Tax Policy & Inequality

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Multiple Goals for Tax Policy

• Revenue raising, Redistribution (inequality), Environmental Externalities, Private-Sector Development (‘Industrial Policy’) etc. Can conflict with each other.

• Most (all?) tax systems are the result of changing political priorities over time, inc. over inequality

• ‘For too long... tax reforms have been approached ad hoc, without regard to their effects on the evolution of the tax structure as a whole. As a result many parts of our system seem to lack a rational base. Conflicting objectives are pursued at random; and even particular objectives are pursued in contradictory ways’ (Director, UK’s Institute for Fiscal Studies, 2011).
History Matters : Inequality ↔ Tax

• Example: Latin America’s income taxes smaller % of total taxes compared to similar countries & to North America – colonial histories

• Often starts with land inequality (i.e. productive assets): different patterns of land ownership => different structures of political power => fiscal incidence (tax/spending).

• High thresholds on income tax. Many countries have multiple (& opaque exemptions) benefiting higher-income groups.

• Wealth taxes: Political mobilization by wealthy (collective action). Media framing of debate.
Revenue Mobilization & Composition (Lustig 2017)

FIGURE 1: SIZE AND COMPOSITION OF GOVERNMENT REVENUES (as a % of GDP; CIRCA 2010)

(ranked by total government revenue/GDP; GNI right hand scale)

- Direct taxes
- Indirect and other taxes
- Social security contributions
- Other revenues

United Nations University – WIDER
Tax Structures, Southern African countries (% of GDP), 2012

Source: ICTD – UNU WIDER GRD
International Development debate focuses on Revenue Raising Goal

• Lot tax policy goals, but revenue goal pre-eminent in debate

• **MDGs** seen mainly through the prism of social spending (health, education etc.) => less inequality in HD outcomes & perhaps incomes (if more human capital formation among poor). Delivered: Real achievements inc. in inequality of health outcomes (children especially)

• => Maximize domestic revenues to finance spending (especially in recent years as aid stalled. Pushed hard by donors themselves).

• But low per capita income does set an upper bound on revenue mobilization – do need (sustainable) economic growth
SDGs cont

• **SDGs** still have social spending focus, though more attention now to **job creation** (influence of Arab Spring, ‘Jobless Growth’ etc.)

• This debate continues long-standing concentration on livelihood creation via community development/small (informal enterprise). Great!

• But too little attention to job creation via creation of medium/large firms (‘superstars’) & role of tax policy in helping shape this (distrust of formal private-sector) => **less income inequality via rapid wage & job growth** (see S.Korea, Vietnam etc.)

• **Tax/GDP ratio** focus of attention. Rising ratio celebrated. Good if it rises via better & fairer tax institutions (+ compliance), more tax of (bad) environmental externalities etc

• BUT not good if Tax/GDP rises due to: distortionary taxes that hit growth & jobs. Or via more taxation of poor people (without commensurate service delivery, or ignores the bigger “**tax fish**” in removing exemptions, getting extractives taxes right)
Quality of Economic Growth

• Is growth process **inclusive** or **exclusive**? (does it create many good livelihoods? -- or not?)

• Exclusive growth – economies driven by extractive industries (e.g. offshore oil) & few 'growth poles'

• High **spatial inequality** : stagnant, rising & declining areas (globalization). Issue for ALL countries : LICS, MICs, HICs
Resource Wealth & High Inequality Societies

- Many: lack of a social contract between state & citizen <-> opaque tax-spending system (also reluctance to create non-resource revenue taxes)

- Citizens have little knowledge about fiscal incidence (what their taxes pay for)

- A few resource-rich countries have diversified their revenue bases (cutting revenue risk) & improved human development but still up against hard constraints (agr. potential, location etc.). Botswana, Namibia: high & rising inequality
Redistribution via Tax/Spending

• Use tax-benefit system to redistribute: more pressure to do this in exclusive growth countries

• But demanding on government capacity (& also data/analysis – need to understand net fiscal incidence)

• Need it most in societies that are politically least likely to do it (Resource-rich countries – often no attempt to build a fiscal contract between state & citizen)

• Democratic politics in HICs, MICs very much focused around net fiscal incidence & tax level/composition to achieve it (but in context of often low-quality growth)
Benefits shrink UK wealth gap

Effect of taxes and benefits on UK household income

By quintile groups, average per household, financial year ending 2016 (£'000)

Source: Office for National Statistics
Redistribution via Fiscal System

• Trying to deliver Redistribution via fiscal system in context of:

• **Changing Composition in Tax Sources** over time: VAT etc, personal Income tax, corporate tax, extractives (& non-tax revenues like user charges).

• Impact of **globalization** : placing limits on national policy, increasing need for more international cooperation, BUT expanding scope for growth (& total revenues) if your economy integrates into the global economy in a ‘smart’ way.
Falling Corporate Tax Rates

Figure 2: Corporate income tax rates, 1980–2013

- High income: OECD
- High income: non-OECD
- Upper middle income
- Lower middle income
- Low income
- Tax haven
Global Tax Avoidance

• Tax avoidance by corporates via profit shifting across tax jurisdictions, Use of Tax havens etc

• Crivelli, de Mooj, Keen (IMF) : $650 bn (annually)

• Cobham & Jansky. (WIDER) : $500 bn (annually)

• But balance in tax policy needed for private-sector to create more livelihoods (i.e need MNCs to invest before you can tax them)

• => Increased pressure on revenue mobilization via user fees, indirect taxes, personal income tax etc
Income Taxes (% of GDP), 2012

Avg.: 6.1%

Source: ICTD – UNU WIDER GRD
Transparency: Why? Unfair Tax Burdens

• Need transparency in **public spending system**

• Otherwise, taxation system can be viewed as unjust (leading to grievances over who bears burden)

• Need transparency in **revenue system**

• Transparency is central to **accountability** – to the legislature but also citizens (tax-payers) => compliance

• Finland: public aware of how the fiscal system redistributes <=> trust in tax system => high compliance
Tax simulation supports governance

SOUTHMOD – simulating tax and benefit policies for development

Tax-benefit microsimulation models, which combine representative household-level data on incomes and expenditures and detailed coding of tax and benefit legislation, have proven to be an extremely useful tool for researchers and policy makers alike. The models apply user-defined tax and benefit policy rules to micro-data on individuals and households and calculate the effects of these rules on household income. The effects of different policy scenarios on poverty, inequality, and government revenues can be analysed and compared.

Simulation in developing countries
While microsimulation models are routinely used by researchers and policy makers in developed countries, few developing countries have access to such tools. Many of the developing countries are now building up their social protection systems and the financing of public spending will need to be increasingly based on domestic tax revenues. In this process, understanding the system-wide impacts...
Summing up: 3 issues for future

• **Revenue volatility**: from extractive sectors (commodity-price volatility), business-cycle (over-dependence on few revenue sources), climate change etc => affects ability to address **inequality**

• **International Corporate Tax Avoidance**: inflexion point? More international co-operation?

• **Demographic change**: ‘young’ v ‘ageing’ societies – how this affects revenues (& inequality). Demographic ‘dividend’? Young people finding only livelihood in (untaxed) informal sectors
GRD – Government Revenue Dataset

The most recent version of the Government Revenue Dataset – released in January 2016 – is open and free to use. The primary data file (core dataset) is available for download in two formats and can be downloaded below.

Please contact the database manager for any questions on the dataset. We also encourage comments on this revision and contributions of updated data points. The dataset will be updated and notifications and details on the updates will be given on the website.