Actrav Symposium on

‘Income Inequality, Labour Market Institutions and Workers’ Power‘

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Defending and increasing the fiscal space

Progressive Tax Reform in OECD Countries: Perspectives and Obstacles

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Overview

- Traditional standards of tax justice under pressure: taxation trends since the 1980s
- Has the recent crisis broken the downward trend?
- Standard arguments against progressive taxation under scrutiny
- Macroeconomic arguments in favour of progressive taxation
- Policy strategies on the international and national level

Traditional Standards of Tax Justice under Pressure

Allocation Function (upgraded)

Distribution Function (downgraded)

comprehensive income tax base

➔ trend of dualisation

high degree of progression and redistribution

➔ weakening of progression and redistr.

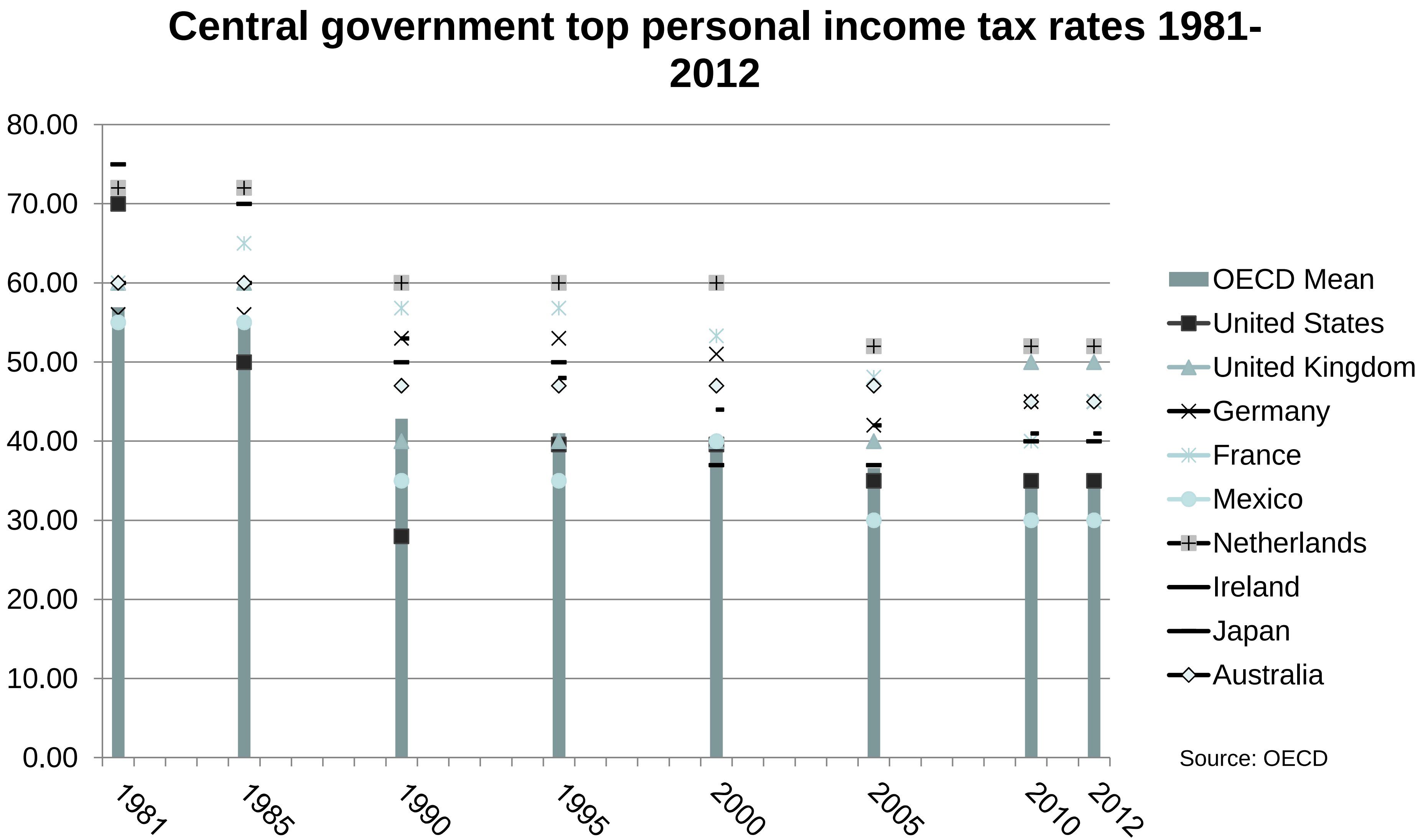
Stabilisation Function (downgraded – neglected)

Regressive Taxation
Trends in OECD Countries

Comparing the development of Gini-Values for market incomes and the Gini-Values for disposable incomes the OECD (2011) observes:

- Market incomes have become more unequal since mid-1980s
- On average redistribution by the state has become less effective since 1990s:
  - Between mid-1980s and mid-1990s redistribution systems compensated about 73% of the increase in market-income inequality.
  - Between the mid-1990s and mid-2000s this percentage decreased to 53%.

Cutting the Top Income Tax Rates



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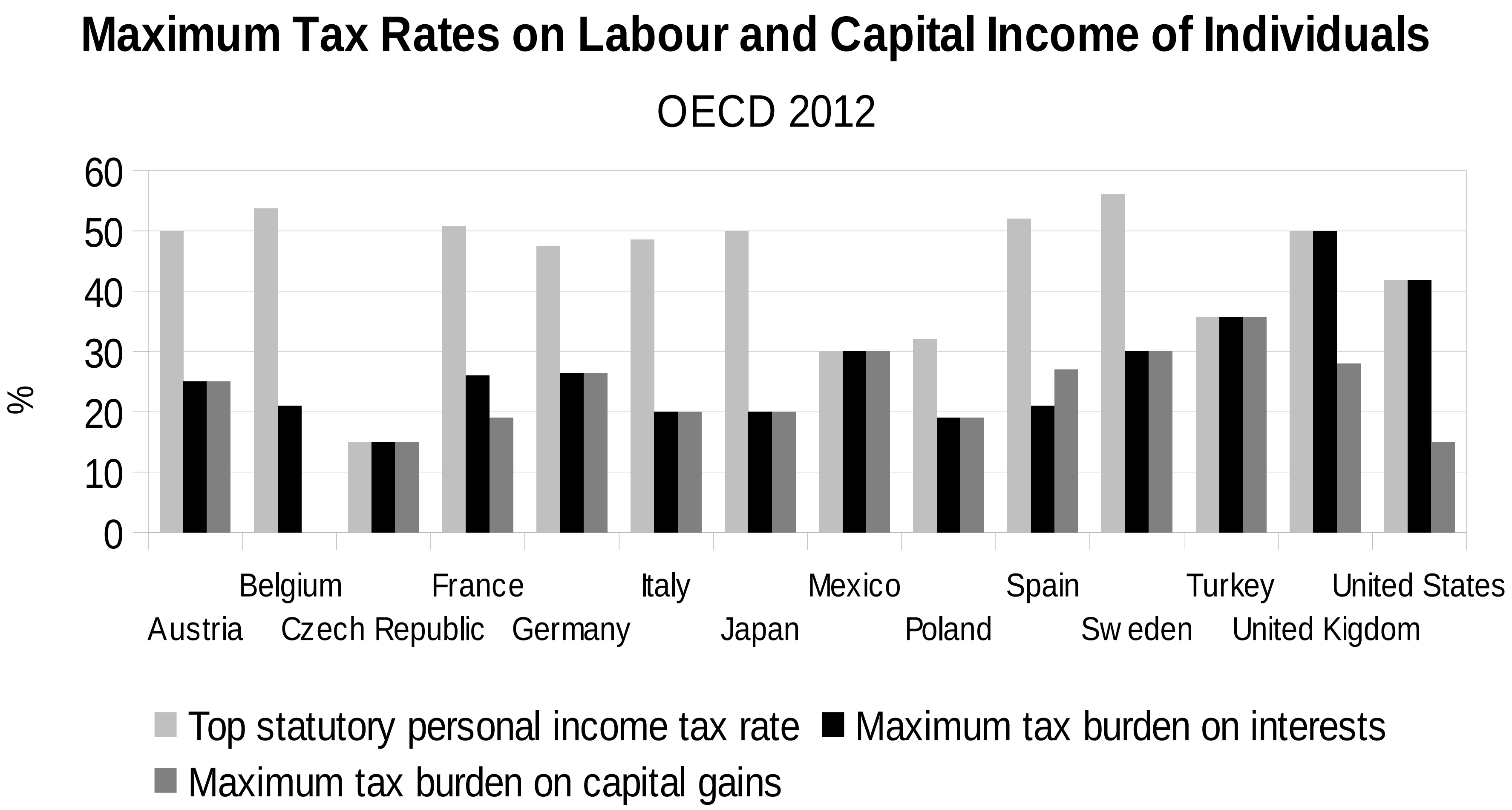
Preferential Tax Rates for Capital Income



Source: OECD Tax Database 2013, Deloitte 2013, KPMG 2012

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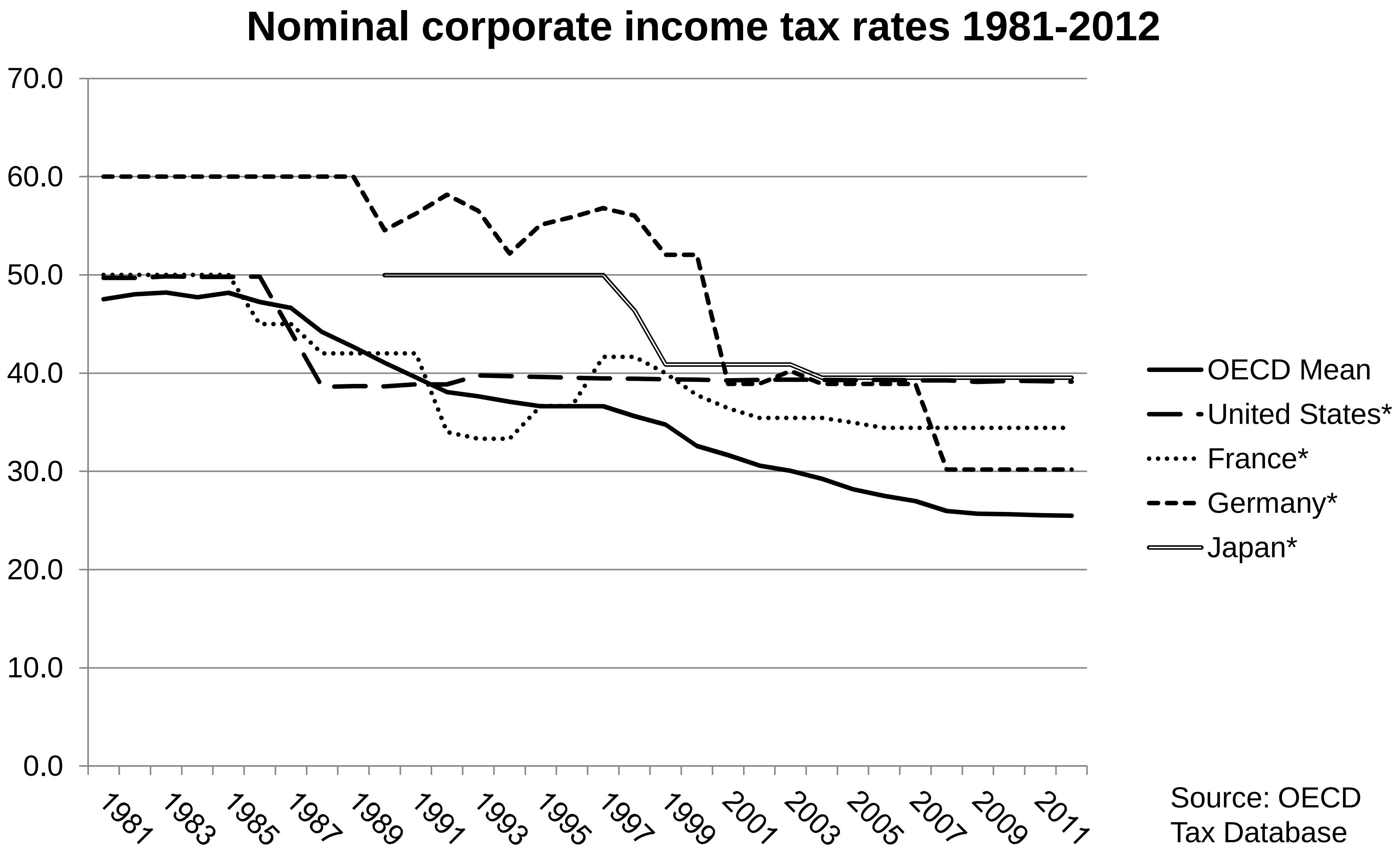
Taxes on Property

- On average property taxes as a percentage of GDP remained fairly stable and decreased slightly as a percentage of total taxation as compared to 1970. (This is not true for Belgium, France, Japan, Iceland, Sweden.)

- But, according to Piketty & Zucman (2013), since 1970 the ratio of private wealth to national income has risen constantly in many rich countries: Australia, Canada, USA, Germany, France, Italy, Japan, UK

Declining Corporate Tax Rates



Source: OECD Tax Database 2013

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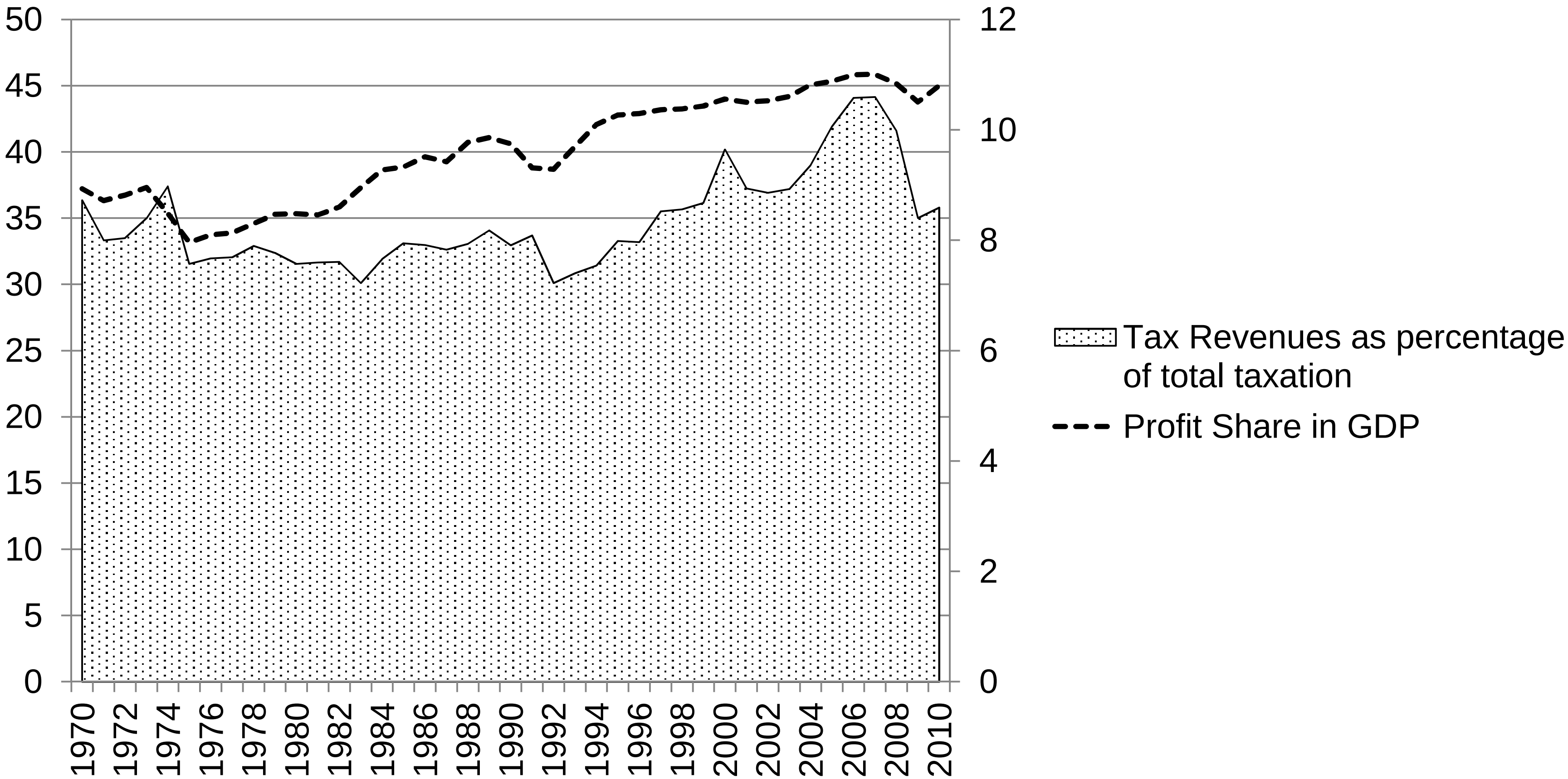
Declining Corporate Tax Rates II

Corporate Tax Revenues and Profit Share –
OECD Average 1970-2010



Goals of Taxation – Shifting Priorities

- Shift in priorities towards allocation function
- Redistribution function: less concern with relative income positions and excessive income at the top
- Instead: provide tolerable floor at the lower end of income distribution

Taxation trends: a threat to the welfare state?

- No immediate direct threat, because effect on revenues seemed limited
- the general trends in the gross income distribution have (over)compensated the tax cuts
- Indirect threat, because negative distribution trends underminde the perceived legitimacy of the welfare state

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Has the Crisis Broken the Downward Trend?

- Top personal income tax rates: OECD average stopped declining in 2008. (Greece, Spain, UK, France, Iceland, Ireland, Italy, Korea, Portugal) > a turning-point?
- Capital gains tax: Ireland, Italy, Spain, Portugal, U.S., France
- Taxes on Property: Increasing taxes on immovable property: Greece, Portugal, Spain, Ireland, UK
- Corporate Taxes: stable since 2008 (Only Canada, Greece, and UK further decreased nominal rates.)
- Consumption Tax: Revenue raising measures in EU have been concentrated on consumption taxes: 12 European countries, New Zealand, Mexico

Has the Crisis Broken the Downward Trend?

Table 9. Tax Measures in Selected Countries, 2010–13

Country	Personal Income Taxation		Corporate Income Taxation		Value-Added Tax		Social Security Contributions		Excises		Property	
	Rate	Base	Rate	Base	Rate	Base	Rate	Base	Rate	Base	Rate	Base
Advanced economies												
Australia		↑		↓				↓				
Austria		↑		↑		↑		↑	↑			
Belgium	↑	↑		↑		↑	↑		↑		↑	↑
Canada	↑	↑	↓						↑			
Czech Republic	↑	↑		↑	↑		↓	↓	↑			
Denmark	↑	↑		↑		↑			↓	↑		
Finland	↑	↑	↓		↑				↑			
France	↑	↑	↑		↑	↑	↑		↑			
Germany		↓					↓		↑			
Greece	↑	↑	↑		↑	↑	↑		↑		↑	
Hong Kong SAR												
Iceland		↑	↑			↑	↑		↑			
Ireland	↑	↓			↑	↓	↓	↑	↑		↑	
Israel	↑	↑		↓	↑		↑		↑			
Italy	↑			↓	↑				↑			↑
Japan			↓									
Korea	↑	↑	↑									
Netherlands	↑	↓	↓		↑				↑		↓	
New Zealand	↓		↓		↑				↑			
Norway												↑
Portugal	↑	↑	↑		↑	↑	↑		↑		↑	
Singapore			↓								↑	
Slovak Republic	↑	↑	↑		↑		↑	↑	↑			
Slovenia	↑		↓						↑			
Spain	↑	↑		↑	↑	↑			↑		↑	
Sweden		↓	↓						↑			
Switzerland		↓			↑							
United Kingdom	↓	↑	↓	↓	↑		↑		↑		↑	
United States	↑	↑					↑					
Emerging market economies												
Brazil						↑	↓	↓	↓			
Bulgaria					↑	↑	↑		↑			
Chile	↓		↑	↑								
China	↓	↓			↓	↑		↑			↑	↑
Estonia									↑	↑	↑	
Hungary	↓	↓	↓		↑		↑		↑			
Latvia	↓	↓		↓	↑	↑	↑		↑	↑	↑	↑
Lithuania	↓		↓	↓		↓		↑	↑		↑	↑
Mexico	↓		↓									
Philippines						↓			↑			
Poland					↑	↑	↑		↑	↑		
Romania					↑				↑			
South Africa				↑					↑	↑		
Turkey									↑		↑	

Sources: European Commission; Organisation for Economic Co-operation and Development; and IMF staff.
Note: An upward (downward) arrow indicates a revenue-increasing (-decreasing) change.

Source: IMF 2013

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Standard arguments against progressive Tax Reform…

Strong belief that many types of progressive taxes do harm to output and employment.

As the OECD (2012d, p. 39) puts it:

"Simply raising marginal personal income tax rates on high earners will not necessarily bring in much additional revenue, because of effects on work intensity, career decisions, tax avoidance and other behavioural responses."

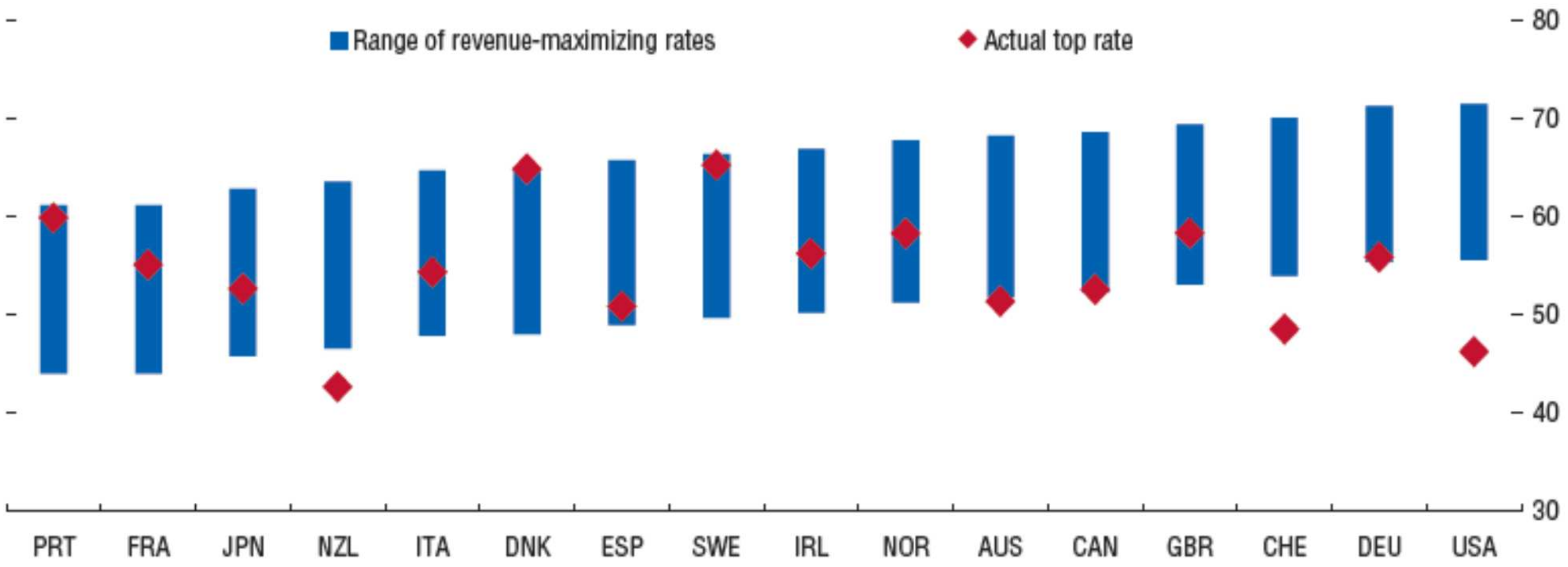
- High top marginal tax rates discourage labour supply, labour effort, entrepreneurial investment
- High taxes on personal savings discourage investment
- High corporate tax rates discourage investment
- Tax evasion and tax planning undermine revenue raising potential

…Standard arguments against progressive Tax Reform do not hold:

- Empirical estimates typically show moderate effects so that increased redistribution is possible without great damage to output and with increased revenue
- Public spending may compensate for some negative effects
- Macroeconomic effects support the case for higher redistribution

…Standard arguments against progressive Tax Reform do not hold:

Figure 17. Top Marginal Rates and Revenue-Maximizing Rates, Late 2000s
(Percent)



Sources: OECD (2011); World Top Income Database (Alvaredo and others, 2013); and IMF staff estimates.

Note: Saez (2001) shows the optimal top marginal rate to be $T = (1 - \omega)/(1 - \omega + ae)$, where ω is the weight attached to the welfare of those in the top income group, *a* is the parameter of the Pareto distribution assumed to characterize the distribution of income in this group, and *e* is the average elasticity of taxable income (with respect to unity minus the marginal tax rate). The calculations here set ω equal to 0 (meaning that the changes in welfare of those with the top incomes are not valued by policymakers), set *e* to between 0.25 and 0.50 (based on the review of the evidence, which is mainly for the United States, in Saez, 2012; Mertens, 2013, using a narrative-based time series approach, finds higher values), and take *a* from the World Top Incomes Database. The actual marginal tax rate reflects the top combined federal and subnational statutory personal income tax rate, social contributions (taking account of any cap on the latter), and the value-added tax.

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Source: IMF 2013

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Progressive tax reform: a macroeconomic perspective

- Redistribution may be directly conducive to output and employment if the economy is constrained by a lack of demand and if inequality is detrimental to private consumption.

- Increasing taxes and spending (part of) the revenue will usually be expansionary

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Fiscal Consolidation in Times of Rising Inequality – Recent Policy Proposals

OECD, EC and IMF:

- Consensus: combat tax evasion and limit tax avoidance (by rich individuals and multinational companies), some interesting initiatives
- tax-base broadening, close loop-holes, increase taxes on immovable property and consumption, environmental taxes + targeted transfers to reduce regressive effects
- (EC and IMF: Financial Transaction Tax)

- ILO (2011): Increase or implementation of wealth taxes and capital gains taxes, Financial Transaction Tax, Financial Activities Tax, environmental taxes (less regressive with personal energy allowances)
- ETUC (2010): Increase pressure on high savings: business profits, dividends, interests, capital gains, big fortunes
- Attac Network (2013): Europe-wide coordinated non-recurring levy on wealth
- (...)

Fiscal Consolidation in Times of Rising Inequality – Recent Policy Proposals

Table 8. Conventional Wisdom: Advice for the Revenue Side of Consolidation

Recommendation	Rationale
Exploit *consumption taxes* more fully, expanding the base of the value-added tax (VAT) before raising standard rates (using the transfer system to protect the most vulnerable as needed), and reviewing excise levels.	Most rate differentiation under the VAT is rationalized by distributional concerns that could be better achieved by direct transfers; excises better handle environmental and other concerns requiring differentially high tax rates.
Look for opportunities to broaden the base of the *personal income tax*—a first step being to quantify all tax expenditures—and, while recognizing that increased inequality might call for increased progressivity, avoid very high marginal effective tax rates.	Exemptions and deductions remain significant in many countries, and their cost should be transparent; raising effective rates can have strongly adverse effects on incentives, in terms of both real and avoidance activities.
Resist increasing *social contributions* and consider combining a cut in the employers' contribution with an increase in consumption taxation—*a fiscal devaluation*.	Unless increased contributions are perceived as carrying matching increased benefit entitlement, they can have strong incentive and employment effects. With a fixed exchange rate, a fiscal devaluation can boost net exports—temporarily—by reducing the foreign currency price of exports and increasing the domestic relative consumer price of imports.
For the *corporate income tax*, quantify and review tax expenditures, resisting further inappropriate base erosion and pressure to cut statutory rates; reduce the tax bias toward debt finance.	Intense international tax competition is likely to continue, and addressing it will require strong international cooperation; tax distortions can jeopardize financial stability by encouraging excess leverage.
Increase *property taxes*, especially recurrent charges on residential properties; scale back *transaction taxes*.	Property taxes appear to be relatively growth-friendly and can serve equity and accountability aims; transaction taxes impede efficient trades.
Implement effective *carbon pricing*, either by carbon taxation or by full auctioning under cap-and-trade schemes; eliminate *fossil fuel subsidies* and review environmental taxes more generally.	Pricing measures are essential to encourage efficient mitigation and so are a particularly efficient source of revenue; fuel subsidies are very poorly targeted to distributional aims.
In the *financial sector*, adopt tax measures to discourage volatile financing as well as financing improved resolution mechanisms; counteract the VAT exemption for financial services by adopting a financial activities tax (FAT).	These measures would ensure a "fair and substantial contribution" of financial institutions to the fiscal costs of their potential distress and failure; as a tax on the sum of wages and profits of financial institutions, a FAT would provide a fix, albeit an imperfect one, for a major distortion in the VAT.
Strengthen tax compliance by identifying and acting on compliance gaps, aggressive tax planning, and offshore tax abuse.	Improving tax compliance would promote fairness and reduce distortions.

Sources: de Mooij and Keen (2013); and IMF (2010a, 2010b).

Source: IMF 2013

Policy Strategies on the international level

- **combat tax evasion and avoidance**
  - revision of EU savings directive
  - OECD action plan in base erosion and profit shifting
  - Unitary taxation (caution!)
- **Financial Transaction Tax**

PLUS

- **Further measures (e.g. levy on wealth)**
- **Tax harmonisation (minimum tax rates)**

➔ Some promising initiatives but high risk of watering down and vested interests preventing the reform!

Source: IMF 2013

Policy strategies on the national level

- ‚conventional wisdom' is extremely cautious and goes into the wrong direction by focussing on consumption taxes
- increase tax compliance by stronger enforcement
- broaden tax base in redistributive manner
- increase taxes on immovable property

PLUS:

- **use leeway to increase top PIT rate, CIT and wealth and inheritance taxes!**

Thank you very much for your attention!