May 30, 2014


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ABSTRACT

The rise of the super-rich in the United States during the last thirty years has rekindled concerns about oligarchic political influences. Following recent theoretical work by Winters (2011), we conceptualize oligarchy as a defense against threats to income accumulation by the super-rich. We focus on two threats: taxes and financial regulations. In addition, we consider the potential role of countervailing power resources: Democratic Congressional power and unions. Using annual multiple time-series data covering 1918 through 2012 and Vector Autoregression (VAR) analysis, we find that the pre-tax income of the top 0.1% decreases in response to shocks in capital gains tax rates and marginal income tax rates, but not estate tax rates. Financial deregulation, the loss of Democratic seat share in Congress, and declines in labor union membership have likewise enhanced the income share of the top 0.1%. While tax rates on regular incomes and capital gains do not respond to the power of oligarchs, estate tax cuts, financial deregulation, and declines in Democratic seats in Congress accelerate following a windfall for the top 0.1%. Overall, the results imply that as oligarchs get richer, they minimize income and wealth loss due to the estate tax while enhancing their ability to extract rents in financial markets. But at the same time, the power resources of labor and society have important impacts on oligarchic incomes and top tax rates.
INTRODUCTION

When a small minority takes an increasing share of a society’s income, can they translate their economic power into political power that can be effectively deployed to protect and further enhance their economic advantages? The Medici dynasty in 15th century Florence suggested this much in a well-known phrase attributed to them: “Money to get power, power to protect the money,” (quoted in Fusfeld, 2001: 100). But could such a situation exist in an institutionalized capitalist democracy like the United States?

The small minority at the very top of America’s income distribution, while relatively well-off by definition, has seen their economic standing fluctuate fairly dramatically over the past century (Williamson and Lindert, 1980; Keister, 2000; Atkinson, Piketty, and Saez, 2011; Grusky, 2012; Wolff, 2012; Keister and Lee, 2014; Piketty, 2014). During the “roaring twenties” the rich saw substantial gains in their income share that continued until the eve of the Great Depression. But after the Great Depression and World War II, the richest Americans experienced a sharp drop in their share of income while the middle class and poor received substantial gains (Harrison and Bluestone, 1988; Ryscavage, 1999; Atkinson, Piketty, and Saez, 2011; Pizzigati, 2012). Beginning in the early 1980s, such gains were reversed with the super-rich capturing most of the subsequent income growth. By 2007, those at the very top obtained pre-tax income shares that actually exceeded the pre-Depression peak recorded in 1928. And even after the downside shock to top incomes during the the financial crisis of 2007-2008, by 2012 the super-rich had made a strong recovery with their income shares approaching levels not seen since before the crisis (Piketty and Saez, 2013).

Not surprisingly, the recent resurgence of inequality has prompted analysts to speculate about its political causes and consequences (Enns et al., 2014). In 2001, The American Political
Science Association formed a special task force on inequality and its implications for democracy. In their report, the task force concluded that “Our government is becoming less democratic, responsive mainly to the privileged and not a powerful instrument to correct disadvantages or to look out for the majority” (Jacobs et al., 2004: 18). Various analysts have reached similar conclusions. Gilens (2012), Bartels (2008), and Krugman (2002) suggest that the doubling in the income share of the richest 1 percent since the late 1970s reflects a “new gilded age,” while Hacker and Pierson (2010: 4) more explicitly argue that the U.S. now resembles “…the capitalist oligarchies, like Brazil, Mexico, and Russia, with their much greater concentration of economic bounty.” Johnson and Kwak (2010), Phillips (1994; 2002), and Ferguson (2012) argue that the U.S. is dominated by a “financial oligarchy,” while Winters and Page (2009: 731) state that “In the U.S. context, as elsewhere, the central question is whether and how the wealthiest citizens deploy unique and concentrated power resources to defend their unique minority interests.” The most important minority interest of oligarchs is likely “wealth defense” (Winters and Page, 2009; Winters, 2011).¹ Our analysis is motivated by these concerns: What is the link between the income share of the very rich and various policies which promote income and wealth defense?

Recent research suggests there is a link in at least one direction: top income shares (and overall income inequality) respond in relatively predictable ways to shifts in politics, tax rates, and financial markets (Bartels, 2008; Kelly, 2009; Volscho and Kelly, 2012; Piketty, 2014). But it is quite possible that the causal arrow runs the other way as well. In a representative democracy with equal political representation, the policy preferences of citizens, regardless of income, would play an important role in how policy evolves (if elected officials align their votes with public opinion). But in an oligarchy, oligarchs’ policy preferences trump those of the mass

¹ Specifically, Winters (2011) argues that in a “civil oligarchy” (which prevails in the United States), income defense is a primary means of wealth defense.
public when their interests diverge. In the contemporary United States there is increasing evidence of the latter.
When people with different incomes have the same opinions on policy, there is a concordance between what the public wants and the policies that prevail (Enns and Wlezien 2011; Page and Hennessey, 2010; Ura and Ellis 2008; Gilens, 2005). However, when the preferences of high and low-income people diverge, public policy is likely to align with and shift in the direction of the rich (Bartels, 2008; Gilens, 2005; 2012).² Of course, measuring the opinions of the extremely affluent is difficult in most publicly available survey datasets, but Page, Bartels, and Seawright (2011) recently surveyed a sample of top 1 percent wealth holders in the U.S. (those with a mean net worth of $14 million and average annual incomes of $1.04 million) and found a substantial divergence in opinions between them and the general public. Top 1 percent wealth holders are overwhelmingly against the regulation of large corporations.

² One fascinating finding is that liberal public mood declines in response to higher overall income inequality among both those with higher and lower incomes (Kelly and Enns, 2010). On a related note, political participation, consciousness, and voting have been found to decline with income inequality (Bartels, 2008; Solt, 2008; 2010).
favor lower estate, capital gains, and income taxes, and favor cutting Social Security, healthcare spending, and jobs programs. The general public, on the other hand, holds opposite views on these issues (Page, Bartels, and Seawright, 2011). There are profound differences between the very wealthy and the general public on major policy issues, and no set of issues appears more important to the very rich than taxes and financial market regulation.

In this paper, we examine whether the United States political economy can be characterized as a capitalist oligarchy similar to that depicted in Figure 1. That is, when the super-rich accrue a greater share of the nation's income, will policies that benefit those with high incomes shift in their favor? And do those policies in turn generate increasing inequality as part of a positive feedback loop in which rising inequality is self-reinforcing? Piketty (2014) certainly suggests as much in his groundbreaking new work, but answering these questions more systematically is important for at least two reasons. First, it helps us understand whether income concentration provides the super-rich with an ability to defend and further enhance their relative economic standing. Second, existing research positing politics as a cause of inequality could have the direction of causation between politics and inequality at least partially reversed if the political factors posited to drive inequality are, in fact, a response to rising inequality. Rather than assuming inequality to be either a cause or consequence of politics, we allow for the possibility that inequality is both a cause and consequence of politics. Empirically, we focus on the link between the income share of the very rich (potential oligarchs), the possible countervailing forces of labor unions and Democratic strength in Congress, and public policy (specifically financial regulation and top tax rates on regular income, capital gains, and estates). In the sections below, we discuss recent developments in the study of oligarchy and theoretical perspectives on how tax rates, financial deregulation, unions, and Democratic seats in Congress
relate to the income share of the very rich. Next, we outline our methodological approach to studying oligarchy in the United States using multiple time-series data that cover 1918 through 2012. Finally, we present our results and conclude with a discussion of the significance and implications of the findings.

THE THEORY OF OLIGARCHY AS INCOME AND WEALTH DEFENSE

In sociology, the concept of oligarchy is often used to describe a tendency toward hierarchical control in organizations (“rule by the few”). The most cited authority on this perspective is Robert Michels (1911) who argued for an “iron law of oligarchy” whereby large organizations evolve into bureaucracies which subsequently foster a concentration of elite power within that organization. After a thorough review of the literature on oligarchy spanning political science, social psychology, and political sociology, Leach (2005, p. 329) offered a definition of oligarchy as “…a concentration of entrenched illegitimate authority and/or influence in the hands of a minority, such that de facto what that minority wants is generally what comes to pass, even when it goes against the wishes (whether actively or passively expressed) of the majority.” While this definition is useful for studies of organizations and social movements, another perspective on oligarchy proposed by Winters (Winters and Page, 2009; 2011) is more closely related to our examination of the super-rich as a political force interested in wealth and income defense.

Oligarchies are political systems dominated by a minority of individuals and families (oligarchs) who possess a concentration of material resources and who use a fraction of those resources for the political defense of their income and wealth.3 Oligarchs can utilize material resources for the political defense of their income and wealth.

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3 We do not mean to imply that the class of oligarchs is perfectly fixed in the United States (or any other context). Membership in this elite group changes over time, but in an oligarchic system, those who are at the top at any given time have the capacity to utilize economic power to generate political power that protects their economic standing.
resources (whether individually owned or not) “to defend or enhance their personal wealth and exclusive social position” by using “wealth for wealth’s defense,” (Winters, 2011: 6). In societies where property rights are not as clearly secured by the state, oligarchs may engage in direct rule. In advanced industrial capitalist societies like the United States, where property rights are strongly and reliably defended by the state, oligarchs are more likely to engage in indirect rule such as influencing political actors and policies that impinge on their ability to accumulate larger shares of income and wealth (Winters, 2011). A bureaucratic state that defends property rights therefore reduces the need for direct and personal rule by oligarchs.
Extreme income and wealth inequality typically corresponds to extreme political inequality (Phillips, 2002; Bartels, 2008; Gilens, 2012). Gilens (2012), for example, finds evidence that if policy more closely corresponded with the wishes of the poor and middle class, we would have higher minimum wages, more stringent corporate regulations, and a more progressive tax system. Likewise, Bartels (2008: 2) concludes that “…elected officials are utterly unresponsive to the policy preferences of millions of low-income citizens, leaving their political interests to be served or ignored as the ideological whims of incumbent elites may dictate.”

A recent pilot study of top 1% wealth holders suggested that not only were there significant and stark differences in policy preferences, but that around half of all very high net worth survey respondents reported initiating contact with a House member, Senator, executive branch official, or head of a regulatory agency in the prior 12 months (Page, Bartels, and Seawright, 2011). While access to power (e.g. emailing a House or Senate member) is technically possible for the vast U.S. population, most of the general public does not engage directly with elected and unelected officials in Washington, and it is unlikely that elected officials attend to a letter from an average constituent in the same way as a contact from an economic elite.

Perspectives related to Winters’ oligarchy theory that imply a link between wealth and power are found in Mills (1956), Domhoff (2010), and Ferguson (1995) in addition to more modern and historical treatments (Phillips-Fein, 2009; Hacker and Pierson, 2010). Writing in the 1950s, Mills (1956: 99) argued, “The general facts, however, are very clear: the very rich have used existing laws, they have circumvented and violated existing laws, and they have had laws created and enforced for their direct benefit.” Domhoff (1990; 2010) suggests the “Who Benefits” question is indicative of power resources. Those who have vast material wealth can

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4 Though see Ura and Ellis (2008) and Enns and Wlezien (2011) for more detailed discussion of policy responsiveness to citizens in various income strata.
advance the “narrow and short-run policy concerns of wealthy families,” influence policy through funding think tanks, foundations, charities, media ownership, as well as strongly influence the selection of political candidates and influence public opinion. Others have argued that political power and policy can be linked to those with the ability and means to invest in the political process.  

WEALTH DEFENSE: TAXES, FINANCIAL DEREGLULATION, AND POLITICS

We focus here on two policies that are particularly salient to income and wealth defense: top tax rates and the regulation of financial markets. The first, and perhaps most germane, aspect of wealth defense we examine is taxation. Because taxation by government reduces the cash available to high-income families that can be converted into wealth holdings, taxation of high incomes is likely the most important threat to oligarchic wealth accumulation in “civil oligarchies” like the United States (Winters, 2011). As such, the authors of one of Citigroup’s leaked “Plutonomy” memos argued that while government enforcement of property rights remain secure in the United States, the government’s other means of “wealth expropriation” (i.e. 

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5 The “investment theory of politics” (Ferguson, 1995) argues that competing but wealthy investor blocs rooted in labor and capital-intensive industries invest in politics to maximize their own material interest. Labor-intensive industries have policy preferences more hostile to unions and New Deal programs while capital-intensive industries are thought to be more tolerant of unions and the New Deal welfare state (Ferguson, 1995). “Banks” are considered part of the “capital-intensive” bloc and we should expect that they would be more in favor of financial deregulation, despite the banking and financial regulations passed after the Great Depression. Our analysis is focused more closely on the income shares of high-income individuals and families (i.e. oligarchs) as opposed to industries.

6 While it would be preferable to have a measure of top wealth shares to measure the political power of oligarchs, we must rely on Piketty and Saez’s (2003) data based on U.S. income tax returns because there are not lengthy and consistent annual measures of top wealth shares suitable for a time-series analysis. We use the share of income accruing to the top 0.1 in the Piketty and Saez dataset: the share of capital-gains inclusive income going to the richest 0.1 percent of the income distribution. The Piketty and Saez estimates are noted by Winters (2011; see also Winters and Page, 2009) to be a reasonable approximation of oligarchic power.
taxation) may pose a significant threat to wealth accumulation (Kapur, Macleod, and Singh, 2005).

Second, financial regulation is important because of the intense financialization of the U.S. and world economy since the 1970s (Arrighi, 1994; Phillips, 1994; Henwood, 1997; Davis, 2009; Krippner, 2011; Lucarelli, 2012) and the concentration of financial wealth in the hands of the super-rich (Kennickell, 2009; Domhoff, 2010; Wolff, 2012; Nau, 2013). Governmental regulation of financial markets followed in the wake of the Great Depression in the 1930s. The major impetus originated with “…the alleged abuses stemming from the combination of commercial and investment banking activities” (Krippner, 2011: 60). Financial regulation imposed by the state sought to determine the conditions under which financial activity occurred and thereby served as a check on the power of financial actors in the economy. Financial deregulation can therefore be viewed as the sometimes gradual, sometimes radical, abolition of state financial and banking regulations established in the 1930s (e.g., the Glass-Steagall Act) that functioned to isolate and/or “compartmentalize” (Hacker and Pierson, 2010; Johnson and Kwak, 2010; Krippner, 2011; Campbell and Bakir, 2012; Hudson, 2012) various aspects of financial activity with the aim of ensuring stability in financial markets and the overall economy. Given the significant growth of the financial sector and concentrated ownership of stock, bond, and other financial asset wealth among the very rich (Kaplan and Rauh, 2010; Foster and Holleman, 2010; Wolff, 2012; Keister, 2014), financial deregulation is likely to be a very important aspect of oligarchic wealth accumulation and protection in the United States.

The income share of the super-rich is also arguably a measure of their power resources (Winters and Page, 2009; Winters, 2011). To wit, their income share is influenced not only by their own power resources but by the power resources of other groups. Power Resources Theory
(PRT) suggests that the organizational power of left parties (party control of government) and labor unions influence many outcomes such as how generous welfare benefits are (Huber and Stephens, 2001; Huber et al., 2006; Brady, 2009) and the pre-tax market income distribution and poverty rate (Bradley et al., 2003; Kelly, 2009; Volscho and Kelly, 2012). As such, left party control and union power may act as a countervailing check on the wealth-accumulating policy preferences of oligarchs (Hacker and Pierson, 2010). This can occur both through the market (where unions can push for higher wages) and in politics (where Democratic governments can legislate higher taxes or more regulations on businesses). We discuss these policy and power resources factors in more detail below.

**TAXATION AS A THREAT TO WEALTH**

Taxation and tax policy are easily some of the most important and contested policies in the United States and especially so in the last thirty-five years. Ideas about how taxes will impact the economy have a range of built-in assumptions about how the economy works and how people will respond to tax changes (Berman and Pagnucco, 2010). Correspondingly, the appropriation of income via taxation is likely the central threat to oligarchic income and wealth in the United States and therefore oligarchs have a direct material stake in minimizing their tax burden (Winters, 2011). As noted, however, there are various hypotheses about how top incomes will respond to changes in tax rates. Since this study is focused on pre-tax incomes as a source and consequence of oligarchic power, not only do we examine how pre-tax top income shares respond to tax rates, we also ask how top tax rates respond to pre-tax top income shares.

*Origins of Income Taxation*

Modern federal income taxes were first levied in 1913 during the progressive era. The establishment of the income tax in the United States in the early twentieth century is seen as a
response to the concentration of economic power that occurred in the late 19th century (Morgan and Prasad, 2009). At its inception, it applied to a very few high-income people—approximately 2% of the population (Higgs, 1987). Between 1913 and the 1920s, the number of returns filed was quite low, but by the dawn of World War II, the majority of the working-age population was filing tax returns (Hollenbeck and Kahr, 2008). In terms of raising revenue, the federal government became heavily dependent on income taxes. The percentage of federal revenue generated by income taxes increased from 11 percent in 1914 to 69 percent by 1920 (Blough, 1940), however there were drastic cuts in the income tax rate in the 1920s (Smiley and Keehn, 1995). While “supply-side” justifications for tax cuts are associated with political discourse from the late 1970s and 1980s, Andrew Mellon, the wealthy steel industrialist and Treasury secretary in the Harding administration, made the “supply-side” argument that top tax rate cuts could increase revenue (Smiley and Keehn, 1995). The basic idea is that tax cuts unleash economic growth as high income people invest in new businesses and the increase in economic output leads to greater government revenue (Gilder, 1981). According to this view, higher tax rates operate as a disincentive to investment and therefore lower economic growth.

During the New Deal period, Roosevelt pushed for higher tax rates on top incomes. Some analysts suggest that Roosevelt’s push for high taxes on the rich were designed to enable some redistribution of income from the rich to the middle class and to thwart the potential challenge of Huey Long’s “share our wealth” platform (Amenta, Dunleavy, and Bernstein, 1994; Thorndike, 2009). What is perhaps most interesting is the idea that reductions in top tax rates may lead to increases in government revenue not because of a “supply-side effect” of increasing economic activity, but because tax avoidance and evasion among the wealthy increases with higher top tax

7 One of the motives was that the rich invest in tax-exempt municipal bonds as a tax-avoidance strategy and that a rate cut would shift their money into actual productive investment.
rates (Smiley and Keehn, 1995; Winters, 2011). Because top marginal tax rates are a potential threat to those with high incomes, there will likely be behavioral responses to higher top tax rates among the super-rich.

The key responses to higher top tax rates depend on which tax is being raised and when. For certain top marginal income tax cuts occurring in the twentieth century there is evidence of a response in decreasing shares of top incomes, such as during the 1986-88 tax cut period (Feenberg and Poterba, 1993). Since the top marginal tax rate was cut from 50% to 28%, the rich delayed realizing incomes until the year in which the lower tax rate would be in effect (Saez, 2004). And in the year before the 1993 tax increase, there was a notable increase in the top 1 percent’s income share likely so that income would be taxed at the lower 1992 rate (Saez, Slemrod, and Giertz, 2012).

High income people, most importantly those in the upper reaches of the top 1 percent, tend to be the most responsive to changes in tax rates (Saez, 2004). But this has not been true for every tax cut. The 1964-65 Kennedy-Johnson tax cut was a relatively sharp reduction in the top income tax rate (from 91 percent to 70 percent), but top income shares did not change in response (Saez, 2004). Thus, there seems to have been no “behavioral response” or shift in top income shares while the 1981 and 1986 Reagan tax cuts show evidence of strong changes in the pre-tax income share of the very rich in response (Slemrod, 1990; Feenberg and Poterba, 1993; Feenberg and Poterba, 1993).

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8 In fact, Smiley and Keehn, using annual data from 1915-1929, found that tax return filings for a given bracket decreased when the maximum tax rate of that bracket increased. They interpreted this finding as indicative of tax avoidance--that tax avoidance and evasion should proliferate when the marginal tax rates on those with high incomes increase.

Saez, 2004). Again, in 2012 there was evidence of a sizeable shift in pre-tax incomes toward the super-rich and part of it is likely to avoid the higher tax rates effective in 2013 (Piketty and Saez, 2013). The super-rich have the ability and means to shift the timing of their income to periods in which it will be taxed at the lowest rate possible. While the discussion so far has centered on the top marginal income tax rate, there are two other top tax rates that are likely important to oligarchic wealth accumulation: capital gains and estate tax rates.

Capital gains taxes are levied on the sale of property and assets (stocks, bonds, real estate, etc.) where the selling value is more than the buying value. Capital gains were treated the same as ordinary income until 1921 when separate (lower) rates were established (Minarik, 1981). Between 1942 and 1969, capital gains on assets held for 6 months or longer were treated as “long-term” and taxed at half of ordinary income. Between 1970 and 1978 an especially progressive approach to taxing capital gains increased the maximum rate to as high as 50 percent (Minarik, 1981). By 1978, however, we see the beginning of the wave of federal tax cuts for the wealthy when the capital gains rate is incurrs the first cut (Prasad, 2006). Although the 1981 Reagan tax cut is often viewed as the beginning of the perennial tax cuts that began in the 1980s, the capital gains tax cut in 1978 seems a likely candidate as a start to the age of tax cutting.

The Economic Tax Recovery Act of 1981 is seen as one of the more significant developments in U.S. taxation largely because it severely cut top marginal tax rates (Slemrod 1990). The Tax Reform Act of 1986 later reduced weighted average marginal tax rates from 45 to 29 percent (Saez, Slemrod, and Giertz 2009), and income concentration seems to have responded

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10 One possible reason is that the income and wealth defense industry was in its “infancy” and not well organized nor effective around the time of the Kennedy-Johnson tax cut (Winters, 2011).
to these shifts (Gordon and Slemrod 2000).\textsuperscript{11} While tax progressivity is typically studied in the context of explicit redistribution, where a more progressive system by its very nature reduces inequality in after-tax income, recall that we are examining market-generated (pre-tax) inequality in this paper.

The estate tax differs from capital gains and top marginal tax rates because it is a one-time tax on wealth at the time of death. The “estate” is the entity or person who holds the assets between the time a person dies and payment of any tax and distribution of the wealth to heirs and heiresses (Burman and Slemrod, 2013). One possible response of the top 1 percent to a shock in the top estate tax rate is to find ways to decrease their share of inheritance that is counted as an income flow. One strategy had been for the wealthy to “gift” portions of their estate while still alive. The federal government responded by introducing a “gift tax” in 1924. But this rate was lower than the estate tax. Eventually estate and gift tax rates were equalized to prevent the gift vs. estate tax avoidance strategy. Estate tax rates did not change between the end of World War II and 1976, in fact there is almost no mention of the estate tax in the Congressional record during this time (Beckert, 2008). Estate tax rate cuts did not coincide strictly with the Reagan administration because the beginning of rate cuts and the raising of exemption levels started in the mid-1970s.\textsuperscript{12} From the perspective of oligarchy, however, there are possible material interests at stake following a lucrative increase in the income share of the rich. After a good year in the stock or bond markets, the portfolios of rich families can be threatened by the rate of estate tax.

\textsuperscript{11} At the time, Reagan’s director of the Office of Management and Budget confided to journalist William Greider that the overall purpose of the tax act was to be a “trojan horse” for a rate cut to the highest income households in the United States (Greider, 1982; Prasad, 2006).

\textsuperscript{12} In his study of inheritance taxes, Beckert (2008) finds that in the U.S. case, debates around estate taxes in the early 20\textsuperscript{th} century justified the tax as preventing a tendency toward plutocracy while in the 1970s a new neoliberal discourse emerged that justified estate tax cuts on the basis that they were now an “…unfair taxation of entrepreneurial initiative,” (Beckert, 2008: 201).
taxation when an older member of the family dies. Thus, heirs and heiresses to be have a material stake in seeing estate taxes reduced. As such, a shock to the income share of the rich may forecast a reduction in top estate tax rates.

The effect of taxation rates on concentration of income may be a straightforward market conditioning effect: higher rates of taxation may generate disincentives to accrue more earned income and act as an investment deterrent thereby lowering capital income. But there is certainly debate on this point in the economic literature. Auerbach and Hassett (1990) find that the Reagan tax reforms did not have much of an effect on investment patterns in the U.S. in the 1980s. Reporting incentives can also influence estimates of how income responds to tax rates. That is, changes in tax rates can impact how income is reported, the legal charters of corporations, and how compensation is timed (Slemrod 1992). Interpretation of the response of top income concentration to top tax rates is dependent on the incentives of high-income units to shift income to a time-period in which it will be taxed at the lowest effective rate.

The oligarchic defense of income is made possible by the vast collection of professionals hired by the rich to protect and preserve their income and wealth. In relation to financialization and taxation this is an acute problem when tax rates differ (such as the lower rate for capital gains compared to ordinary income) because “…the tax code needs complex rules to delimit the boundary between capital gains and other income,” (Burman, 2012: 6-7). These professionals consist of accountants, tax lawyers, lobbyists, former IRS and Treasury Department officials, and wealth management consultants (Winters, 2011). Their chief function is “…to make a man who

13 In testimony before the House Ways and Means Committee one economist noted that “Tax lawyers have told me that half of the Internal Revenue Code is devoted to defining the difference between capital gains and ordinary income,” (Burman, 2012: 7). Thus, the notoriously complex U.S. tax code would be simplified by setting the rates on capital gains equal or close to the rates on ordinary income.
appears as a Midas before his bankers look like a pauper to the taxman,” (Johnston, 2004: 8). C. Wright Mills noted this in the 1950s:

The manner in which the corporate rich pay their taxes is more flexible and provides more opportunities for shrewd interpretations of the law than is true for the middle and lower classes. People of higher income figure their own tax deductions, or more usually have them figured by the experts they hire. Perhaps those whose income derives from property or from entrepreneurial and professional practice are as honest—or as dishonest—as poorer people on wages and salary, but they are also economically bolder, they have greater opportunities and greater skill, and, even more importantly, they have access to the very best skills available for such matters: accomplished lawyers and skillful accountants who specialize in taxation as a science and a game (Mills, 1956: 152).

Quite pointedly, economist Leonard Burman noted “Since tax shelters that can pass legal muster or escape detection tend to be extremely complex, brilliant financial planners, lawyers, and accountants turn their talents to this lucrative, but socially unproductive line of work,” (Burman, 2012: 4-5). In this regard, wealth and income defense are strongly conditioned by selective accounting and shifting of income.

We therefore offer a set of hypotheses about how the pre-tax income share of the super-rich will respond to changes in tax rates if the U.S. can accurately be described as a civil oligarchy.

H1: The pre-tax income share of the super-rich (top 0.1%) decreases in response to an increase in the top capital gains, overall top marginal, and top estate tax rates.

While the above proposition concerns the effect of tax rates on top income shares, in an oligarchic system rising income concentration would also have effects on tax rates, with tax rates
falling as income concentration increase. This is possible due to the increased material interest and power of the rich to strategically avoid threats to their accumulation of income and wealth (Winters, 2011). Therefore, we test the following hypothesis about how top tax rates will respond to an increasing share of income accumulating to the super-rich:

\[ H_2: \text{Top tax rates on capital gains, overall income, and estates} \]
\[ \text{decline following a positive shock to the incomes of the super-rich.} \]

The possibility that very rich individuals have the capacity to shift income temporally in order to minimize taxation makes it essential to understand the timing of income gains at the top and changes in policy. Declining top income shares in the years immediately after a tax increase could be evidence of temporal income shifting. But if top income shares decline for a substantial period of time after a tax change, this is stronger evidence of longer-lasting distributional effects. Similarly, if tax rates only fall immediately after an increase in income inequality, this could be attributed to income shifting in anticipation of an announced change in policy. However, if the response of taxation is longer-lasting, this is more likely evidence of the role of oligarchic power generating a policy response. As we discuss below, we utilize techniques that allow us to address these questions of timing.

**FINANCIAL DEREGULATION AND THE SUPER-RICH**

One of the most striking trends in the U.S. economy since the 1990s is the increasing importance of financial activities. Wall Street banks are emblematic of this shift coupled with the seeming enhanced political power of financial actors in the economy (Arrighi, 1994; Phillips, 1994; Johnson and Kwak, 2010; Krippner, 2011; Philippon and Reshef, 2013). The financial sector has replaced the oil and gas sector in rankings of the Forbes richest 400 since the early 1980s (Foster and Holleman, 2010). An important consideration for our immediate purposes is the connection
between the rising power of finance and the shift of income and capture of rents by finance (Tomaskovic-Devey and Lin, 2011; Philippon and Reshef, 2012). The financialization of the economy corresponds to a world where businesses increasingly derive revenue from financial means where wage-setting processes have drifted away from workers and toward elite-level executives (Lin and Tomaskovic-Devey, 2013).

The lead-up to the financial crisis of 2008 corresponded to hyper-inflation in stock and real estate prices (Baker, 2009; 2010) which shifted a sizeable share of income to the top 1 percent (Volscho and Kelly, 2012). As Philippon and Reshef (2012) show, deregulation of finance predicts higher wages in the financial sector (Tomaskovic-Devey and Lin, 2011; Lin and Tomaskovic-Devey, 2013). Financial deregulation, following Philippon and Reshef (2013) refers to a) the proportion of the population that lives in states that have removed intrastate banking regulations, b) the separation of commercial and investment banks, c) interest rate ceilings, and d) the separation of banks and insurance companies. Thus, we expect that an acceleration of deregulation in finance and banking should be associated with an increased share of income accruing to the super-rich. This is because financial deregulation likely enhances the opportunity for rent-extraction. But at the same time, an increase in the income share of oligarchs may also be associated with an intensification of financial deregulation as oligarchs pressure state managers to help them convert returns from their income shares into further opportunities for rent-extraction and income and wealth accumulation.

H3: The income share of the super-rich increases in response to more financial deregulation, while financial deregulation increases as the super-rich accrue more income.
POWER RESOURCES AND OLIGARCHIC INCOME CONCENTRATION

While we are certainly interested in the expression of power by oligarchs, there is the possibility that Democratic power in Congress could blunt the ability of oligarchs to accumulate larger portions of the income distribution. Power Resources Theory (PRT) has often been used to study the expansion and size of the welfare state across countries, but here we apply this perspective to the relationship between top incomes, taxes, and financial regulations. In a recent study of the income share of the top 1 percent, Volscho and Kelly (2012) found evidence for PRT in that both Democratic Congressional seat share and labor union membership exerted independent and significant negative impacts on top income shares.

While the Democratic Party in the United States is not necessarily a left party when compared to other nations, it has been the case that the Democratic Party long favored higher rates of taxation on the rich. Therefore, we expect Democratic Party strength at the national level and union strength to be associated with lower levels of income concentration. At the same time, however, it is possible that greater financial resources at the very top enable the super-rich to exert influence on elections and labor laws in a way that reduces the power of Democrats and diminishes the power of unions.

H4: The income share of the super-rich decreases in response to increasing Democratic power in national policymaking institutions and union strength.

H5: Democratic power in national policymaking institutions and union strength declines in response to increased income concentration among the super-rich.
If increasing economic inequality feeds back into the political system by reducing Democratic power and increasing Republican power, this would be evidence of a positive feedback loop in which economic inequality begets political and policy changes that produce yet more economic inequality. While we have described civil oligarchy as an essentially closed positive feedback loop system, we want to note that there are exogenous factors that likely prevent the U.S. political economy from spiraling uncontrollably toward ever more economic and political inequality. Most notably, economic shocks that are partially distinct from both politics and economic inequality can shape the fortunes of the political parties. While the general pattern of oligarchy implies positive feedback between economic inequality, partisan power, and policy outcomes; partisan power in particular is likely sensitive to economic shocks in factors such as economic growth or unemployment (Campbell 2005; Erikson, MacKuen, and Stimson 2002; Hibbs 1987; Wlezien and Erikson 2004; Hibbs 2008). Our simplified theoretical model of oligarchy is represented as a closed system, but we are cognizant of the fact that the system is not completely closed and account for this in the analysis below.

DATA AND METHODS

We use several annual multiple time-series to assess the hypotheses about the link between the income share of the super-rich, financial deregulation, top tax rates, and Democratic seats in Congress. The measure of the super-rich (the capital-gains inclusive income share of the Top 0.1%) comes from Piketty and Saez’s (2003) dataset on top incomes based on tax filings and updated to 2012.\(^\text{14}\) This measure likely best captures the income of very high net worth individuals compared to what can be estimated from the Census Bureau’s *Current Population Survey* (CPS) – which employs top-codes (thereby deflating high incomes) and does not consider

\(^{14}\text{Piketty and Saez’s data is available at: http://elsa.berkeley.edu/~saez/TabFig2010.xls}\)
capital gains income (which is an important source of income for the very rich). Additionally, respondents to the CPS may not report their incomes as accurately as they would to the Internal Revenue Service (IRS) where there are legal and economic ramifications for hiding income from tax authorities (Winters, 2011). Although Piketty and Saez (2003) also include a measure of the richest 0.01% there is a high degree of income cyclicality.\(^\text{15}\)

Our measures of top tax rates are the rate for the highest income bracket for three types of income. First, we include a measure of the top capital gains tax rate – the rate applied to the highest bracket of capital gains income for each year.\(^\text{16}\) The maximum capital gains tax rate in its first year was 15%, raised to 67% in 1917 then cut to around 12.5% in the 1920s. It hovered in the 25% range until the late 1960s and then there were several increases until the 1978 capital gains tax cut bringing the maximum rate down from 39% to 28% in 1979 and down to 20% by 1982 where it remained until the 1986 tax reforms brought it up to 28% and in 1993 it was raised to 29.2% and then cut in 1997 to 21.2% and ultimately down to 15% by the mid-2000s.

The second measure is a measure of the top marginal tax rate on regular income available from the IRS (IRS, 2002). This measure ranges from 7 (1913) to 94 percent (1944). Beginning in 1981, the Reagan administration dropped the top rate from 70 to 50 percent by 1982 and then to 28 percent by 1987. The top tax rate on estates comes from the IRS and ranges from a low of 10 percent in 1916 to a high of 77 percent in 1941 where it remained until 1976. The first cut is implemented in 1977 to 70 and then again in 1982 to 65 percent. The rate was cut again numerous times to reach 35 percent by 2010 (where it remains). Our measures of financial

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\(^{15}\) As top incomes have risen, there has been a rise in their volatility (Parker and Vissing-Jorgensen, 2010). While Piketty and Saez’s measure of the top 0.01% might be indicative of oligarchy, we decided to use the top 0.1% to guard against volatility.

deregulation is an index provided by Phillippon and Reshef (2012) that ranges from -2.75 (maximum regulation) to 1 (maximal deregulation).\textsuperscript{17} Our measures of Democratic share in Congress come from multiple issues of the \textit{Statistical Abstract of the United States} and labor union membership comes from Hirsch and Macpherson (2008). We also add an exogenous control variable for economic performance. We use the log of real GDP in constant dollars to account for potential effects of economic growth on election outcomes, policy decisions, and income concentration.

\textbf{Vector Autoregression Model}

We use a Vector Autoregression (VAR) modeling approach in this study due to the potentially dynamic two-way relationships between our variables. VAR treats each variable as potentially endogenous and models the joint dynamics between all variables (Sims, 1980; Brandt and Williams, 2006). To test our hypotheses we utilize Impulse Response Functions (IRFs) to examine the potential dynamic inter-relations between each of our time-series with reference to the hypotheses stated above. Consistent with current practice, we use the Bayesian shape error bands to test for the statistical significance of impulse responses (Sims and Zha, 1998; Brandt and Freeman, 2006). We therefore mix Bayesian inference with frequentist estimation of the VAR following the lead of other recent studies using a VAR framework (see e.g., Eshbaugh-Soha and Peake, 2005; Wood, 2009).\textsuperscript{18} As noted above, we enter a single lag of log transformed real GDP as an exogenous control variable in the VAR.

\textsuperscript{17} The financial deregulation index consists of four components: a) the proportion of the population living in states that have removed intra-state banking restriction b) the separation of commercial and investment banks (legislated in 1933, gradually weakened beginning in 1987 and finally repealed in 1999), c) interest rates ceilings, and d) the separation of banking and insurance companies (Philippon and Reshef, 2012: 1580).

\textsuperscript{18} We used the Akaike Information Criterion, Bayesian Information Criterion, the Hannan-Quinn Information criterion to test for lag length and found support for 1-lag. The full VAR results and
RESULTS

The IRFs are reported in Figures 2 and 3. In Figure 2 we focus on the response of top income shares to shocks in the other variables included in the system. Each IRF shows how top income shares change over time in response to a shift of one standard deviation in the explanatory variable. The value of the IRF in periods 1 through 20 is the predicted shift in top shares at various time lags after the shift in the explanatory variable. Since our data are measured annually, then, we report the predicted effect on top income shares from 1 to 20 years after the initial shock to the explanatory variable. Importantly, since these IRFs are based on a VAR analysis, the predicted shock in top income shares accounts for both the direct effect of a shock to the explanatory variable and also the indirect effects that a shock to the explanatory variable has through other variables in the system, including any feedback that top income shares has on itself. We turn now to discussing the results.

Hypotheses 1-3 stipulate that the pre-tax income share of oligarchs will decrease in response to a shock in the top capital gains tax rate, the top marginal tax rate, and the estate tax rate. Our results show that top income share declines temporarily in response to a shock in the top capital gains tax rate. This effect begins in the first year after the shift in capital gains rates and is sustained for five years after the shock. However, by six years after a change to capital gains rates, any continued effect on top income shares dissipates to the point of statistical insignificance. The somewhat ephemeral effect of capital gains tax rate changes may be due to the fact that capital gains realizations can be timed with respect to capital gains tax rate changes (Slemrod, 1996). The response of top income share to a shift in top marginal income tax rates is

all IRFs produced in the analysis are reported in a supplemental file. Also included are tests for unit roots, Granger causality, and a Chow test for a structural break around the time of World War II, in addition to the RATS code for duplicating the results of our analyses.
slower, but more sustained. The effect of an increase in top income tax rates does not become statistically significant until about seven years after the tax rate change. But from that point forward, it is clear that an increase in the top marginal tax rate reduces top income shares substantially. This sustained negative response is likely due to the more fixed nature of non-capital gains income and the reduced incentives for income accumulation that higher income tax rates produce. The effect of estate tax rates on top income shares follows a pattern very similar to income taxes, though the effect of estate taxes is smaller. This suggests that income concentration generated by inheritance is effectively reduced when estate tax rates increase.
Figure 2. Impulse Response Function of Top .1% Share to a Shock in Other System Variables
The next portion of the figure examines the response of top income shares to a shock in financial deregulation. As expected, financial deregulation has a positive impact on the income share of the very rich. The top 0.1 percent share increases in response to a shock to financial deregulation—an effect which starts immediately after the shock and is statistically significant for a full 20 years. When state regulation of financial markets declines, the very rich seem to benefit.

The next two panels of the figure examine traditional lower class power resources variables – Democratic strength in Congress and union strength. Consistent with prior research (Volscho and Kelly, 2012), Democratic dominance of Congress and increased labor union membership are associated with decreases in income concentration among the rich. The effect of Democratic strength in Congress has a quite sustained effect, maintaining statistical significance in all periods reported in the IRF. The effect of union strength is somewhat more time-constrained, dissipating by about ten years after an initial shock. The overall message of Figure 2 is that the effects of politics and policy required for the existence of oligarchy are present. That is, changes in politics and policy largely have the expected distributional effects. But an oligarchic system also requires feedback from income concentration to politics and policy.

We turn to evidence on this point in Figure 3, which presents evidence needed to assess the impact of oligarchic power (increased income concentration) on tax rates, financial regulations, and power resources. Top income tax rates do not respond to increases in top income shares. Top capital gains rates, however, decline in the long run as top income shares increase. This effect attains statistical significance from approximately 10 to 20 years after the initial

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19 Note also that this is not being channeled through stock prices because we have controlled for stock price changes by entering the inflation-corrected Dow Jones Industrial Average as an exogenous variable in a supplementary VAR model reported in the SI file.
increase in the income gap. Note that if this were an income re-timing effect, then we would expect to see a shock to the super-rich associated with higher subsequent tax rates in the short term because the rich would be realizing more income at year 1 to avoid losses from higher tax rates in future years. The fact that the effect of income taxes occurs only with a very long time lag argues against the idea that the policy response is driven by income timing effects rather than an oligarchic process in which rising inequality provides opportunities for wealth defense. With regard to the estate tax, we also see evidence of a sustained downside impact on top estate tax rates because there is a persistent decrease in rates following a shock to the top 0.1% share.

A shock to the super-rich likewise accelerates the intensity of financial deregulation. The findings above suggest that when the rich accrue a large share of the pie they may put pressure on the state to reduce taxes so as to minimize their tax loss. A shock to the income share of the rich may also provide the motivation and the opportunity for the rich to put pressure on the state to deregulate financial markets as their increased income share could be utilized for rent extraction in financial markets. In terms of political power, we see evidence of a downward impact of the income share of the top 0.1% on the share of Democrats in Congressional seats. This suggests that oligarchic income concentration may be a predictor of decreased Democratic power in Congress. Overall, the results in Figure 3 show substantial evidence of feedback from income concentration to politics and policy that is broadly consistent with the expectations of oligarchy. Income concentration produces changes in politics and policy that, in turn, produce yet more income concentration.
Figure 3. Impulse Response Function of Other System Variables to a Shock in Top .1% Share
DISCUSSION AND CONCLUSION

Oligarchy refers to the concentration of material resources among a numerical minority of actors who use a fraction of those resources to sustain and enhance their claims to income and wealth. In a civil oligarchy like the United States, the greatest threat to oligarchs is the taxation of income flows while one of the greatest means of enhancing short-term wealth has been the deregulation of financial markets. Thus, we examined the link between the income share of the top 0.1% and top tax rates on capital gains, regular income, and estates as well as financial regulations. Additionally, we also looked at the other end of the spectrum to see if the power resources of labor (Democratic dominance of Congress and labor union membership) have the ability to blunt income concentration among oligarchs.

The core finding of the paper is that the empirical signature of a civil oligarchy is present in the United States. Much of the evidence presented in the paper is consistent with the argument that as the super-rich accrue increasing income shares, they are able to deploy their economic power in the political realm to protect and further enhance their relative economic position. None of the results in the paper directly contradict the expectations generated from a theory of oligarchy.

First, we examined how the pre-tax top income share is shaped by the top tax rates on capital gains, regular income, and estates. As expected, the pretax top income share declines in response to increases in capital gains, regular top tax rates, and top estate tax rates. This is not surprising because an increase in top tax rates is likely to decrease the incentive of the rich to accrue higher compensation and investment income, as well to increase the incentive to engage in tax avoidance and evasion in their ordinary and capital gains sources of income. This effect is likely a manifestation of the micro-level behavior of high income tax filers and their tax
attorneys, wealth management advisors, employers, and accountants who may be able to get them to appear, in varying degrees, like a “pauper” before tax authorities (Johnston, 2004; Winters, 2011).

Additionally, we find evidence that the top income share is inversely related to the degree of financial deregulation. Thus, the deregulation of financial markets appears to have increased the income share of the rich. One way to understand this is that deregulated financial markets may create an environment in which new opportunities for rent-extraction are possible (Tomaskovic-Devey and Lin 2011). After a lucrative year of income returns, top income recipients may lobby for further financial market deregulation to increase the scale of rent-generating outlets for their excess share of income. The deregulation of financial markets is part of a new political-economic institutional environment that emerged in the late 1970s and early 1980s that coincides with the inability of government to regulate new financial investment vehicles such as derivatives (Hacker and Pierson, 2010; Krippner, 2011; Lin and Tomaskovic-Devey, 2013) and the importance of financial investments to elite incomes (Nau, 2013).

We also found evidence that the economic and political power resources of lower and middle income citizens have the potential to serve as a counterbalance to the power of the oligarchs. An increase in Democratic seat shares in Congress and labor union membership are both associated with a reduction in top income shares. Thus, Power Resources Theory suggests that when union membership and left-party control are higher, oligarchic income concentration can be directly and indirectly affected by changes in tax rates and financial regulations.

Importantly, though, the effects of partisan politics and policy on top income shares provides a powerful incentive for the very rich to undermine such policies and parties. A civil oligarchy requires more than an effect of politics and policy on income concentration. It also
requires positive feedback from income concentration to politics. And we found evidence of this as well. When top income shares rise, capital gains and estate tax rates fall in the medium to long term. As well, financial deregulation increases and Democratic power in Congress declines in response to an increase in income concentration. The evidence that tax increases, financial deregulation, and Democratic Party strength produce increased income concentration and that income concentration then feeds back into politics by reducing tax rates, increasing deregulation, and reducing Democratic power is broadly consistent with an oligarchic system.

Perhaps the most important implication of these results is that while a democratic political system has the potential to rein in the power of oligarchs, the way the current system functions makes this unlikely. Rather than fueling policies that reduce income inequality, the concentration of income at the very top of the income distribution seems to be self-reinforcing in the realm of politics. However, as we mentioned earlier, economic shocks can disrupt the feedback loop between income concentration and election outcomes and policies serving to enhance inequality. Such economic shocks have likely been central to preventing an even stronger cycle toward income concentration, and any reversal of the trend toward inequality will likely be at least partially supported by economic shocks that generate a political reality in which a more egalitarian politics and policy can prevail.

Finally, we would note that while a theory of oligarchy involves feedback between economic inequality, political inequality, and policy outcomes; our analysis did not explicitly examine political inequality as part of the empirical model. Rather, we simply examined feedback between economic inequality and partisan politics and policy. In part, we chose this route because we have been unable to develop a credible alternative to political inequality as a mechanism linking economic inequality and inegalitarian political outcomes. However, if
theoretical alternatives to political inequality can be developed, a fruitful line of future research could explore the relative role of political inequality and other factors in this system of oligarchy. It is also difficult to conceive of measures of political inequality that are available over the lengthy time span needed to utilize the type of analysis we conducted here. If reasonable measures of political inequality could be devised, it would be possible to differentiate the effects of various forms of political inequality.
References


