# BRIEFING: Summarising and signposting essential reading we've seen elsewhere...

## MARGINAL TAX RATES AND INCOME: New time series evidence

**The debate over top tax rates has** been raging in political circles in the last three years. Until recently, there was a consensus in favour of a top rate of 40 per cent in the UK (relatively low by post-war standards). The rate was then increased to 50 per cent by the last government. Despite the fact that the now opposition Labour Party regarded that increase as temporary, they objected when the coalition government reduced the rate to 45 per cent. It is also worth noting that there is also little sign that the current government wishes to reduce the top tax rate back to 40 per cent. A further matter of contention is whether it was wise for George Osborne to begin his fiscal consolidation by increasing taxes.

This paper by Karel Mertens is important for these debates. Mertens' results show that reductions in tax rates for the top one per cent increase pre-tax incomes for that group; this is not simply caused by reduced avoidance. There is also an increase in national income following cuts in top marginal tax rates as well as an increase in incomes for the lower paid. This suggests that increasing taxes on those on higher incomes is likely to reduce national income and reduce the incomes of the less well off. Unsurprisingly, the author shows that increasing taxes on the top one per cent of income earners will reduce inequality. Regarding the fiscal consolidation issue, the author comments: "The results imply that raising marginal tax rates to resolve budget deficits comes at a high price and that a proportional across-the-board tax cut provides successful stimulus that does not necessarily lead to greater income concentration at the top".

KAREL MERTENS
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***NBER Working Paper 19171 (2013)***
*www.economics.cornell.edu/km426/papers/MTRI_article.pdf*

## CAPITAL MARKET INTEGRATION and WAGES

**Though some economists like to cite the exceptions, most agree that free** trade increases wealth. There is more controversy, however, about whether openness to capital flows always benefits a developing country. This paper, one of the authors of which is a former Obama advisor who has an impressive career trajectory as an economist, demonstrates the clear advantages of countries opening up capital markets. The authors point out that, due to the opening up of a number of countries in the 1980s and 1990s, we have an unprecedented body of data which can be used to examine whether capital market liberalisation leads to higher wages. In theory, it should. In developing countries labour is often plentiful and capital scarce (though China, of course, has a very high savings ratio). Capital market liberalisation should therefore raise wages and reduce the rents that can be received by owners of capital. In a sample of 25 emerging economies, which had significantly increased capital flows after liberalisation between 1986 and 1996, the authors' estimates show that the growth rate of real wages jumped from 1.8 per cent per year in the pre-liberalisation period to an average of 5.7 per cent in the year of liberalisation and the subsequent three years. Of course, there are a large number of potential data problems in this analysis. However, the authors find strong evidence for the argument that it is capital market liberalisation that causes increases in real wages. For example, labour productivity also increases along with the import of capital goods in those countries that liberalise. Capital market liberalisation also promotes the diffusion of technology into developing countries.

The authors conjecture – though do not investigate this further – that the increase in wage inequality in developing countries might be partly explained by the more complex technologies that are employed in production processes due to the import of capital goods.

ANUSHA CHARI, PETER BLAIR HENRY AND DIEGO SASSON
***American Economic Journal: Macroeconomics 2012, 4(2): 102–132***
*http://archive.nyu.edu/bitstream/2451/31604/3/pbh%20%20capital%20market%20integration.pdf*

## JUVENILE INCARCERATION, HUMAN CAPITAL and FUTURE CRIME: Evidence from randomly assigned judges

**In the US in 2010, nearly 0.25 per cent of all 10-19 year olds were in prison. This** is a rate out of all proportion to that experienced in any other country. A stay of 12 months in prison costs the taxpayer about £50,000 in the US. In this research, the authors examine the impact of the use of juvenile detention (imprisonment) on future outcomes. Using a database of 35,000 people over ten years, they find that, for those for whom the decision to detain is marginal, there is a decrease in high school completion and an increase in the likelihood of adult imprisonment if the individual is imprisoned. It therefore appears that, for the individual, juvenile imprisonment undermines human capital accumulation and increases the probability of a person pursuing crime as an adult. The authors point out that there are effective alternatives to juvenile detention. The most obvious are properly monitored and enforced curfews and electronic monitoring. It could be objected that, though these results suggest that imprisonment should be used less and would reduce future crime, it is possible that strict punishments might deter other juveniles and also that, whilst incarcerated, juveniles cannot commit crime and thus imprisonment may have a direct effect on crime. The authors argue that the first objection at least is likely to be of marginal significance.

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***NBER Working Paper No. 19102 (2013)***
*www.mit.edu/~jjdoyle/aizer_doyle_judges_06242013.pdf*