *complete* and *transitive* preferences.[34]

While the rational choice approach has not performed well when trying to explain individual human behavior such as turnout, it has been more successful in explaining party competition and economic effects of constitutions and ideology (Bendor et al. 2011, ch. 1). Assuming rationality brings order to actors' behaviors that are needed for theoretical analysis. This assumption is especially important in Paper 4 (which uses game theory) since "even in very simple game situations (involving only two players and having a rather simple logical structure in other respects) it may be virtually impossible to suggest reasonable hypotheses about the players' likely behavior without having a clear systematic idea of what it means to behave *rationally* in the relevant class of game situations" (Harsanyi (1977), p. 18). If we do not make any assumptions regarding the behavior of agents (i.e., if their actions are random with respect to their goals), then an analysis of how institutions affect outcomes of distributive conflict becomes difficult, if not impossible. In the words of Harsanyi:

> [W]e cannot really understand and explain a person's behavior (or indeed the behavior of another intelligent organism or even of an intelligent robot) unless we can interpret it *either* as *rational behavior* in this particular situation *or* as an *understandable deviation* from rational behavior. For example, we may be able to interpret it as an understandable

[33] Assumptions with respect to the basic motivation of parties are more important when analyzing coalition formation and minority governments (e.g., Strøm 1990).

[34] McCarty and Meirowitz (2007) distinguishes between "thick" and "thin" rationality, where the former includes specifying the goals of actors while the latter is just about behavior, not the goals as such.

> mistake, as an understandable emotional reaction, or as an understandable intentionally suboptimal response. (1977, p.18, emphasis in original).[35]

In sum, political agents are assumed to act rationally to attain their own goals, not societal welfare. These rational actors often find themselves in what I refer to as a "strategic situation". A strategic situation is "when anyone premises her instrumental actions on what she expects some relevant others might do" (Johnson 2010, p. 283).[36] The politics of taxation reflect strategic interdependence where institutions regulate how players interact.

ACTORS AND PREFERENCES

When considering the preferences of political actors and who they represent, it is important to be precise. In fact, one of the main causes of confusion and debate in the literature on tax policy is a lack of clarity on this point. A recurrent theme in my dissertation (especially in Paper 2 and Paper 3, but also in Paper 1) is that preferences related to taxation, in particularly with regards to redistribution, are often ignored or treated too simplistically by earlier research.

In his 1986 Nobel Lecture, James M. Buchanan (1987) called for behavioral consistency, arguing that analyzing actors in the marketplace should be no different than in politics: "[T]he choice behavior of the individual is equally subject to the application of analysis in all choice environments. Comparative analysis should allow for predictions of possible differences in the characteristics of the results that emerge from market and political structures of interaction" (p. 245).[37] But, as mentioned in the previous section, this idea is much older as Wicksell argued that in a democratic context government policy is not the outcome of a benevolent social planner but of self-interested parties. Parties need to bargain in order to reach their goals, and the compromises as the result of political negotiations in no way guarantees that the best interest of the population is prioritized.

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[35] An example of an "understandable intentionally suboptimal response" is a chess move, since humans lack the cognitive abilities to calculate the optimal move in a complicated game as chess every move is intentionally suboptimal (Harsanyi (1977), p. 292).

[36] Note that this is different from a decision-theoretic situation in which the probabilities used in expected utility calculations are exogenous (i.e., set by "nature") (Tsebelis 1989).

[37] This is also the approach taken by Anthony Downs in his *An Economic Theory of Democracy* (1957).

I treat political parties as representatives of economic classes. Analyzing tax policy in terms of class conflict is not new, and this conflict is commonly analyzed in terms of demand for redistribution (Alt 1983). Regardless of whether one is interested in the effect of democratization or the impact of ideology, one needs to make assumptions about how tax preferences are formed and how they are translated into policy. In his seminal *Essays on Taxation*, Edwin Seligman points out the importance of conflict between economic classes such as farmers, urban workers, landed elites, and capitalists when explaining modern tax systems. In fact, Seligman holds that "[t]he history of modern taxation is largely the history of these class antagonisms" (1921, p. 14, cf. Hinrichs 1966).

A common starting point in the literature is to consider only two groups: the rich and the poor. The poor wants to redistribute resources from the rich to themselves and since the poor are more numerous than the rich, democracy will lead to the poor controlling government and implementing redistributive policy (see Acemoglu and Robinson 2001; Meltzer and Richard 1981). Implicit in these models are assumptions regarding the tax and spend systems, their impact on economic inequality, as well as assumptions about the identity of relevant groups and their preferences. Consequently, these models perform best in a framework in which government policy is also very simple (pro-rich or pro-poor). However, tax systems are much more complex, and so are economic interests in society. First, "the rich" is not a homogeneous group with identical preferences over taxation; for example, landed elites have different economic preferences than urban elites (Ansell and Samuels 2014; Mares and Queralt 2015). Moreover, I present evidence in the first paper suggesting that the urban poor have different preferences than the rural poor and that this difference affects how democracy function. Similarly, ethnic heterogeneity influences how states, specifically democracies, prioritize social spending, suggesting that ethnic identity among the poor matters (Jensen and Skaaning 2015). That is, the actors in the first paper are voters, and their preferences are influenced by sector (urban or rural).

In Paper 2 and Paper 3, the actors are political parties representing economic classes. To discuss parties' tax preferences, tax incidence – i.e., what groups carry the burden of a specific tax – is key. As mentioned above, it is common to distinguish between "progressive taxes" – falling relatively heavier on the rich – and "regressive taxes" – falling relatively heavier on the poor. Traditionally, income and property taxes are viewed as progressive taxes, whereas consumption taxes are viewed as regressive taxes. A simple model assumes that parties to the left, which typically presume to represent the poor, prefer to shift taxation from regressive to progressive taxes. But this is too simplistic. We also need to consider the impact on total tax revenue and by extension the spending programs in place. That is, more tax revenues mean more funds available for government programs, and the effect of these programs can more than make up for the distributive effect of taxation (Engel, Galetovic and Raddatz 1999). As Alt (1983, p. 193) notes that "[a]ny political account of redistribution must deal with the fact that those seeking redistribution may choose to pursue it through benefits *or* taxation" (my emphasis). This general argument – that one cannot focus solely on taxes or expenditures when considering the impact of a tax – was articulated by Wicksell in 1896, and was later picked up and developed by Buchanan in 1949. Buchanan argues that if benefits from government spending are equal for all, then we can focus solely on taxation and if they are not, we cannot study taxation in isolation: "It is impossible to speak of the 'burden of taxation' without considering, at the same time, the benefits from expenditure made out of such taxation" (Buchanan 1949, p. 501). When examining the preferences of political actors over taxation, we need to consider what assumptions are made regarding spending, because, as Buchanan puts it, "[t]he statement that progressive taxation will redistribute incomes but that proportional taxation will not implies that benefits are returned to individuals in proportion to incomes and wealth [...] [t]he same amount of redistribution may be as well accomplished by the levy of a sales tax to provide expanded social services as by an increase in the higher-bracket income-tax rates to finance additional defense expenditure" (ibid. 503). Moreover, it has been shown that proportional (or even regressive) taxes under certain conditions yield a higher overall revenue, freeing up more resources for spending (Engel, Galetovic and Raddatz 1999). This means that an actor wishing to redistribute resources in society might prefer *less progressive* taxes, if the taxes provide better opportunities to redistribute wealth and income using government expenditures. This reasoning involving both taxing and spending was prevalent in British and Swedish tax policy in the post-war era (see Paper 3).

In sum, expenditures should be considered when analyzing the tax preferences of different groups. Moreover, a proper understanding of the politics of taxation requires a more nuanced approach than merely relying on the rich-poor and progressive-regressive dichotomies.

INSTITUTIONS

Preferences over taxation are key to understanding tax policy change since they determine the goals actors pursue in the political arena. However, equally important is the fact that the outcome of this conflict is shaped by the rules of the game – i.e., political institutions. In the first paper, the independent variable is democratization, a major institutional change. Paper 2 and Paper 3 examine how the electoral system shapes left-wing tax strategy. The fourth paper contrasts institutions that *concentrate* power with those that *share* power.

When we have a minimal definition of the behavior of the actors, we can consider the role institutions play in the outcome of political conflicts over taxation. Writing in a time before universal suffrage, Wicksell was not only concerned with how the enfranchisement of the working class would affect tax policy but also with how different constitutional rules would shape this effect. In Wicksell's ideal political system, government projects generating a net benefit would always be implemented since taxes and spending can spread the gains.[38] In practice, the so-called unanimity rule would hardly be feasible, but he considered the proportional representation electoral system to be a close approximation since it shared power broadly (as compared with plurality systems) (Wicksell [1896]1958). While Wicksell did not ignore the problem of credible commitments, he did not present a deeper analysis of the timing of costs and benefits or the future distribution of political power (for a discussion of this key issue see Powell 2004).

The temporal nature of a policy and the possibility of credible commitments are crucial when considering tax reform. As Besley and Persson (2011, ch. 2) point out, a main problem in politics is that change of power leads to short-sightedness: Why take on costs today if one cannot be certain to reap the benefits tomorrow? This is especially problematic in tax policy, as taxes are more persistent and harder to change than expenditures (Alt 1983). Moreover, many social programs have insurance-like properties (Iversen 2005) that will take time before they affect inequality. Therefore, introducing a tax today that hurts voters in the short term but leads to a higher fiscal capacity, which can be used to compensate those voters through social programs, is risky if you lose power. Since different political institutions allow for different degrees of opposition influence (Powell 2000), political parties adapt their redistributive strategies to cope with political risk.

[38] A similar argument based on constitutional veto points is presented in (Lindvall 2010).

For example, even though left-wing parties have similar preferences regarding redistribution, they will use different tax strategies depending on the institutional environment (see Paper 2 and Paper 3).

The question of time not only affects decisions to invest in a new tax (or reforming an old one) but also affects how governments respond to short-term crises. While several scholars have analyzed the influence of institutions on the trade-off between stability and flexibility/adaptability (e.g., MacIntyre 2001; Tommasi, Scartascini and Stein 2014; Tsebelis 2002), we identify a trade-off between being able to deal with short-term crises and overcoming investment dilemmas. Paper 4 shows that institutions encouraging investments (e.g., fiscal capacity) are less apt at responding to short-term crises.

SUMMARY

The main point in this section – as well as underlying all four papers – is that we need to think carefully about who the actors are and what they really want. When we have a clear conceptual understanding of the actors and their motivations, we can formulate precise hypotheses regarding the influence of political institutions on policy outcome (Paper 1). Institutions affect how actors choose to pursue their interest (Paper 2 and Paper 3) as well as their ability to overcome investment dilemmas and respond to sudden crises (Paper 4).

Paper 1 describes how democratization allows previously disenfranchised groups to participate politically. Urbanization is a proxy for their diverse tax preferences. Although the independent variable is democratization, the actor is a voter. In practice, in democracies voters are represented by political parties. Therefore, although the proper actors are voters, their role is implicit since the independent variable is an institutional change. Urban and rural voters have different tax preferences: rural voters often want lower property taxes and higher income taxes, whereas urban voters often want to shift taxation from consumption to property and income.

In Paper 2, the actors are left-wing political parties and they want lower economic inequality (compared with the preferences of right-wing parties). The optimal strategy is conditioned by electoral institutions.

In Paper 3, the actors are left-wing parties and trade unions. These actors can also be viewed as a labor movement coalition with two veto players: left-wing parties and peak trade union organizations. The preference of this coalition is lower inequality and how they seek to attain this goal is affected by how institutions structure temporal risk.

In Paper 4, the actors are once again political parties, but this time in a more abstract sense. That is, we do not analyze them in terms of "right" or "left". The parties have different preferences over spending on two goods provided by the government. The degree to which their preferences diverge is allowed to vary and is important for the likelihood of crises being averted and political investments made.

Table 1 lists the actors and their preferences in all four papers. The reader will find a longer discussion about the actors, their preferences, and the impact of institutions in the individual papers.

Table 1: Actors and Preferences

	Actor	Preference
Paper 1	Rural voters	Lower property tax and higher income tax
	Urban voters	Shift from consumption taxes to income and property taxes
Paper 2	Left-wing parties	Redistribution
Paper 3	Left-wing parties and unions	Redistribution
Paper 4	Parties	Levels of government spending on two goods

1.5 A Note on Research Design

When investigating claims regarding tax structure change over time, previous research has been severely constrained by a lack of comparative public finance data with broad geographic and temporal coverage. Comparative information about historical tax revenues for a large cross-section of countries is crucial for a comprehensive investigation of the root causes behind the evolution of tax systems. As Lord Kelvin once wrote: "When you cannot measure [...] your knowledge is [...] meagre [...] and [...] unsatisfactory".[39] The dataset presented in this

[39] This is the version of the quotation carved into stone in University of Chicago's Social Science Research Building at 1126 East 59th Street in Chicago. For a

dissertation will for the first time allow a measure of the development of taxation in as many as 31 countries.[40]

Studies using a small number of countries – e.g., a handful of European states – run the risk of drawing conclusions based on very specific circumstances, such as the impact of regional wars. On the other hand, analyzing a large cross-section of countries but only for a short time ignores important historical variations in many of today's advanced democracies. Moreover, tax systems are strongly path dependent, which means that understanding a tax system's history is crucial if we want to explain the variation in tax systems today (Morgan and Prasad 2009). To learn how today's rich nations overcame the problem of fiscal capacity or how democracy affected early tax decisions, we need to cover a much longer period than previous research.

The first two papers use statistical analysis to test theories regarding long-term patterns in taxation and political institutions.[41] While useful for testing hypotheses concerned with broad patterns and general associations, macro data is less useful when evaluating the theory on a micro level. Often, especially when there is no random variation, several explanations fit the observed patterns, implying that even though associations exist, it is not possible to verify which explanation is most valid.

Qualitative case studies are generally praised for their ability to shed light on the causal process at the micro level as well as causal ordering. Cases can be chosen in a way to facilitate this exploration, but cases can also be chosen with the purpose of estimating a casual effect in mind (e.g., Geddes 1990, and King, Keohane and Verba 1994). In fact, much of the criticism of studies with small sample sizes (i.e., small-n studies) starts from the assumption that the ultimate goal is the estimation of causal effects. If that is the case, then there are some issues that cannot be avoided; after all, observations and variation are crucial when estimating the impact of a variable, and small-n studies per definition have fewer observations. Often the advice seems to be "increase the number of observations". This advice has two problems: first, it is not very helpful as case studies are often very time consuming

thorough treatment of the quotation, its history, and Jacob Viner's famous response "When you can measure it, when you can express it in numbers, your knowledge is still of a meagre and unsatisfactory kind", see Merton, Sills and Stigler (1984).

[40]But, as Koopmans (1947) reminds us, pure empiricism is bound to be inferior to clever use of theory together with observation and measurement.

[41]Since the statistical challenges associated with this particular data structure are quite technical, I refer the reader to the methods sections in Paper 1 and Paper 2.

and it is rarely possible to research more than one or a couple of cases and second, it is a bit confused since what is meant by "observations" differs between quantitative and qualitative approaches.

One suggestion for why the concept of "observation" changes when moving from quantitative to qualitative work is that the former examines *data set* observations, whereas the latter examines *causal process* observations (Collier, Brady and Seawright 2004).[42] In effect, this means that one case is not one observation, but consists of several observations in sequence, an approach that is developed in process tracing methodology (see George and Bennett (2005) for an introduction).

Another source of confusion concerns generalizability. A key element in a quantitative design, apart from estimating the causal effect, is to generalize. But the goal of a case study is often somewhat different. As Mahoney (2010) argues: "Case studies seek to tell us why particular outcomes happened in specific cases; statistical studies try to estimate the average effects of variables of interest" (p. 141).

In my view, the purpose of case studies is not to primarily estimate casual effects and to generalize. Instead, I think the usefulness of qualitative small-n studies is more in line with Levi's approach where the aim is "to demonstrate that the model is consistent with the facts" (1988, p. 6). That is, the purpose is to *illustrate the causal process*. However, this way of implementing case studies needs to be combined with quantitative analysis to realize its full potential, since any theory is more valuable if it can be shown to be operating in several situations.

Quantitative and qualitative approaches complement each other since the disadvantages of quantitative studies are exactly what qualitative studies excel at, and vice versa. Here I use both methods not only to show robust associations across time and space, but also to investigate the plausibility of the proposed causal process at the micro level. For example, in Paper 2 I present data suggesting that the impact of ideology depends on the electoral system, and in Paper 3, I refine the theoretical argument and provide qualitative evidence in support of the proposed causal process – i.e., strategic considerations of left-wing political parties.[43]

Finally, Paper 4 uses formal analysis, an excellent method for exploring the logic of an argument as well as for uncovering new

[42] Mahoney (2010) further categorizes causal process observations into "independent variable", "mechanism", and "auxiliary outcome" sub-types.

[43] There are also more structured ways of integrating qualitative and quantitative methods, for example, nested analysis (Lieberman 2005) and the Bayesian approach suggested by Humphreys and Jacobs (2015).

theoretical and empirical implications. This type of exercise also forces one to clarify the assumptions used and lays bare the logic of the argument (or lack thereof). Paper 4 provides novel insights into how institutions shape the behavior of political parties and exposes a trade-off associated with short-term crisis management and long-term investment policies. The next section presents the Government Revenue Dataset and provides a brief description of the evolution of taxation and institutions from 1800 to 2012.

1.6
Taxation in the World 1800-2012: The Government Revenue Dataset

Alexander Hamilton once claimed that "[t]here is no part of the administration of government that requires extensive information and a thorough knowledge of the principles of political economy, so much as the business of taxation" ([1788] 2008), and as the first Secretary of the Treasury, he was a key figure in the early fiscal history of the United States. For example, in this position he was behind a controversial tax on whiskey in order to repay the debt that had accumulated during the revolutionary war (Stockwell 2011, p. 223).[44] While the young federation relied mainly on indirect taxes (in particular customs revenue), the structure of American taxation today is very different, with individual income tax being the main source of revenue.

The change in the tax structure of the United States is part of a more general pattern. In the 31 countries included in the dataset, the type of government revenue has been transformed radically in the 200 years – from a high reliance on tariffs, to the income tax, and in more recent times, to broad-based consumption taxes.[45] Not only has the nature and composition of government revenue changed, but its relative size in relation to the economy has also increased sharply.

As pointed out above, the period under investigation is characterized by revolutionary change not only in economic and demographic structure but also in political institutions. In the early nineteenth century, democracy as a political system was rare. At the same time,

[44] This tax later sparked the so-called "whiskey rebellion" (Stockwell 2011, p. 476).

[45] This last step has curiously enough not been taken by the United States, one of the few developed countries without a VAT (on the federal level).

industrialization had only begun to transform the socioeconomic and demographic structures. By the end of the twentieth century, however, democracy was the norm and most of the countries in the dataset had reached an advanced stage of industrialization.

The first part of this section begins with a brief description of the dataset and how it was collected and coded. The second part provides a short overview of broad international patterns in the history of taxation and institutions from 1800 to 2012.

DATA COLLECTION AND CODING

The Government Revenue Dataset is a joint project with Thomas Brambor. The first version (on which the papers of this dissertation is based) covers thirty-one countries from 1800 (or independence) to 2012.[46] As far as we know, there exists no comprehensive historical dataset on states' revenues. Even among wealthy countries, such as OECD member states, there is no cross-national database providing data from the nineteenth century up to today.

Our dataset is based on secondary sources providing partial temporal or geographic coverage.[47] In many cases, different sources relied on the same underlying data but reported conflicting estimates of revenue yields and the size of the economy. To complement and adjudicate between existing databases, we combined information from these existing datasets with information from country-specific sources. The overall aim of the coding process has been to create time series that are internally consistent within a country over time and connects to contemporary datasets (such as the OECD for European and North American countries and CEPAL for South America) in order to allow easy updates of the dataset.[48] We also aimed at minimizing the number of sources for each country while keeping high coverage over time. When we needed to decide between using one source to obtain cross-country consistency or using different sources to obtain within

[46]The countries included are: Argentina, Australia, Austria, Belgium, Bolivia, Brazil, Canada, Chile, Colombia, Denmark, Ecuador, Finland, France, Germany, Ireland, Italy, Japan, Mexico, the Netherlands, New Zealand, Norway, Paraguay, Peru, Portugal, Spain, Sweden, Switzerland, The United Kingdom, The United States, Uruguay, and Venezuela

[47]For example, Astorga et al. (2010); Dincecco and Prado (2013); Flora, Kraus and Pfenning (1983); Mitchell (2007*b*); (2007*a*); (2007*c*); Mauro et al. (2013); and OECD (2012). In the codebook we list all the country-specific primary and secondary sources that we used in the final version of the dataset.

[48]This approach is particularly suitable for fixed-effects models employed in Paper 1 and Paper 2.

country consistency, we chose the latter. The reason for this is that our main interest in assembling the dataset was to explain long-run trends *within* countries.

Total central tax revenue is divided into direct and indirect taxes. Furthermore, two subcategories of direct taxes, property taxes and income taxes, are measured separately. Indirect taxes are divided into consumption taxes, excises, and customs (which includes taxes on import, exports, exchange profits, and profits from export/import monopolies).[49] Property taxes include taxes on real estate, wealth, inheritance, and land. Income taxes include taxes on income, profits, and capital gains by individuals and corporations as well as taxes on payrolls and workforces. Ideally, these categories should be measured separately, but because of the limits of the historical data sources this was not possible. Tax on consumption consists mainly of sales and turnover taxes prior to the spread of value-added taxes in the 1960s. Excise taxes are taxes on specific goods, for example tobacco or alcoholic beverages. The difference between consumption taxes and excise taxes is that the former are broad-based and the latter only concern specific goods. The important aspect of both consumption and excise taxes is their regressive impact.

The dataset only provides data on the central level because of poor data availability at the local level. By restricting data collection to the central level, we could provide data for a much larger sample, both in time and across countries. However, it is important to note that this is problematic in cases where there is significant subnational authority in the area of taxing and spending, as this revenue will not show up in our data. We chose to express different categories of the budget as shares of total central tax revenue so we could make cross-country comparisons. Another important aspect of the data is that the sample varies over time. Countries are only included once they are independent, which means that the sample is smaller in the beginning of the nineteenth century. This in combination with data limitations also means that Europe is overrepresented for earlier years.

We have collected information on public finance and economic development from a number of existing data sources. Several of these datasets relied partly on the same underlying data. Nonetheless, many estimates of our variables of interest differed substantially. This is

[49] This disaggregation is based on the guidelines in the *Government Finance Statistics Manual 2001* of the International Monetary Fund (2001), but we combined some of the categories because of the scarcity of historical information and the specific focus of our project.

especially the case further back in time. Since many of the sources overlapped, one method is to average values, but this approach is problematic several reasons. First, many sources rely on the same underlying data, so averaging would hide potentially duplicated sources. Second, coverage over time varies substantially between countries, so averaging would mean that some sources are over-weighted. Finally, since the quality of secondary data differs considerably, averaging might increase rather than decrease measurement error.

Instead of averaging across different sources, we followed a decision tree to decide which sources to use as the basis for our estimates. The following rules were used to guide the coding:

1. **Minimize the number of sources.** If several sources cover the same information, we preferred to use a single source across categories for the same time period.

2. **Prefer high-quality sources**. We prioritized primary and country-specific secondary sources. Since these sources often provide more detailed data, this meant that we needed to do some of the categorization ourselves. However, many of the cross-national datasets were of such a high quality that we confidently relied on them for parts of the dataset.

3. **Check the consistency of sources.** When relying on two or more sources to construct a long-run series, we made certain that the information is comparable when covering the same overlapping period within a country. In cases of a significant jump at the intersection of two series, this is indicated by coding the last value of the ending series as missing.

4. **Time series consistency trumps cross-sectional consistency.** As mentioned above, our main interest is long-run trends within countries. When deciding whether to use the same source to obtain cross-country consistency or using different sources to reach consistent within-country estimates, we prefer the latter.

Since the tax categories are expressed as ratios (e.g., the share of the revenue coming from income taxes), we strongly preferred the numerator and denominator coming from the same source. For more information about the dataset and coding, see the individual papers (in particular the appendix to Paper 1) and the codebook.

Coverage per Country. Table 2 reports the coverage in time per country and tax category. Sometimes the information does not extend to 1800. There are three main reasons for this. First, the country did not exist or was not independent at the time (e.g., neither Germany nor Italy were unified until 1871). Second, although countries may have been established, they may not have established that particular tax. For example, income tax was relatively rare in the early nineteenth century and broad-based consumption taxes only became common after the spread of the VAT in the latter part of the twentieth century. Third, although a country and a tax existed, there was no available information.

Since we did not always know if data were missing because the tax was not in place for a specific year, if it was but not collected, if the information was simply missing, or if it was missing because of war or some other major event, the dates in the table begin with the year we first have data. I have marked with asterisks (*) cases where the interval contains several large gaps. There are different reasons for these gaps. For example, a tax can be removed or data can just be missing because of war or occupation.

I have also included two figures showing the development of the different taxes over time for each country. Figure 1 provides information on direct taxes (income and property) and Figure 2 shows the development of indirect taxation (customs, excises, and consumption).[50]

[50] To make it easier to interpret visually, these graphs are based on linearly interpolated data.

Table 2: Coverage per Country

	(1) Tax/GDP	(2) Direct Taxes	(3) Income Tax	(4) Property Tax	(5) Indirect Taxes	(6) Consumption Tax	(7) Excise Taxes	(8) Customs Revenue
Argentina	1810-2009	1895-2011	1895-2011	1932-2011	1864-2011	1932-2011	1990-2011	1864-2011
Australia	1825-2010	1910-2010	1915-2010	1910-2010*	1901-2010	1945-2010	1901-2010	1901-2010
Austria	1880-2011	1800-2011	1850-2011	1850-2011	1830-2011	1845-2011	1850-2011	1845-2011
Belgium	1835-2011	1830-2011	1841-2011	1841-2011	1830-2011	1920-2011	1830-2011	1830-2011
Bolivia	1950-2008	1985-2011	1985-2011		1985-2011		1985-2011	1985-2011
Brazil	1861-2011	1923-2011	1901-2011		1900-2011	1900-2011	1900-2011	1881-2011
Canada	1870-2011	1918-2011	1918-2011	1973-2011	1880-2011	1920-2011	1867-2011	1867-2011
Chile	1810-2011	1895-2011	1895-2011		1895-2011	1973-2011	1973-2011	1895-2011
Colombia	1807-2011*	1928-2011	1928-2011		1928-2011	1971-2011	1990-2011	1807-2011*
Denmark	1853-2011	1872-2011	1914-2011	1872-2011	1872-2011	1940-2011	1872-2011	1872-2011
Ecuador	1939-2011	1990-2011	1981-2011		1990-2011	1981-2011		1981-2011
Finland	1882-2011	1882-2011	1893-2011	1882-2011	1882-2011	1941-2011	1882-2011	1882-2011
France	1815-2011	1815-2011	1822-2011	1822-2011	1815-2011	1920-2011	1815-2011	1815-2011
Germany	1872-2011	1906-2011	1920-2011	1906-2011	1906-2011	1909-2011	1872-2011	1872-2011
Ireland	1926-2011	1922-2011	1922-2011	1924-2011	1922-2011	1963-2011	1922-2011	1922-2011
Italy	1862-2011	1862-2011	1866-2011	1862-2011	1862-2011	1920-2011	1862-2011	1862-2011
Japan	1875-2011	1873-2011	1887-2011	1873-2011	1927-2011	1927-2011	1873-2011	1868-2011
Mexico	1895-2011	1925-2011	1925-2011		1925-2011	1972-2011	1972-2011	1900-2011*
Netherlands	1807-2010	1806-2010	1850-2010	1806-2010	1806-2010	1935-2010	1806-2010	1806-2010
New Zealand	1860-2011	1879-2011	1892-2011	1879-2011*	1841-2011	1932-2011	1841-2011*	1841-2011
Norway	1851-2011	1851-2011	1892-2011	1876-2011	1876-2011	1933-2011	1851-2011	1851-2011
Paraguay	1938-2011	1990-2011	1990-2011	1990-2006		1992-2011	1990-2011	1990-2011
Peru	1900-2011	1899-2011	1901-2011		1899-2011	1972-2011	1972-2011	1899-2011
Portugal	1833-2010	1833-2010	1879-2010*	1879-2010	1834-2010	1966-2010	1973-2010	1833-2010
Spain	1850-2011	1845-2011	1908-2011	1845-2011	1845-2011	1803-2011	1801-2011	1801-2011
Sweden	1800-2011	1850-2011	1861-2011	1850-2011	1850-2011	1940-2011	1850-2011	1850-2011
Switzerland	1851-2011*	1875-2011	1916-2011	1973-2011	1875-2011	1941-2011	1850-2011	1850-2011
United Kingdom	1803-2011	1803-2011	1803-2011*	1803-2011	1803-2011	1941-2011	1803-2011	1803-2011
United States	1800-2011	1916-2011	1916-2011	1929-2011	1800-2011		1863-2011*	1800-2011
Uruguay	1884-2009	1903-2009	1929-2011		1895-2009	1972-2011	1972-2011	1895-2011
Venezuela	1920-2011	1937-2011	1939-2011		1910-2011	1939-2011	1928-2011	1910-2011

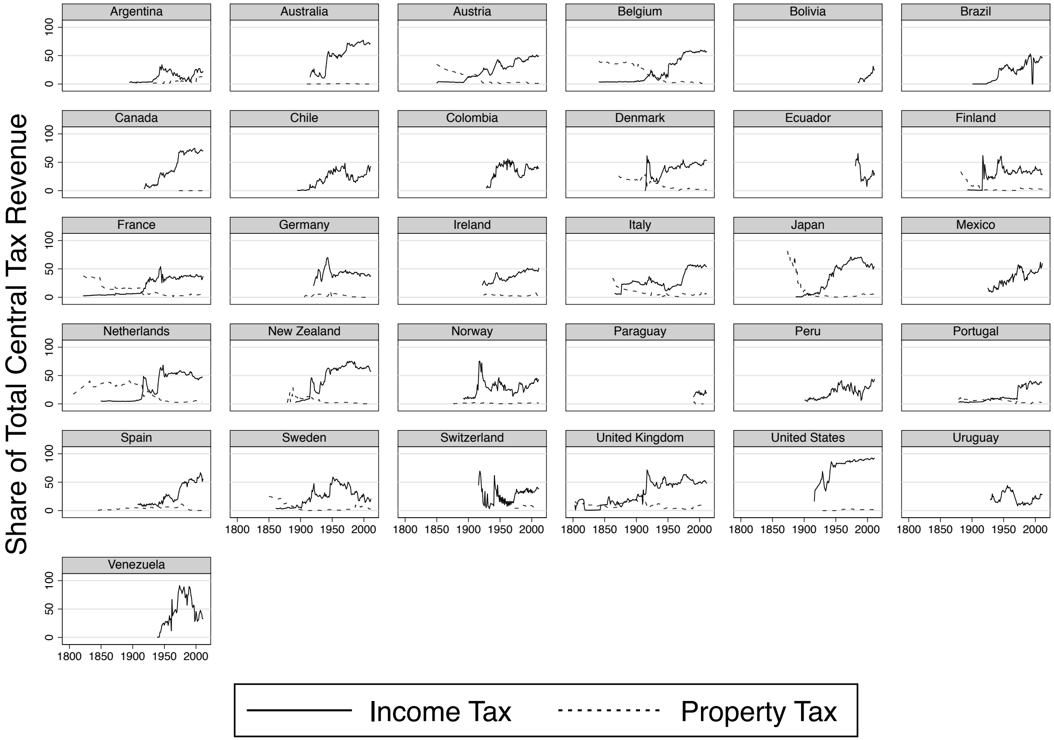


Figure 1: Direct Taxation per Country

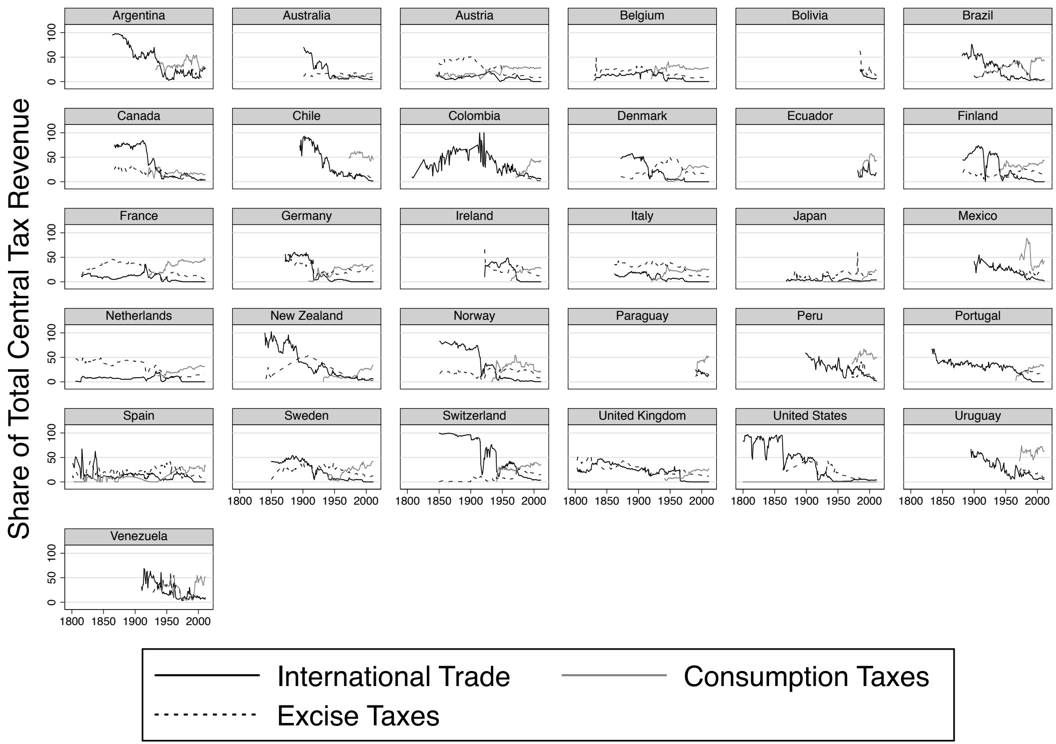


Figure 2: Indirect Taxation per Country

Figure 3: Total Tax Revenue as a Share of GDP

PATTERNS OF TAXATION: 1800-2012

Perhaps the most striking development during the last two centuries is the enormous increase in total taxation. Figure 3 depicts the evolution of total central tax revenue as a share of Gross Domestic Product (GDP) from 1800 to 2012. After the Napoleonic wars, the level of taxation decreases and stays at a fairly stable level until the First World War. The average tax level decreases somewhat in the interwar period but never reaches the old levels, and after the Second World War, the overall level of taxation continues to increase.[51]

Figure 4 shows the development of direct and indirect taxes as shares of total central tax revenue from 1800 to 2012 in the 31 countries covered by our data. While there was considerable variation in the nineteenth century, it is not until the First and Second World War that direct taxation reaches the same level as the share from indirect taxes. Between 1950 and today, there has been less volatility and the shares of revenue from indirect and direct taxes are almost identical. While most empirical research into the political economy of taxation focus

[51] For an analysis of the so-called "ratchet effect" of war in the United Kingdom, see Peacock and Wiseman (1961).

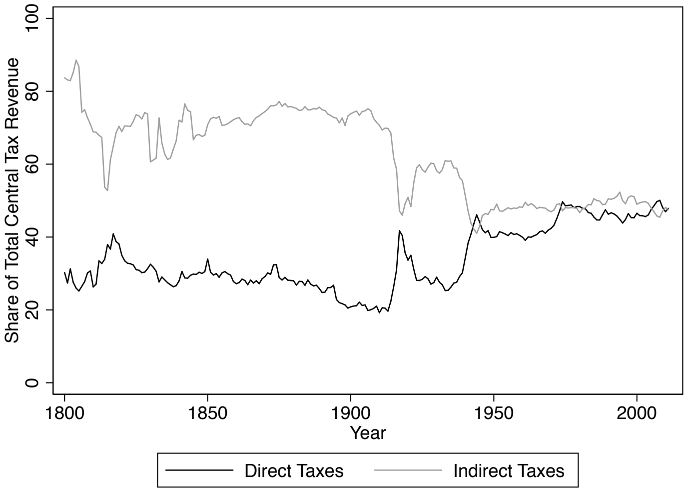


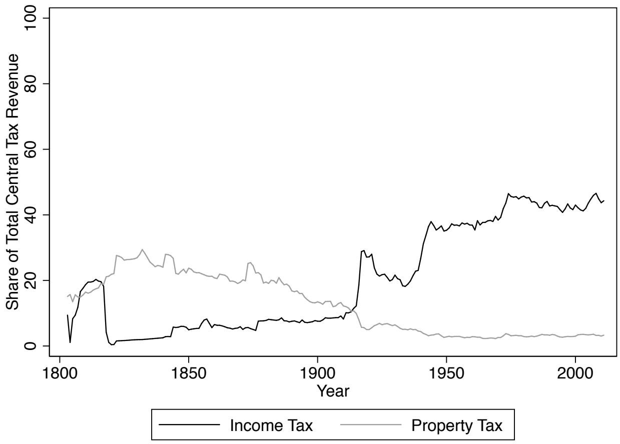
Figure 4: Direct and Indirect Taxation

on the period from 1960 or later, this figure shows that major changes occurred long before that.

Analyzing taxation in terms of indirect and direct categories is common, especially in more historical research. However, there are important developments within these two groups that are not captured by aggregate measures. Figure 5 shows the development of property and income tax (direct taxes) and customs, consumption, and excise taxes (indirect) separately. It is important to note that these categories can have different distributional consequences. For example, the social groups being hurt by raised tariffs are not necessarily the same as those who are hurt by a broad based consumption tax. Thus, it is an oversimplification to assume that direct taxes are progressive and indirect taxes are regressive.

The graphs show considerable variation within these two categories of taxes. Although the aggregate direct taxation has become more important as a source of revenue, Figure 5 shows that this is driven by increased income tax. With regards to indirect taxation, both customs revenues and excises have decreased in importance while broad-based consumption taxes have become more important over time. This

Figure 5: Subsets of Direct and Indirect Taxes



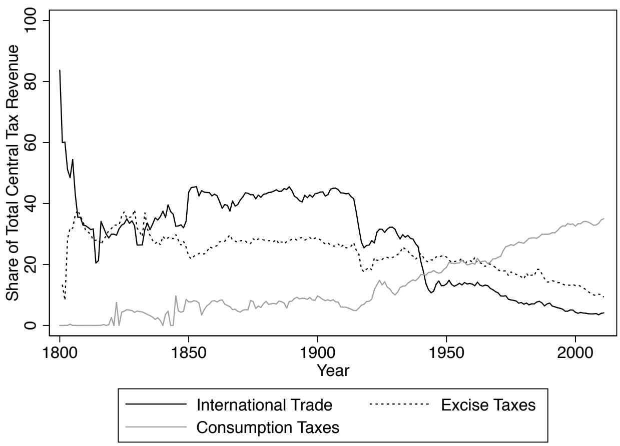
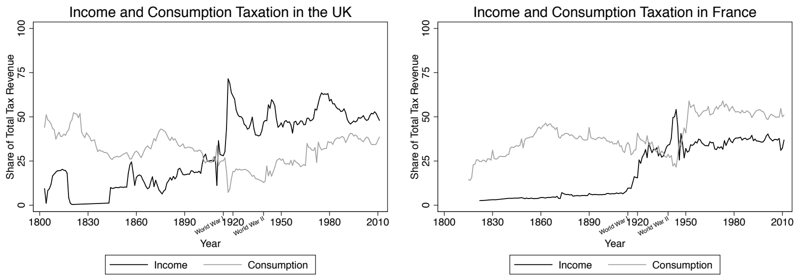


Figure 6: Taxation in the United Kingdom and France



development accelerated with the spread of the VAT in the 1960s and 1970s (James 2015; Keen and Lockwood 2010).

Although there are common patterns in taxation across countries, large differences can be observed between countries. Figure 6 shows the development of income and consumption taxes in the United Kingdom and France from 1800 to 2012. It shows that the United Kingdom historically relied more on income tax than France, a pattern that was strengthened after the First World War and persists today. After the Second World War, the share of income tax was almost twice as high in the United Kingdom as in France. Instead, France has relied more heavily on excise and consumption taxes both before and after the two World Wars. Hence, despite general patterns, there are important differences in taxation between countries that cannot be explained by democracy or war alone.

In all, these descriptive graphs show that there have been considerable changes in taxation during the last two centuries. Income and consumption taxes have increased in importance while taxes on trade and property are no longer major sources of revenue. These changes have not only been driven by a strive for greater revenue capacity and efficiency, but also by distributional struggles between social groups. Even if a tax reform increases efficiency, it will not be implemented if the group in power will be economically worse off (see Paper 4). Furthermore, a change in the tax code is bound to create conflict between different groups in society (Alt 1983). How these conflicts play out and are solved (or not solved) is linked to the political institutions structuring the interaction between actors (Paper 2 and Paper 3).

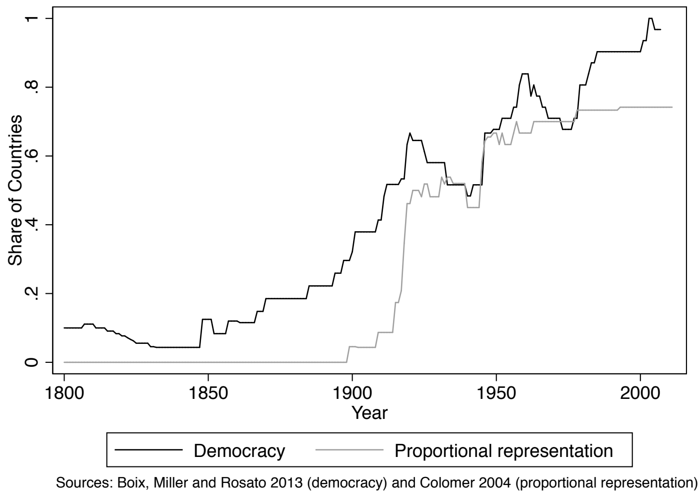


Figure 7: Democracy and Proportional Representation

When considering the development of tax reform over two hundred years, we should keep in mind that the political institutions changed dramatically. Countries not only democratize (and in some cases revert back to authoritarianism) but also adopt different democratic institutions. Figure 7 describes the evolution of two major changes taking place in this period: the spread of democracy and of proportional representation electoral systems.[52] As the graph shows, in the late nineteenth century most countries in the dataset were non-democracies and none used a proportional electoral system. After the Second World War, the majority were democratic and used a proportional electoral system.[53]

The papers follow the changes in countries: from the impact of democracy to specific political institutions within democracies to the challenges of long-term investments and crisis management.

[52] Using data from Boix, Miller and Rosato (2012) and Colomer (2004).

[53] As earlier theorists have pointed out, extending political rights to broader segments of society should have profound effects on the tax system (e.g., Meltzer and Richard 1981; Romer 1975). These descriptive data lend some tentative support to this idea in that both the number of democracies and the share of income tax are increasing over time.

1.7
Summary of Papers

Paper 1 is concerned with the impact of democracy on taxation. The canonical models (Meltzer and Richard 1981; Romer 1975) predict that democracy, by including the previously disenfranchised poor, leads to more redistribution and by extension more progressive taxes (such as income tax). However, existing research presents conflicting results. Although some indeed find this effect (e.g., Lindert 2004), others claim there is evidence that democratization is unrelated to redistribution (e.g., Ansell and Samuels 2014). In Paper 1, I argue that these inconclusive findings are due to insufficient attention to the differential tax preferences of low-income voters. That is, urban and rural poor have different views on taxation. Urbanites want to shift taxation away from consumption and onto land and income, whereas the rural poor are mainly concerned with lowering taxes on land. Using the novel dataset over government tax revenue as described in section 1.6, I present evidence suggesting that the effect of democracy does indeed depend on the urbanization rate. More specifically, democratization in highly urbanized states is associated with greater shares of revenue coming from taxes on income and property and lower shares from excise and consumption taxation. In contrast, democratization in a rural context is associated with less tax revenue from property, excise, and consumption taxes.

Paper 2 focuses on tax policy within democracies. I ask why and when left-wing governments tax the poor. Intuitively, governments to the left should tax the rich relatively harder than the poor, but the historical record shows that more often than not the pattern is the opposite. In fact, left-wing governments are frequently associated with heavier taxation of consumption relative to taxation of income and wealth. However, there is no consensus regarding if, when, and why this is. Moreover, previous research is mainly concerned with the last decades of the twentieth century, a temporal limitation overcome by the government revenue dataset I use. My argument is that to understand the effect of ideology on taxation we need to consider how taxation and spending interacts with the institutional environment. First, the fact that left-wing governments prefer a more equal distribution of income and wealth does not necessarily predict a certain tax structure. Rather, it crucially depends on government expenditures. This implies that different tax structures can be compatible with redistribution.

Second, what type of tax/spend mix is employed depends on how political institutions shape electoral risk. In a system concentrating power to one actor, the impact of losing power is greater than in a system where power is more widely shared. Redistributive taxation and redistributive spending have different temporal distributions as taxation starts today while the effect of spending takes time (barring lump sum transfers). Electoral systems create different strategic contexts in which the left operates. PR systems grant the opposition greater influence, thus extending the time horizon of an incumbent government. In these systems, the left shifts taxation from income to consumption, generating a higher total tax yield, and redistributes mainly on the expenditure side. In majoritarian systems, on the other hand, because the left will have no influence if out of power, the left will opt for a safer redistributive strategy that mainly relies on progressive taxation of income. In the paper, I present data indicating that left-wing governments are associated with heavier taxation of consumption in countries using proportional representation (PR) electoral systems, while the opposite is the case in countries using majoritarian electoral systems.

Paper 3 continues the logic in Paper 2, but refines the theory by spelling out the causal process on a micro level. To explore the proposed causal process, Paper 3 studies reforms of consumption taxation in Britain and Sweden in the decades following the Second World War. In both countries, policymakers acknowledged the advantages of broad-based consumption taxation in terms of revenues and the possibility of counter-acting the regressive effects with compensatory spending. In Sweden, the Social Democratic Party (and initially also the trade unions) was convinced that they could use a national sales tax to forward a redistributive spending agenda, so the party implemented the tax. In Britain, massive resistance from within the labor movement, and especially the trade unions, made Labour reluctant. The opposition from the Trades Union Congress was driven by the risk associated with a future Tory government, which might keep the tax but not implement the promised compensatory spending. In sum, the decision whether to introduce a new broad-based consumption tax was strongly influenced by risks shaped by the different political institutions in place.

The final paper, co-authored with Johannes Lindvall, uses a formal model of political conflict to analyze government performance with respect to crisis management (e.g., financial or banking crises) and investment policies. An example of an investment is tax capacity (see Besley and Persson 2011, ch. 2), since adding, reforming, or in other ways changing the tax system can all be used to increase fiscal capacity, but all are costly. Introducing a new tax such as an income or a value-added tax requires considerable investments in administrative capacity. This cost means that less government funds are available for spending today. Importantly, the decision to add or change taxes depends on what governments spend on in the future. Our analysis shows that countries using institutions that share power widely (e.g., proportional representation electoral systems and/or with multiple constitutional veto points) are more likely to engage in investment policies than countries employing power-concentration institutions (e.g., systems with majority governments with no veto points). However, there is a trade-off: Power-sharing institutions are worse at handling sudden crises when swift and decisive action is needed.

1.8
Contributions and Future Research

This dissertation consists of four independent papers, each emphasizing a different aspect of the politics of taxation. Empirically, the main contribution is the novel dataset over government revenues from 1800 to 2012 that is used in two papers to shed light on how democracy and ideology influence tax structure. Qualitative and analytical approaches complement the statistical evidence and provides new insights into left-wing tax strategy and how constitutions differ in their ability to handle crises and investment dilemmas. The main contributions can be summarized in four points:

1. The dissertation is partly based on a novel dataset presenting information on government tax revenue from 1800 to 2012 for 31 countries. This is a significant contribution since earlier work has been based on either a small number of European countries over a long period or a larger number of states for a very short period (most often the decades following the Second World War). By providing data covering Europe, both Americas, the English speaking off-shoots, and Japan, it is possible to trace the evolution of the modern tax state without being constrained by a small sample restricted to Europe.

2. The second main contribution is a new take on the effects of democratization. I argue in Paper 1 that the impact of democratization on taxation is not as straightforward as commonly thought.

This impact depends on the tax preferences of the previously disenfranchised citizens. This understanding is important because it means if one is analyzing the impact of democracy in a sample of predominately rural countries (such as early nineteenth century Europe), one finds very different effects compared with a sample with more urbanized states.

3. This dissertation provides a new analysis of left-wing party tax strategy. The link between ideology and economic policy has long puzzled scholars and I argue that by taking into consideration how electoral institutions shape the strategic environment, some of the previously surprising patterns make more sense. Using the most comprehensive database of tax revenues, I present evidence of an interaction effect where the impact of left-wing government is different depending on the electoral system. Moreover, Paper 3 provides additional evidence supporting the theoretical argument on the micro level.

4. Paper 2 and Paper 3 shows that how a government makes tax policy decisions depends on the political institutions in place, which affects the inter-temporal risks associated with tax policy. Paper 4, a collaboration with Johannes Lindvall, develops a general theoretical framework where we compare how different institutions affect the ability of governments to respond to sudden crises and to make political investments.

There are a number of fruitful avenues for future research in the area of tax policy, both empirically and theoretically. Among the most important are listed below:

1. In this dissertation, I present data on the revenue side of the budget. A natural next step is to collect information also on the expenditure side. As mentioned above, our understanding of tax policy is incomplete without considering what the revenue is spent on.

2. In Paper 1, I make the point that urbanization matters since urbanization is a proxy for voters' tax preferences. But the geographic distribution of voters also matters for how well different electoral systems represent different socioeconomic groups (e.g., Rodden 2011). Thus, how the choice of electoral institutions

affect politics is likely to depend on the spatial distribution of voters. It is likely that the effect of democratization depends on urbanization as well as the electoral system.

3. In Paper 2 and Paper 3, the focus is on left-party tax strategy. An extension should develop an argument for other political parties as well.

4. The model developed in Paper 4 is very simple and excludes several potentially important aspects of the politics of investment and crisis management. Two of the more important extensions would be to incorporate elections and the economy. Elections could possibly introduce a tension between policy-oriented and office-oriented goals. And including private economic decisions adds an important constraint on taxation.

For a more comprehensive discussion about possible future research in the context of the specific contributions of this dissertation, the reader is referred to the individual papers.

1.9

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