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Reuven S. Avi-Yonah

University of Michigan Law School, aviyonah@umich.edu

Orli Avi-Yonah

University of Michigan Law School, oaviyona@umich.edu

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BE CAREFUL WHAT YOU WISH FOR?

REDUCING INEQUALITY IN THE 21ST CENTURY

A REVIEW OF WALTER SCHEIDEL, “THE GREAT LEVELER: VIOLENCE AND THE HISTORY OF INEQUALITY FROM THE STONE AGE TO THE TWENTY-FIRST CENTURY” (Princeton Univ. Press, 2017)

Reuven S. Avi-Yonah¹

Orli K. Avi-Yonah²

1. Introduction: Inequality and the Great Recession of 2008

In 2014, a surprising best-seller swept the United States. *Capital in the Twenty-First Century* by the French economist Thomas Piketty was published in English translation in April 2014.³ By May 18, the English edition reached number one on the New York Times list for hardcover nonfiction and became the greatest sales success ever of Harvard University Press. As of January 2015, the book had sold 1.5 million copies in French, English, German, Chinese and Spanish.

The success of Piketty’s book stemmed from the aftermath of the Great Recession of 2008-2009. The recession focused attention to the increasing inequality in the U.S. since the early 1970s. The “Occupy Wall Street” movement, as well as the Tea Party, were both responses to the realization that while the recession was over by 2009, over 95% of the subsequent growth in the US economy inured to the benefit of the top 1% of the income distribution.⁴

Piketty explained this phenomenon in detail. Moreover, he posited that it was a historical constant: The main driver of inequality, he argued, was the tendency of returns on capital to exceed the rate of economic growth ($r > g$). “In slowly growing economies, past wealth naturally takes on disproportionate importance, because it takes only a small flow of new savings to increase the stock of wealth steadily and substantially. If, moreover, the rate of return on capital remains significantly above the growth rate for an extended period of time...then the risk of divergence in the distribution of wealth is very high.”⁵

¹ Irwin I. Cohn Professor of Law, the University of Michigan.

² Clinical Psychologist (Ph.D., Boston University, 1991), Human Trafficking Clinic and Family Assessment Clinic, the University of Michigan.

³ Thomas Piketty, *Capital in the Twenty-First Century*, translated by Arthur Goldhammer, Harvard University Press, 2014.

⁴ Saez, Emmanuel, *Income and Wealth Inequality: Evidence and Policy Implications* (January 2017). *Contemporary Economic Policy*, Vol. 35, Issue 1, pp. 7-25, 2017. Available at SSRN: <https://ssrn.com/abstract=2873965> or <http://dx.doi.org/10.1111/coep.12210>.

⁵ Piketty, 25.

Moreover, Piketty did not just pose the problem: He proposed a solution. In the last part of the book, Piketty advocated several steps to remedy inequality by regulating capital: Strengthening the welfare state, dramatically increasing income tax rates on the rich, and imposing a new global tax on capital.⁶ While none of these steps were taken, several of them were influential in shaping the Democratic platform for the 2016 presidential campaign, especially through the impact of Sen. Bernie Sanders (I-VT).⁷

But, of course, the Democrats lost. The Republicans took the White House and kept both houses of Congress, and immediately proceeded to propose policies that went in the opposite direction of Piketty's proposals: First, abolishing the tax increases on wealthy Americans that helped fund the Affordable Care Act (ACA); Second, rolling back the welfare state, as embodied in the ACA, and especially converting Medicaid from an entitlement to a capped program; and third, proposing an extremely regressive tax reform, including cutting the top marginal individual and corporate rates, abolishing the estate tax, and converting the corporate tax (which falls primarily on capital) to a consumption tax (that falls primarily on consumers).⁸

In this environment, a new book appeared. Stanford historian Walter Scheidel's *The Great Leveler: Violence and the History of Inequality from the Stone Age to the Twenty-First Century* (Princeton Univ. Press, 2017), is, in some respects, the anti-Piketty. Scheidel accepts Piketty's view that inequality tends to grow over time, but adds a crucial caveat than runs directly opposite to Piketty's optimistic proposals. Scheidel argues that the historical record demonstrates that inequality can **only** be reduced by violent means.⁹ Therefore, the Piketty proposals to reduce inequality peacefully are unrealistic, and Scheidel concludes his book by arguing that we should accept inequality as the price of peace: "All of us who prize greater economic equality would do well to remember that with the rarest of exceptions, it was only ever brought forth in sorrow. Be careful what you wish for."¹⁰

This review will first summarize Scheidel's thesis and the evidence for it (part 2). It will then argue that the twentieth century history of the United States shows that in fact inequality can be reduced by peaceful means, even though such reductions are not easy to achieve and usually require bipartisan consensus (part 3). Next, the review will address why the Great Recession of 2008-9 did not lead to a reduction in inequality, unlike the Great Depression (Part 4). Finally, the

⁶ Piketty, 471-540.

⁷ http://www.presidency.ucsb.edu/papers_pdf/117717.pdf.

⁸ <https://abetterway.speaker.gov/assets/pdf/ABetterWay-Tax-PolicyPaper.pdf>. For a critique, see Avi-Yonah, Reuven S. and Clausing, Kimberly A., Problems with Destination-Based Corporate Taxes and the Ryan Blueprint (February 5, 2017). U of Michigan Law & Econ Research Paper No. 16-029. Available at SSRN: <https://ssrn.com/abstract=2884903>.

⁹ Scheidel, 51: "But were there also other, more peaceful means of lowering inequality? If we think of leveling on a large scale, the answer must be no. Across the full sweep of history, **every single one** of the major compressions of material inequality we can observe in the record was driven by one or more of these four levelers." (Emphasis added).

¹⁰ Scheidel, 444.

review will ask what can be done, and propose certain steps that may be more achievable than Piketty's proposals (part 5).

2. The Scheidel Thesis

Scheidel summarizes his thesis as follows:

For thousands of years, civilization did not lend itself to peaceful equalization. Across a wide range of societies and different levels of development, stability favored economic inequality. This was as true of Pharaonic Egypt as it was of Victorian England, as true of the Roman Empire as of the United States. Violent shocks were of paramount importance in disrupting the established order, in compressing the distribution of income and wealth, in narrowing the gap between rich and poor. Throughout recorded history, the most powerful leveling **invariably** resulted from the most powerful shocks. Four different kinds of violent ruptures have flattened inequality: mass mobilization warfare, transformative revolution, state failure, and lethal pandemics.¹¹

The rest of the book marshals powerful evidence in support of this thesis. First, Scheidel shows convincingly (and consistently with Piketty, but with data stretching much farther back in history) that in peaceful times, inequality tends to grow. For example, historical data enable Scheidel to show that inequality in Europe grew from pre-historic times to reach a peak at the height of the Roman Empire (around 200 CE), declined with the downfall of the empire, rose again gradually from 650 CE to the Black Death (1350 CE), declined sharply and then began rising again until the outbreak of WWI in 1914, then declined in the "Great Compression" of 1914-1975 and began rising again from 1975 on.¹²

Similar trends are visible in the United States. The Gini coefficient, which Scheidel uses as his main measure of inequality, rose from 0.44 in 1774 to 0.49 in 1850 to 0.51 in 1860, and the share of national income earned by the top 1% of the income distribution rose from 8.5% in 1774 to 9.2% in 1850 to 10% in 1860.¹³ The Civil War reduced inequality in the South but increased it in the North: The top 1% income share reached 18% in 1913, and the share of all assets held by the richest 1% of US households rose from 25% to 46% between 1810 and 1910.¹⁴ In the long run, inequality in the US increased steadily from 1650 to WWI, with only a small reduction during the American Revolution and none during the Civil War. From WWI to 1970,

¹¹ Scheidel, 6 (emphasis added).

¹² Scheidel, Figure 3.1.

¹³ Scheidel, 333. The Gini coefficient equals 1 when a single individual controls all resources and 0 when all individuals control equal resources. Scheidel recognizes that there may be better measures of inequality, but the Gini is the only one that can be measured across history, with better data for more recent periods. Scheidel does a great job in obtaining the best measures across time given the limitations of available data. The breadth of his expertise is astonishing.

¹⁴ Scheidel, 333-334.

however, inequality dropped sharply, rising thereafter but still not reaching the height of the first “gilded age.”¹⁵

Second, Scheidel shows convincingly that **most** reductions of inequality were indeed the result of his “four horsemen”: mass mobilization war, transformative revolution, state collapse and pandemics. The effects of the two world wars in Europe illustrate the first, the Russian and Chinese revolutions the second, contemporary Somalia and Libya the third, and the Black Death the fourth.¹⁶

But Scheidel’s hypothesis is stronger than this: He argues that reductions of inequality “invariably” resulted from the four horsemen (“**every single one** of the major compressions of material inequality we can observe in the record was driven by one or more of these four levelers.”)¹⁷ We believe that this way of stating the Scheidel thesis is too strong, and that the history of the United States in the 20th century provides a counter-example. This, in turn, suggests that it is possible, albeit not easy, to reduce inequality by peaceful means.

3. A Counter-Example: The Great Depression and its Consequences, 1929-1973

In Figure 5.1, Scheidel shows the top 1% income shares in the US, France, Canada and Japan from 1935 to 1975. They all show the same pattern: A sharp decline from the late 1930s to 1945, then a much more gradual decline until 1975. The sharpest fall is in Japan, but the others are not far behind.

Scheidel’s argument is that this decline is the result of World War II and its after-effects. But this presents a puzzle. How can France and Japan, which suffered devastating destruction in the Word War, show the same pattern as the US and Canada, which did not? Moreover, the decline in the US begins in 1936, which was five years before the US entered the war.

In addition, Scheidel’s Figure 5.5, which shows capital income share in total gross income for the top 1% in France, Sweden and the US from 1920 to 2010, shows a gradual decline in Sweden, a very sharp drop in France during WWII, and a less sharp drop followed by a swift recovery and then gradual decline in the US. This pattern does suggest that violence had the expected impact in France, but it also indicates that countries that were not directly impacted by WWII (Sweden) or were involved but were not invaded (the US) reduced inequality by other means.

In general, Scheidel’s claim that all of the “Great Compression” can be traced to the effects of the two World Wars and therefore to “mass mobilization warfare” seems overly -broad. In the US, WWI did indeed cause a sharp rise in income tax rates on the rich, and therefore can be said to have directly contributed to the decline in inequality during the war years. But income tax

¹⁵ Scheidel, 337, Figure 3.5.

¹⁶ Scheidel, ch. 4-5, 6, 10.

¹⁷ Scheidel 6, 51 (emphasis added).

rates were cut in the aftermath of the war, and the 1920s in general saw a rise in inequality, which reached its all-time peak in the US in 1929.¹⁸

The reduction in inequality from 1936 on was not the result of war. It was the direct result of the Great Depression and the election of Franklin Delano Roosevelt in 1932. After his election, FDR proceeded with the large Democratic majorities in Congress (and with significant Republican support) to enact policies that created the American welfare state (Social Security, 1935), strengthened the labor movement (National Industrial Recovery Act, 1933), and increased progressive taxation (the 1936 tax act).¹⁹ None of these steps, which contributed to the reduction of inequality in the pre-WWII years, were the result of war or violence.

While the WWII years further reduced inequality in the US, much of the constraints imposed by the government, such as the “mass tax” (extending the income tax to the middle class) and wage controls, impacted the middle class more than the rich. Moreover, the end of the war was not followed by a cut in taxes as in the 1920s. Progressive tax rates on the rich remained very high (over 90%) throughout the period 1945-1960, and the top marginal tax rate when Ronald Reagan was elected was still quite high (70%).²⁰ Moreover, the 1960s saw a massive expansion of the welfare state with the enactment of LBJ’s “War on Poverty” program, including Medicaid and Medicare.²¹ None of these developments can plausibly be attributed to World War II, which ended twenty years earlier.

It is thus hard to agree with Scheidel that the reduction of inequality in the US in the twentieth century was primarily the result of violence. It was, instead, the result of a peaceful political reaction to the Great Depression, which led FDR to propose programs to create a social safety net. The fear of the Russian Revolution was indeed an inspiration to reform in the US, but fear of revolution is not revolution.²²

Scheidel acknowledges the leveling effect on the Great Depression: “The Great Depression was the only macroeconomic crisis that had a powerful impact on economic inequality in the United States,” noting the decline of the wealth share of the richest 1% from 51.4% to 47% between 1928 and 1932, and of their income share from 23.9% to 15.5% over the same period. But he argues that “income concentration held steady until the beginning of the war”²³ and concludes that without the war the effect of the Depression would have leveled off. This may or may not be true, but Figure 5.1 indicates that the long decline (to 1973) in the top 1% share of income in the US began well before the war.

¹⁸ Scheidel, 337; Saez, *supra*.

¹⁹ Ira Katznelson, *Fear Itself: The New Deal and the Origins of Our Time* (Norton, 2013).

²⁰ Avi-Yonah, Reuven S., *Why Tax the Rich: Efficiency, Equity, and Progressive Taxation*. 111 *Yale Law Journal* 1391 (2002).

²¹ Annelise Orleck and Lisa Hazirjian (Eds.), *The War on Poverty: A New Grassroots History, 1964-1980* (2011).

²² Katznelson, *supra*.

²³ Scheidel, 1040.

Thus, we believe that while Scheidel is correct in that most dramatic reductions in inequality throughout history have been the result of violence, there is at least one counter-example to his claim. This counter-example shows that under the right political conditions, inequality can be reduced by peaceful means. Both FDR and LBJ were able to enact inequality-reducing measures peacefully. But this observation leads to the obvious question: Why did the Great Recession of 2008-9 not lead to a reduction in inequality?

4. Why did the Great Recession not Lead to Reduced Inequality?

The Great Recession of 2008-9 was the sharpest downturn in the economy since the Great Depression. But unlike the Great Depression, it did not lead to any reduction in inequality. Neither the bank bailout, nor the Obama stimulus, nor even the Affordable Care Act affected the Gini coefficient. Until very recently, almost the entire growth in the economy inured to the benefit of the top 1%.²⁴

The second author is a clinical psychologist who experienced the effects of the Great Recession directly in her practice. The following observations are based on her experience, and suggest some psychological reasons why the people in charge of national policy failed to enact policies that would lead to a peaceful reduction in inequality:

“In the fateful days after the demise of Lehman Brothers in September 2008, I often wondered whether the people setting national policies understood the impact of their decisions on the patients I was seeing in my office. This was not a theoretical meditation on the meaning of life. It was born out of an urgency to support people, all of whom attempted to hold on to the American dream: The promise that if you work hard, and honestly, and you give it your all, you will be safe. But safety was not to be had for many of them. The storm bearing bad news never ceased. It came in unforgiving waves of destruction. The people affected represented the entire socio-economic spectrum.

For a long while, it was hard to see the light at the end of the tunnel. The emotions that dominated people’s lives were fear, dismay, disbelief, horror and helplessness. Let me be concrete: People did lose their homes, jobs, health, and their way of life. Relationships and marriages faltered, social relations were severed, and shame and isolation reigned supreme. These were not reckless people who were over-leveraged, who played the stock market like a Russian roulette. By and large, these were highly educated, middle aged, hopeful people who were forced to pick up their shattered lives with no relief in sight. It was, and is, a sobering time. For some, economic and financial recovery has yet to happen.

²⁴ Saez, Emmanuel, *Income and Wealth Inequality: Evidence and Policy Implications* (January 2017). *Contemporary Economic Policy*, Vol. 35, Issue 1, pp. 7-25, 2017. Available at SSRN: <https://ssrn.com/abstract=2873965> or <http://dx.doi.org/10.1111/coep.12210>.

To be clear, the terror of the impending collapse of the auto industry resonated so loudly that it was hard to comprehend how anybody could be oblivious to the potential job loss of millions of people. One question that repeatedly pierced my consciousness was, what was the psychology of the people in charge, who led us into this calamity, and of those who were now entrusted with navigating us out of this storm? My many years of practice in three different states (New York, Massachusetts and Michigan) offered some potential hypotheses. In the winter of 2009, I wrote a draft paper under the title “Disorders of Extreme Privilege” (DEP). I was attempting to illuminate and understand some of the psychological dynamics involved in the decision making of people who hold power to hire and fire people and to buy and sell companies.

I was also pondering the question of “will they ever learn” from the mistakes that led us to the crisis of 2008? Not likely, I answered. There are too few examples in the history of leaders who were able to correct course based on a profound realization of their own faulty assumptions.²⁵ I turned my attention to what may be the psychological phenomenon of inability to change course in the face of an avalanche of data contradicting one’s assumptions.²⁶

This psychological phenomenon that I term DEP involves the ability to isolate oneself from the pain of others, and to remain dispassionate and at times oblivious to the real life consequences of “economic and financial decisions,” oftentimes accompanied by the euphemism of “increased efficiency” and “maximizing shareholder value.” People who suffer from this level of isolation are at times quite fearful themselves. They fear the loss of status, of material possessions, and of power. A subset of them, who ascended from humble beginnings, employ a particularly interesting psychological mechanism, often referred to in the literature as dissociation. “Forgetting” their own personal history and the people who share their early histories, they rather nurture the belief that their ascension and success is due purely to their personal attributes and hard work, which is a conviction that allows them to view the less financially fortunate as lacking in the above attributes. Marinating in that faulty set of beliefs (that one’s own success is purely the result of one’s special attributes) fosters, when interacting with like minded people, a sense of entitlement and disdain for vulnerability in oneself and in others. Distancing from pain becomes an imperative that ensures the resiliency of the grandiose notion that extreme success is

²⁵ Anwar Sadat and Yitzhak Rabin are two recent examples.

²⁶ This phenomenon has been documented in the psychological literature for decades. See, e.g., Leon Festinger, Henry W. Riecken and Stanley Schachter, *When Prophecy Fails: A Social and Psychological Study of a Modern Group that Predicted the Destruction of the World* (1956). For a modern study of the relationship between power and disinhibition see Dacher Keltner, Deborah H. Gruenfeld, and Cameron Anderson, *Power, Approach, and Inhibition*, 110 *Psychological Review* 265 (2003).

accounted for purely by one's own attributes and actions, denying the role of luck and social conditions in economic success.

One illustration would be the tone-deaf objection to the auto bailout in 2009. The economic merit of one plan or another notwithstanding, when millions of people stood to lose everything they had ever worked for or dreamed of, to pronounce that no bailout was necessary was the height of willful ignorance, and a complete disregard for the voiceless. These voiceless found their voices in the next decade, much to the surprise of many who did not listen or chose to avert their gaze from the "flyover" states. Flying over people's pain is a perilous endeavor, I have learned.

One field of inquiry that might assist us in shedding light on the current psychological, social and political landscape would be the study of interpersonal trauma and its impact on people's lives. Ten years later, the economic crisis can be conceptualized as a chronic trauma in one segment of the population, with occasional exacerbations; in other words, a chronic crisis with occasional acute crises. What in 2008 was an acute anxiety was never resolved. It changed from acute to chronic anxiety. It is now accompanied by the well known effects of chronic stress on people's bodies: A diminished immune system, depletion of hope, rising chronic anger, demoralization, chronic health problems and substance abuse, and, worst of all, increased social isolation, which both maintains and reinforces hopelessness, cynicism and dejection.²⁷

Some people were able to recover and regain or even surpass their 2008 success. But the wide swath of people who lost economic and social ground remained until recently stubbornly out of sight and untouched by government policies. Worse, many people were not as affected by chronic crisis and were able to go on with their lives, often unaware that the increased anxiety about their vulnerability they now experienced has transmuted into a ferocious commitment to holding on to their gains, so that they do not end up like the others who lost. This created a social schism characterized by lack of compassion for people who were different and vulnerable.

The recent election, regardless of one's political views, represents the transformation of the pain of some who were left behind into hopefulness that something not only should but can be done to restore the dignity and previous social and economic standing of those who became collateral damage in the recent wave of unbridled globalization."

A good illustration of the political manifestations of DEP and its direct relationship to inequality is the bipartisan saga of how US multinationals came to amass over \$2.5 trillion of

²⁷ See the well-known study of Anne Case and Angus Deaton, *Mortality and Morbidity in the 21st Century*, Brookings Papers on Economic Activity (2017), documenting the increased morbidity and mortality of white working class Americans.

profits in low-taxed jurisdictions offshore. Before 1997, there were provisions in the US tax Code that were enacted in the 1960s and that limited the ability of US-based multinationals to shift profits from high tax to low tax foreign jurisdictions without triggering US tax. The underlying theory of those provisions (“Subpart F”) was that the corporate tax is an important bulwark against increasing inequality, since its incidence is mostly on the rich, and that the US should not leave revenue on the table by allowing US multinationals to escape both foreign and US tax. US multinationals were allowed under Subpart F to defer tax on some foreign earnings, but because of Subpart F the revenue cost of this provision was relatively low (below \$5 billion a year).

In 1997, the Clinton Treasury adopted an innocuous seeming provision called “check the box” which enabled US multinationals to choose whether their foreign subsidiaries would be treated as separate subsidiaries or as branches for US tax purposes. The effect, which was presumably foreseen by the drafters of the regulation, was to completely undermine Subpart F and enable US multinationals to shift profits from high to low tax foreign jurisdictions without triggering US tax. However, this money was “trapped” offshore, since if the funds were distributed to the US parent, this would trigger a 35% US tax.

By 2004, the use of check the box led US multinationals to amass over \$300 billion in low-taxed foreign profits offshore. In that year, the Republican dominated Congress and White House passed an amnesty that allowed them multinationals to repatriate those funds without incurring US tax. This law was called the “American Jobs Creation Act” and the nominal intent was to encourage domestic job creation, but subsequent investigations have shown that the multinationals effectively used the funds to repurchase shares and pay executive compensation, enriching their shareholders and executives, while laying off thousands of ordinary workers.²⁸

By October 2006, it was clear that the Democrats were poised to take over Congress, and that “check the box” may be in danger as a mere regulation of being overridden by legislation. Therefore, the Republican dominated Congress enacted Code section 954(c)(6) as a “temporary” measure, which enshrined “check the box” in the Code. The Democratic majority renewed the provision when it was due to expire in 2007 and 2008.

When President Obama took office in January 2009, the largest international tax revenue raiser in his first budget was repealing both “check the box” and section 954(c)(6). The Democrats had large, filibuster-proof majorities in Congress and could easily have passed

²⁸ United States Senate, PERMANENT SUBCOMMITTEE ON INVESTIGATIONS, REPATRIATING OFFSHORE FUNDS: 2004 TAX WINDFALL FOR SELECT MULTINATIONALS, 2011; Donald J. Marples and Jane G. Gravelle, Tax Cuts on Repatriation Earnings as Economic Stimulus: An Economic Analysis, CRS Report for Congress, Congressional Research Service (2014).

the repeal in 2009-2010. But nothing happened, and by November 2009 the repeal measure was shelved. It was not resurrected again until after the Republicans took over both the House and the Senate in 2014, making the repeal proposal a meaningless gesture by the Obama Administration. Moreover, Congress repeatedly passed and President Obama signed extensions of section 954(c)(6), most recently for five years in 2016.

The result has been an explosion in the growth of the untaxed offshore profits of US-based multinationals. They now exceed \$2.5 trillion (all accumulated since the 2004-5 amnesty), and the choice not to tax them is the second largest tax expenditure (i.e., a subsidy delivered through the tax Code, or corporate welfare) in the federal budget, exceeding for example the home mortgage interest deduction and the exclusion of earnings on 401(k) accounts. Only the exclusion for health care insurance is more expensive.

There is now a bipartisan consensus that these \$2.5 trillion should be taxed lightly (under the House GOP plan, below 10%) and then allowed to be repatriated tax free, and that any future offshore profits should be completely exempt from tax. This “territoriality” proposal was supported by the Obama Administration, by the Hillary Clinton campaign, and by both the Trump Administration and the House GOP majority.

5. What Can be Done?

Scheidel would have us believe that the only way to seriously impact inequality in the twenty-first century is through war or revolution. Unfortunately, unless something is done to reduce inequality, he may be right.

Political theorists have for a long time sought to explain the causes of violent revolutions. In general, such revolutions do not occur when the majority in a given society is beaten down, because people who are too poor to obtain a living invest all their efforts in survival, not revolution. Instead, as James Davies explained in 1962, revolutions occur after a period of sustained growth, in which “actual need satisfaction” matches “expected need satisfaction.” If after such a period there is a sharp down-turn in actual need satisfaction, while expected need satisfaction remains high, an “intolerable gap” arises between what people want and what they get. “Revolution occurs at this time.”²⁹

This “J curve” theory of revolutions has been tested many times since Davies and applied to revolutions that happened long after him, such as the Iranian Revolution of 1979 and the “Arab Spring” of 2011.³⁰ If the theory holds, the US and the rest of the Western world may be ripe for

²⁹ James C. Davies, *Toward a Theory of Revolution*, 27 *Amer. Sociological Rev.* 5 (1962), 6.

³⁰ See generally Crane Brinton, *The Anatomy of Revolution* (1965); Ted Gurr, *Why Men Rebel*. Princeton, NJ: Princeton University Press. 1970; Goldstone, Jack A. and Bates, Robert and Epstein, David and Gurr, Ted Robert and Lustik, Michael B. and Marshall, Monty G. and Ulfelder, Jay and Woodward, Mark, *A Global Model for Forecasting Political Instability* (January 5, 2010). *American Journal of Political Science*, Vol. 54, No. 1, pp. 190-208,

revolution. The Great Recession followed a period of rapid growth and resulted in a wide gap between actual and expected need satisfaction. The election of Donald Trump may be the beginning of an attempt to remedy this gap, but given the policies actually proposed by the GOP, is unlikely to close it.

Scheidel would presumably acknowledge that wars and revolutions are generally not sought out, even though they may reduce inequality. Nobody wanted World War I, but it still happened. The current risk is that if nothing gets done, we may slip into a twenty-first century version of the deadly first half of the previous century. WWI and WWII occurred in part as a result of a violent backlash against the first age of globalization, increased limitations on immigration, and heightened tariff barriers. Current developments in the US and In Europe offer disturbing parallels.

What can be done to ameliorate inequality peacefully? Piketty and his colleagues propose two major steps, both of which involve taxation: A sharp increase in the marginal tax rate on the rich (up to over 90% in some proposals), and a global tax on wealth.³¹

These proposals seem unrealistic at present. The second requires an impossible level of global cooperation (including every tax haven).³² The first was tried before, but as the first author has argued elsewhere, it does not seem to have reduced inequality by much. While the era of very high marginal tax rates (1936-1981) coincided with the “great compression” and a reduction of inequality, it is not clear these two are in fact directly related. Historical evidence of effective tax rates indicates that for most of the period 1936-1980, the actual effective tax rates paid by the top 1% were far below the nominal rates.³³

Moreover, the data for the subsequent period (1980-2009) indicate that while the overall taxing and spending of the Federal government had a significant downward effect on the Gini

January 2010; GMU School of Public Policy Research Paper No. 2010-09. Available at SSRN:

<https://ssrn.com/abstract=1531942>.

³¹ Piketty, *supra*; Diamond, Peter A. and Saez, Emmanuel, The Case for a Progressive Tax: From Basic Research to Policy Recommendations (August 24, 2011). CESifo Working Paper Series No. 3548. Available at SSRN: <https://ssrn.com/abstract=1915957>.

³² See, e.g., the suggestion of Piketty’s student Gabriel Zucman of a global wealth register. Gabriel Zucman, *The Hidden Wealth of Nations* (2016). This, too, seems unrealistic. Even the modest coordination measures advanced by the OECD to attack the tax evasion problems have produced a backlash. Avi-Yonah, Reuven S. and Xu, Haiyan, Evaluating BEPS (January 15, 2016). U of Michigan Public Law Research Paper No. 493. Available at SSRN: <https://ssrn.com/abstract=2716125> or <http://dx.doi.org/10.2139/ssrn.2716125>; Avi-Yonah, Reuven S. and Xu, Haiyan, Global Taxation after the Crisis: Why BEPS and MAATM are Inadequate Responses, and What Can Be Done About It (January 15, 2016). U of Michigan Public Law Research Paper No. 494. Available at SSRN: <https://ssrn.com/abstract=2716124> or <http://dx.doi.org/10.2139/ssrn.2716124>.

³³ Avi-Yonah, Reuven S., The Parallel March of the Ginis: How Does Taxation Relate to Inequality and What Can Be Done About it? (February 9, 2014). U of Michigan Public Law Research Paper No. 385; U of Michigan Law & Econ Research Paper No. 14-003. Available at SSRN: <https://ssrn.com/abstract=2392971> or <http://dx.doi.org/10.2139/ssrn.2392971>.

coefficient, reducing inequality by about 20% on average, the top marginal tax rate on the 1% had very little to do with this trend. This is indicated by the fact that the before and after-tax Gini's move in parallel throughout this period, despite large changes in the top statutory tax rate (from 70% down to 28% and then back up to 39.6%). The only tax that seems to have a meaningful effect on the 1% is the tax on dividends and capital gains, since there are data that indicate that the ACA's increase in the tax rate from 20% to 23.8% also increased the effective tax rate of the top 1% by the same amount.³⁴ This increase, however, is set to be abolished if the GOP majority in Congress manages to repeal the ACA, and Speaker Ryan's tax plan proposes a further reduction to 16.5% (the lowest rate on capital gains since 1916).³⁵

If the top marginal tax rate is not an effective way of reducing inequality, what is? The data suggest that the main driver of the reduction of the Gini from the current taxing and spending of the Federal government comes from the spending side, not from the tax side. In fact, it can be shown that the fluctuations of the Gini in the period 1980-2009 are directly correlated with spending on the "entitlements" (Social Security, Medicaid and Medicare).³⁶

Thus, the most urgent way to address the inequality problem peacefully is to bolster the entitlements. Given the retirement of the baby boom generation, more funding is needed for all of them, including the ACA. The most obvious way of funding the entitlement is to adopt a consumption tax (Value Added Tax, or VAT/Goods and Services Tax, or GST) at the Federal level in addition to, and not as a replacement of, the current individual and corporate income taxes.

Every other developed economy and most other countries (over 100) finance their welfare state primarily from a central consumption tax (VAT or GST). While these taxes are regressive, there are ways to alleviate regressivity, including exempting necessary expenditures or providing income-based refunds. Moreover, these taxes are not regressive when the spending they are used for is taken into account.³⁷

A broad-based federal VAT in the US could raise \$100 billion for every percentage point of tax per year. That means that a low 5% VAT would be sufficient to raise \$500 billion each year, enough to bolster Social Security, Medicare and Medicaid for the foreseeable future, as well as strengthening rather than repealing the ACA.³⁸

³⁴ Emmanuel Saez, "Taxing the Rich More: Preliminary Evidence from the 2013 Tax Increase," *Tax Policy and the Economy* 31 (2017).

³⁵ Avi-Yonah, *Parallel March*, *supra*.

³⁶ *Ibid*.

³⁷ Avi-Yonah, Reuven S., *Designing a Federal VAT: Summary and Recommendations* (June 18, 2009). U of Michigan Law & Economics, Olin Working Paper No. 09-013; U of Michigan Public Law Working Paper No. 155. Available at SSRN: <https://ssrn.com/abstract=1422092> or <http://dx.doi.org/10.2139/ssrn.1422092>.

³⁸ Avi-Yonah, Shera and Avi-Yonah, Reuven S., *Leveling the Playing Field: The Case for an Education Value Added Tax* (July 28, 2015). U of Michigan Public Law Research Paper No. 474. Available at SSRN: <https://ssrn.com/abstract=2636728> or <http://dx.doi.org/10.2139/ssrn.2636728>.

Another promising peaceful way of addressing inequality involves educational opportunity. The current American way of funding education primarily through local property taxes is deeply flawed and results in extreme disparities between poor and rich school districts (e.g., in Michigan the difference is over 50%).³⁹ Funding education instead by a federal consumption tax, as proposed by President Nixon in the 1970s, could significantly enhance educational opportunity and social mobility in poor school districts. Another 5% of VAT could finance all K-12 public education in the US, and a third 5% could finance the much needed rebuilding of our national infrastructure.⁴⁰ A total VAT of 15% would be perfectly in line with rates in other developed countries (15% is the minimum VAT rate in the EU, and many countries have a VAT of over 20%).

A VAT is therefore the best way of addressing inequality peacefully. How likely is such a VAT in the US? There are two possible scenarios: Presidential leadership and a crisis.⁴¹

Under the first scenario, a second term President (since it is unlikely that any President will be elected on a tax-raising platform) proposes a VAT as part of an overall tax reform package. Democrats will have to be convinced that a VAT is the only way to address inequality, and that regressivity can be alleviated (e.g., by payroll tax reductions). Republicans will have to be convinced that a VAT is not just a money machine for growing government (e.g., by making the reform revenue neutral by abolishing the corporate tax).

The famous VAT horror stories are the defeat of Ways and Means Chair Al Ulmann in 1978 after proposing one, and the landslide defeat of Canadian Prime Minister Brian Mulroney after passing one in 1991. But Ulmann was defeated for other reasons, and Mulroney mishandled the introduction of the VAT. In addition, Mulroney's conservatives came back to power in Canada and reduced the VAT rate (but did not eliminate it). A better example of political leadership is Australia's John Howard, who campaigned in 1996 under the promise of "never ever" to introduce a VAT in Australia. Having won, Howard then proceeded to implement that VAT in conjunction with both business and labor, and won re-election twice by large margins.⁴²

³⁹ Ibid.

⁴⁰ Ibid.

⁴¹ Avi-Yonah, *The Political Pathway: When Will the US Adopt a VAT?* *The VAT Reader* 334 (Tax Analysts, 2011)

⁴² Susan C. Morse, *How Australia Got a VAT*, available at ssrn.com, abstract=1653609 (2010). For how VATs got enacted in other developed countries see Kathryn James, *The Rise of the Value-Added Tax* (Cambridge UP, 2015); Avi-Yonah, *The Inexorable Rise of the VAT: Is the U.S. Next?*, 150 *Tax Notes* 127 (Jan. 4, 2016); Richard Eccleston, *Taxing Reforms: The Politics of the Consumption Tax in Japan, the United States, Canada and Australia* 104-06 (2007); Neil Brooks, *The Canadian Goods and Services Tax: History, Policy, and Politics* (1992).

A VAT is not more difficult to adopt than health care reform, or Social Security, Medicare and Medicaid when they were first proposed, or civil rights legislation in 1965. All it takes is an experienced, politically astute president like FDR or LBJ.⁴³

The other scenario is a fiscal crisis. This year, the US Treasury will sell bonds maturing in 2047. By then, the entitlements will consume the entire federal budget because of the aging of the population, leaving no funds to pay interest. Presumably, foreign investors who buy US Treasuries will balk and demand higher interest rates long before 2047. Since it is politically highly unlikely the entitlements can be cut or income tax rates raised sufficiently to fund the burgeoning debt, at that point there will be a crisis similar to 2008, but with no option other than enacting the VAT.⁴⁴

Enacting the VAT is under current circumstances the last and best hope for reducing inequality peacefully. Otherwise, as Scheidel convincingly argues, we may ultimately be faced with an inevitable reduction in inequality by violent means—the same means that have reduced it repeatedly throughout human history.

⁴³ Reuven S. Avi-Yonah, *Designing a Federal VAT: Summary and Conclusions*, 63 *Tax Law Review* 285 (2010);

⁴⁴ Leonard J. Burman, Jeffrey Rohaly, Joseph Rosenberg, and Katherine C. Lim, *Catastrophic Budget Failure*, 63 *Nat'l Tax J.* 561 (2010); Rudolph G. Penner, *Do We Need a VAT to Solve Our Long-Run Budget Problems?* 63 *Tax Law Review* 301 (2010); Alan J. Auerbach and William G. Gale, *Déjà vu All Over Again: On the Dismal Prospects for the Federal Budget*, 63 *Nat'l Tax J.* 543 (2010).