The Scope for Progressive Tax Reform in the OECD Countries:

A macroeconomic perspective with a ‘case study’ for Germany

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(joint work with Sarah Godar and Christoph Paetz within the GLU-Project ‘Combating Inequality‘ funded by Hans-Boeckler-Foundation)

Overview

- **Traditional standards of tax justice under pressure: taxation trends since the 1980s**
- **Standard arguments against progressive taxation under scrutiny**
- **Macroeconomic arguments in favour of progressive taxation**
- **A ‘case study‘ for Germany**
  - Tax cuts and the ‘sick man of Europe‘ (2001-2005)
  - Perspectives of rebalancing under the ‘debt brake‘
- **Policy conclusions**

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)

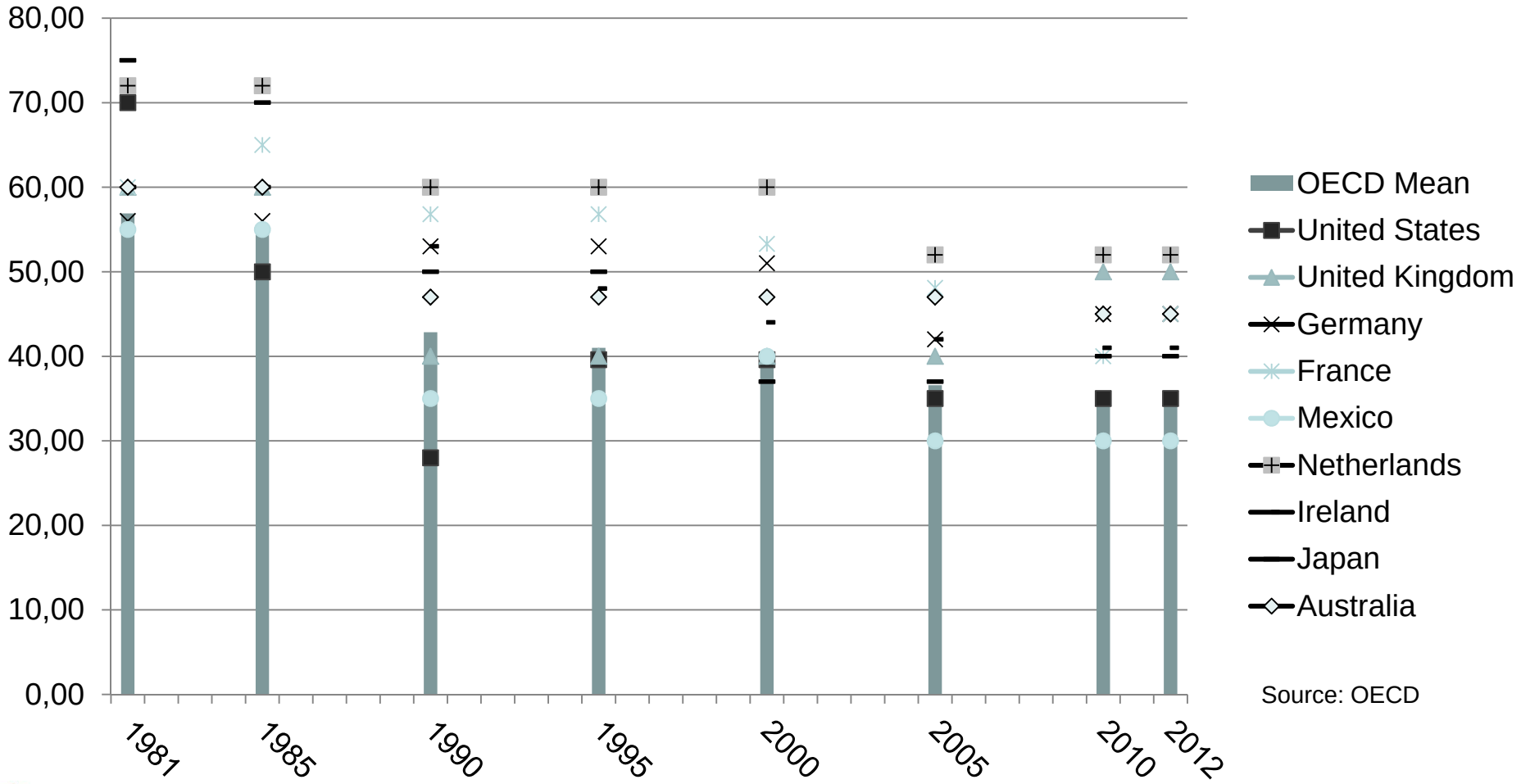
Regressive Taxation
Trends in OECD Countries

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

Central government top personal income tax rates 1981-2012



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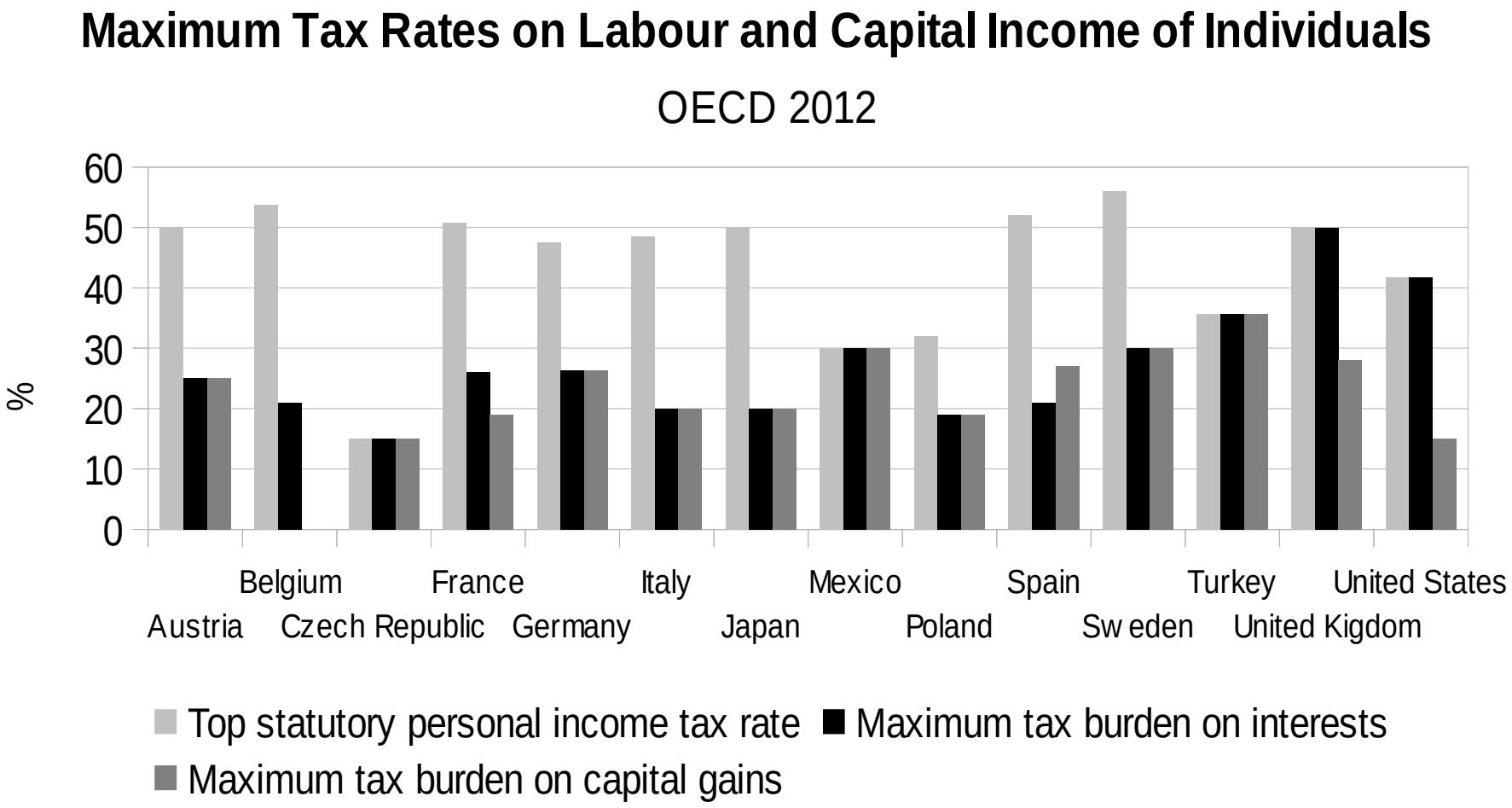
Preferential Tax Rates for Capital Income



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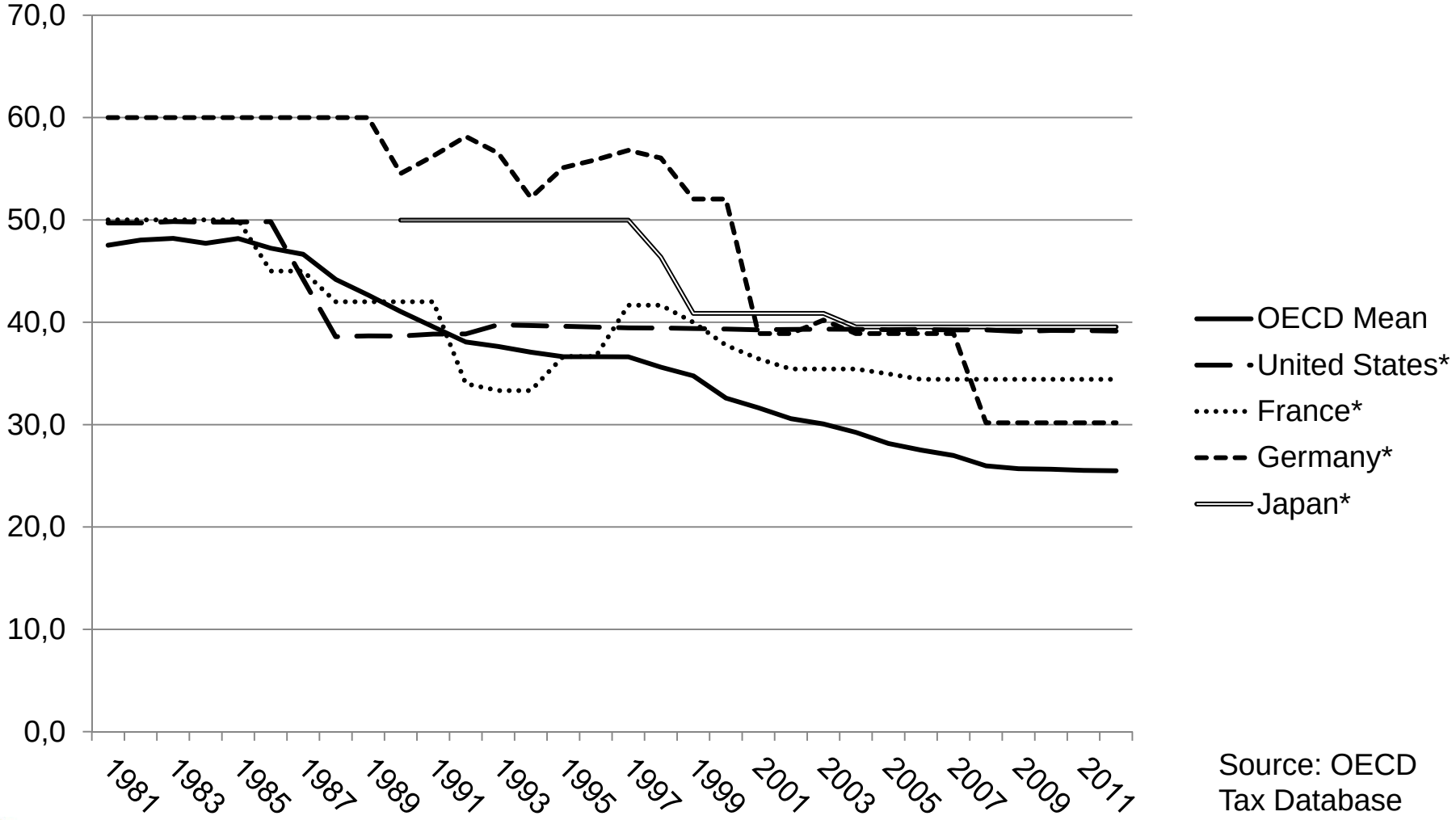
Source: OECD Tax Database 2013, Deloitte 2013, KPMG 2012

Declining Corporate Tax Rates

Nominal corporate income tax rates 1981-2012



Source: OECD Tax Database 2013

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

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."

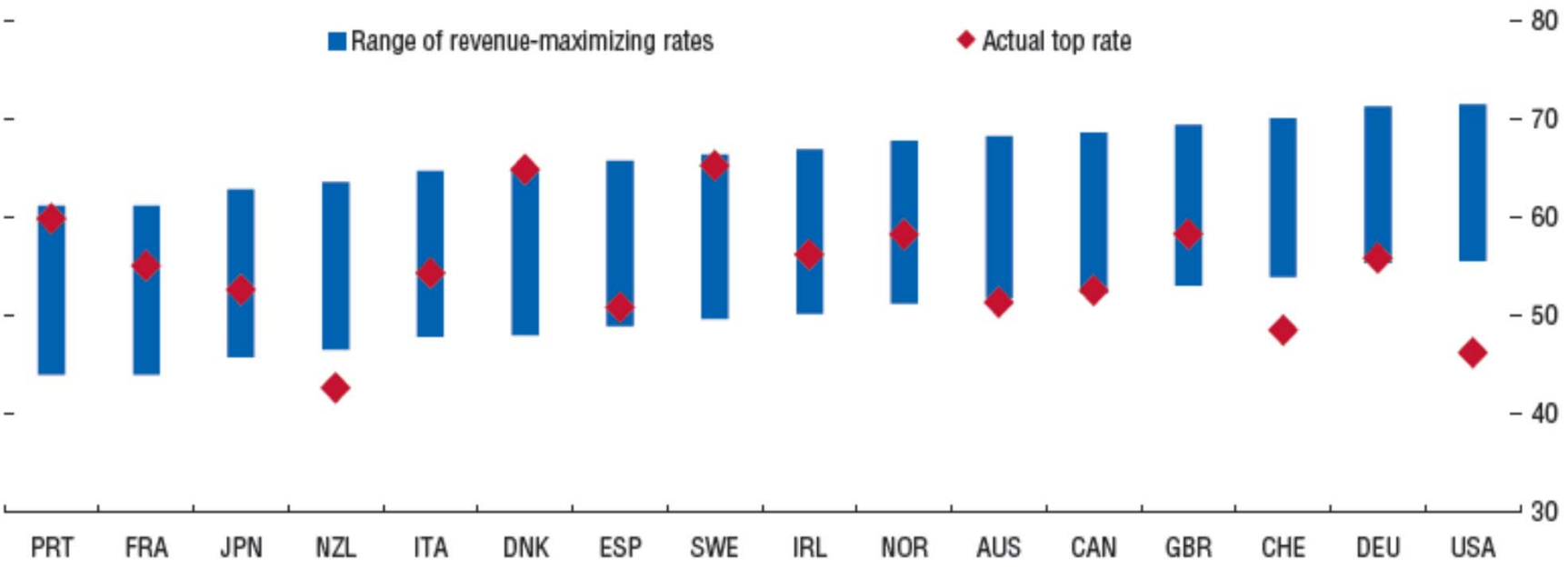
- High top marginal tax rates discourage labour supply, labour effort, entrepreneurial investment
- High taxes on personal savings discourage investment
- High corporate tax rates discourage investment
- Tax evasion and tax planning undermine revenue raising potential

…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.

Source: IMF 2013

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Progressive tax reform: a macroeconomic perspective

- a Keynesian perspective…
- …which has again gained importance and support, recently
- theoretical deficiencies of harmonious NCM-models with downgrading of fiscal policy have been stressed
- average multiplier estimates have been adjusted upwards
- (or may be it is sufficient to take ‘old‘ averaged muliplier estimates seriously…)

A macroeconomic perspective: Three major arguments

- 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.

- Balanced budget multiplier: Increasing taxes and spending (part of) the revenue will usually be expansionary

- Inequality as major reason for international economic imbalances

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Tax cuts, induced expenditure cuts and the

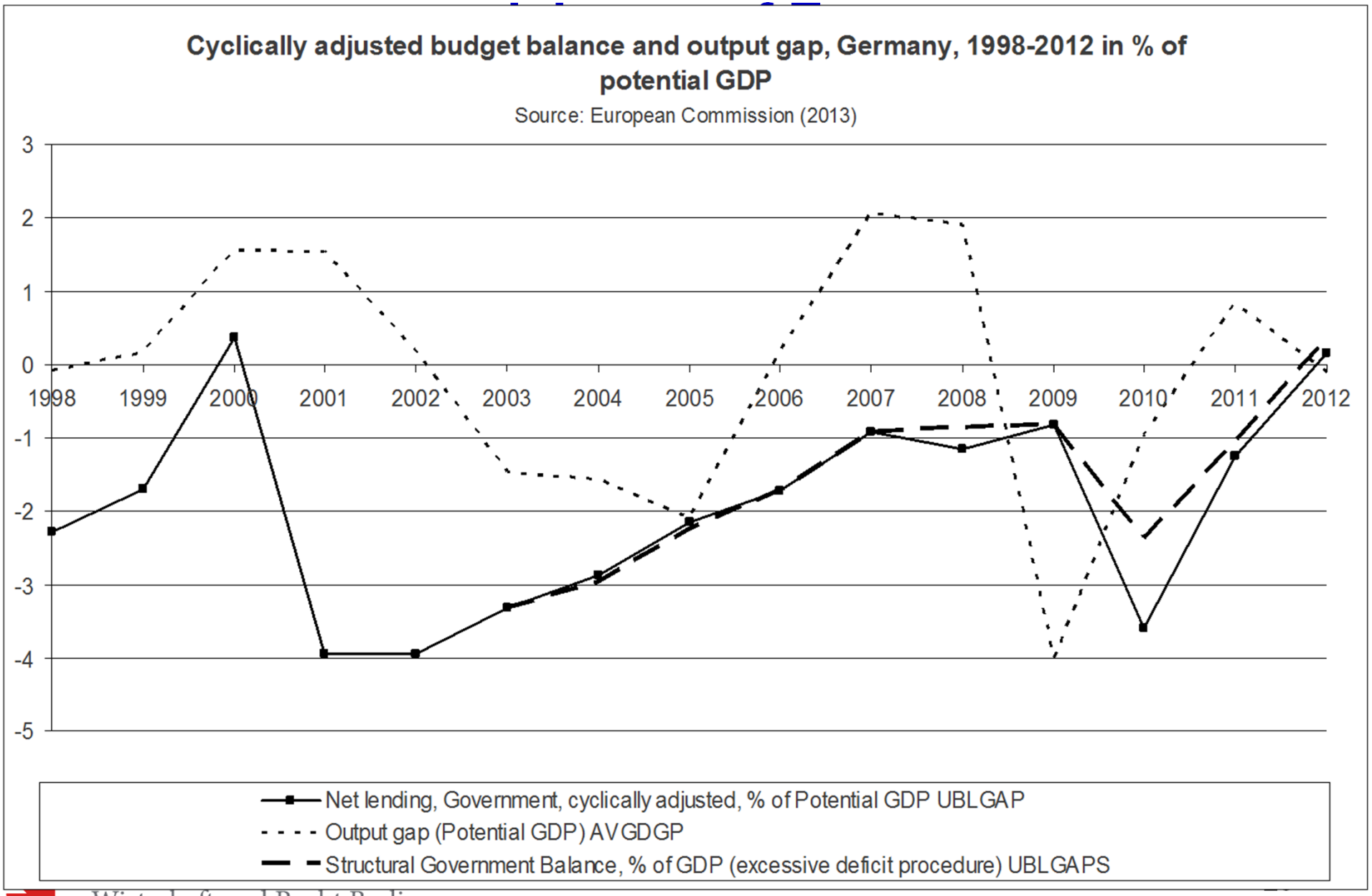
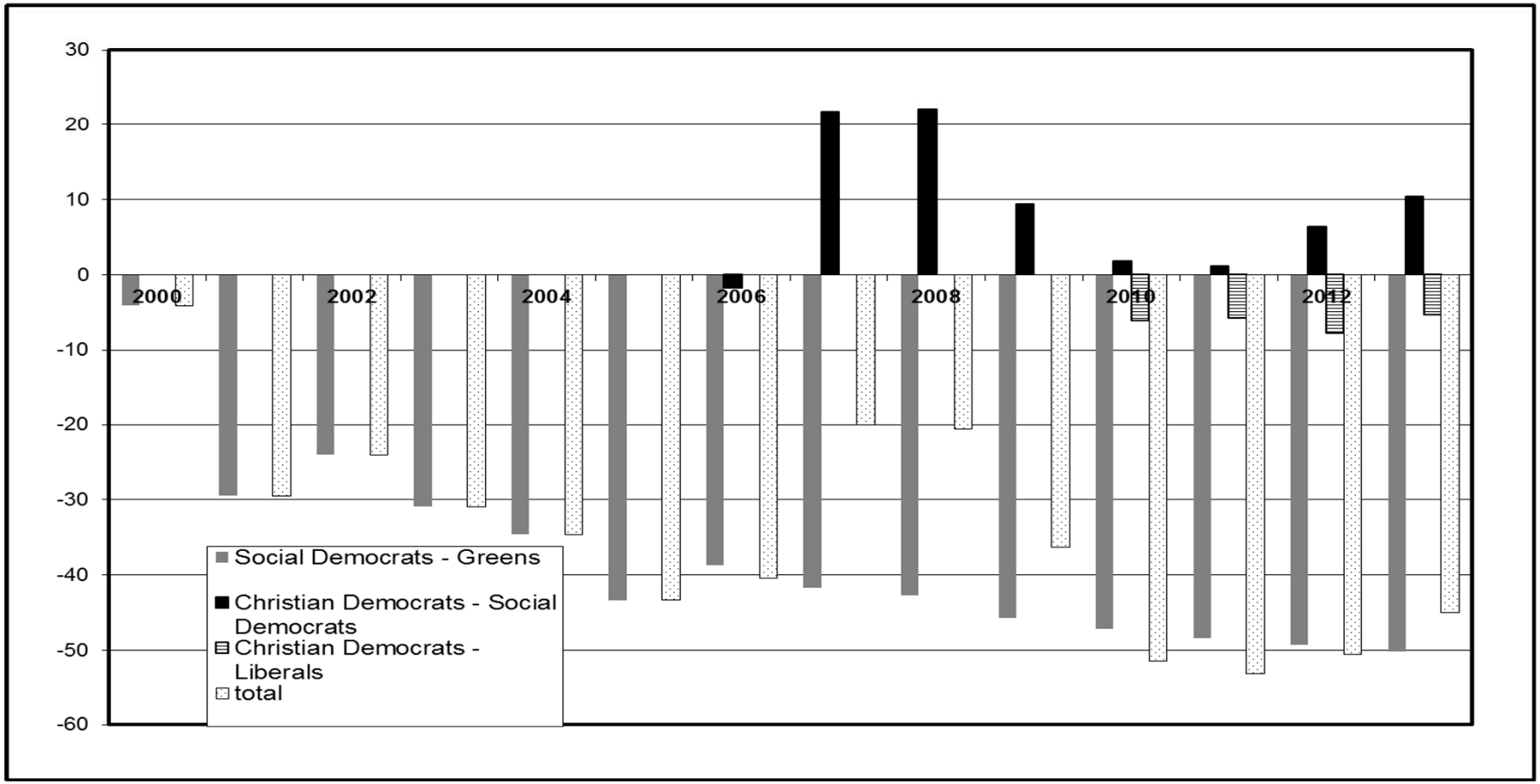
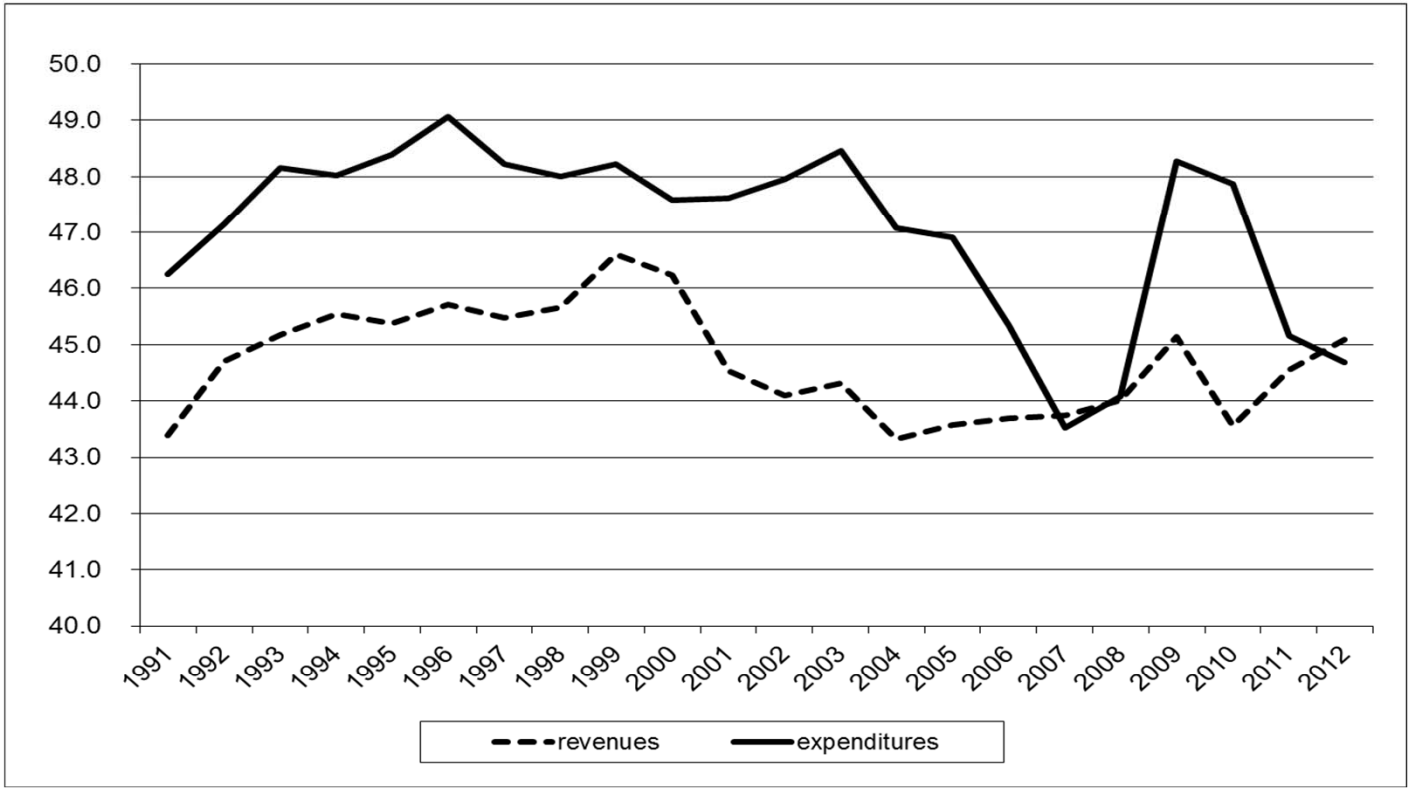


Fig. 1: Impact of tax law changes by the various coalition governments since 1998 (2000 to 2013) in €bn



Sources: Federal Finance Ministry, authors' own calculations.

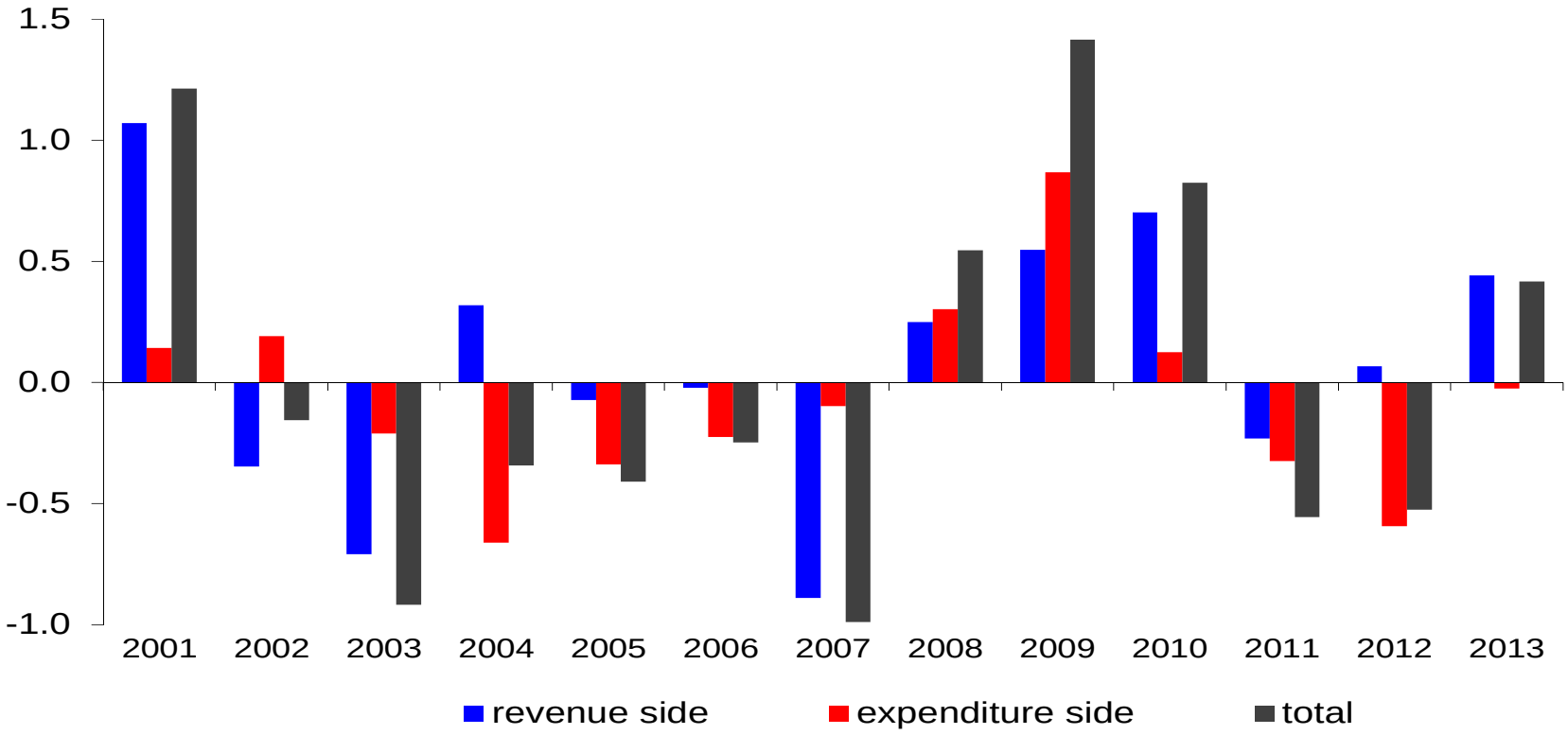
Fig. 2: Overall government revenues and expenditures in relation to GDP, in per cent. 1991-2012*



*** Expenditure in 1995 excluding debt assumption by the Treuhandanstalt (privatization agency for Eastern Germany) and by the housing sector of the former GDR (totalling €119.6bn) and in 2000 excluding the proceeds from the auctioning of UMTS licences (€50.8bn)**

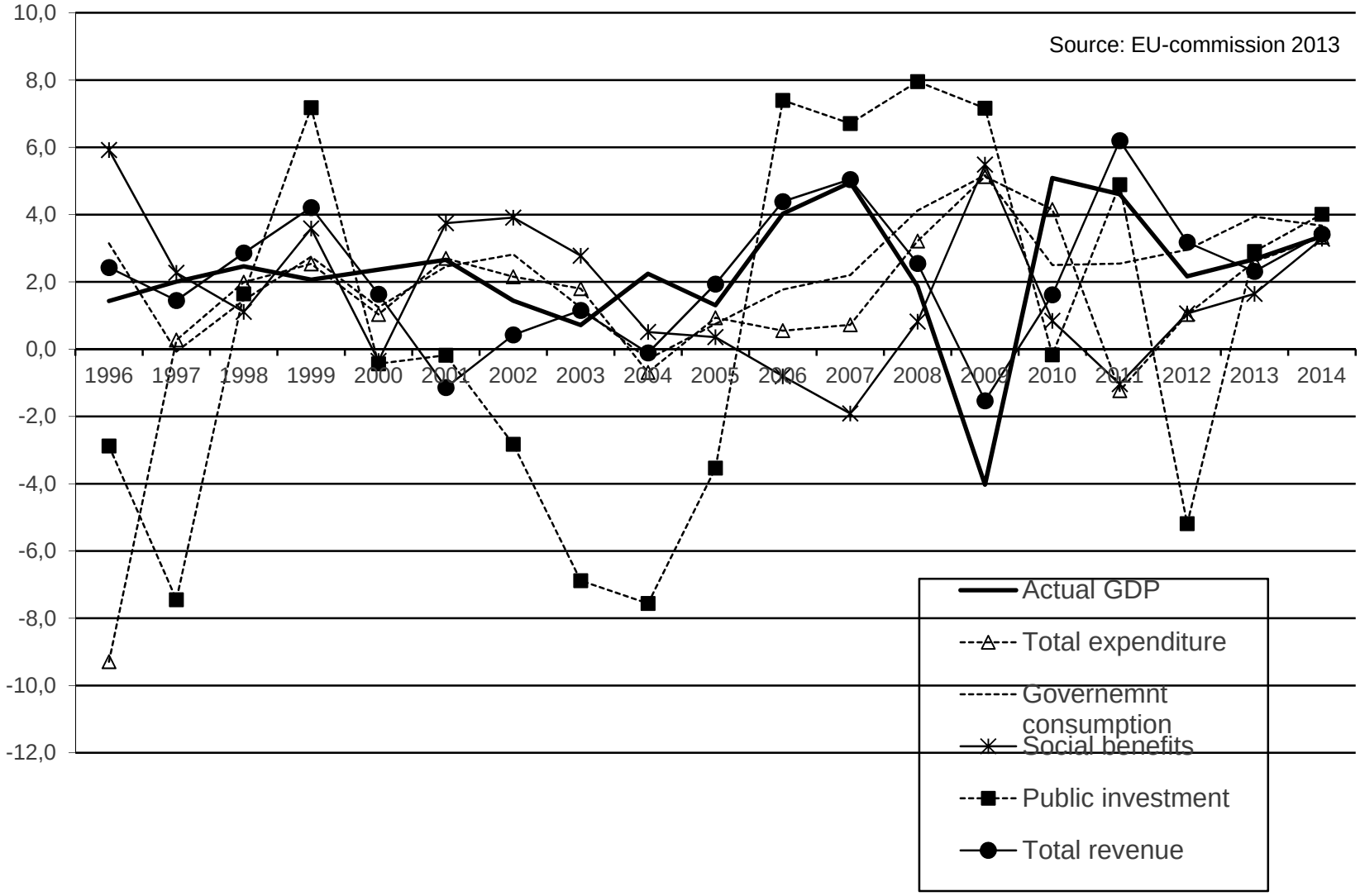
Source: Federal Statistical Office.

Fig. 3: discretionary fiscal stance in % in relation to GDP, in per cent. 2001-2013

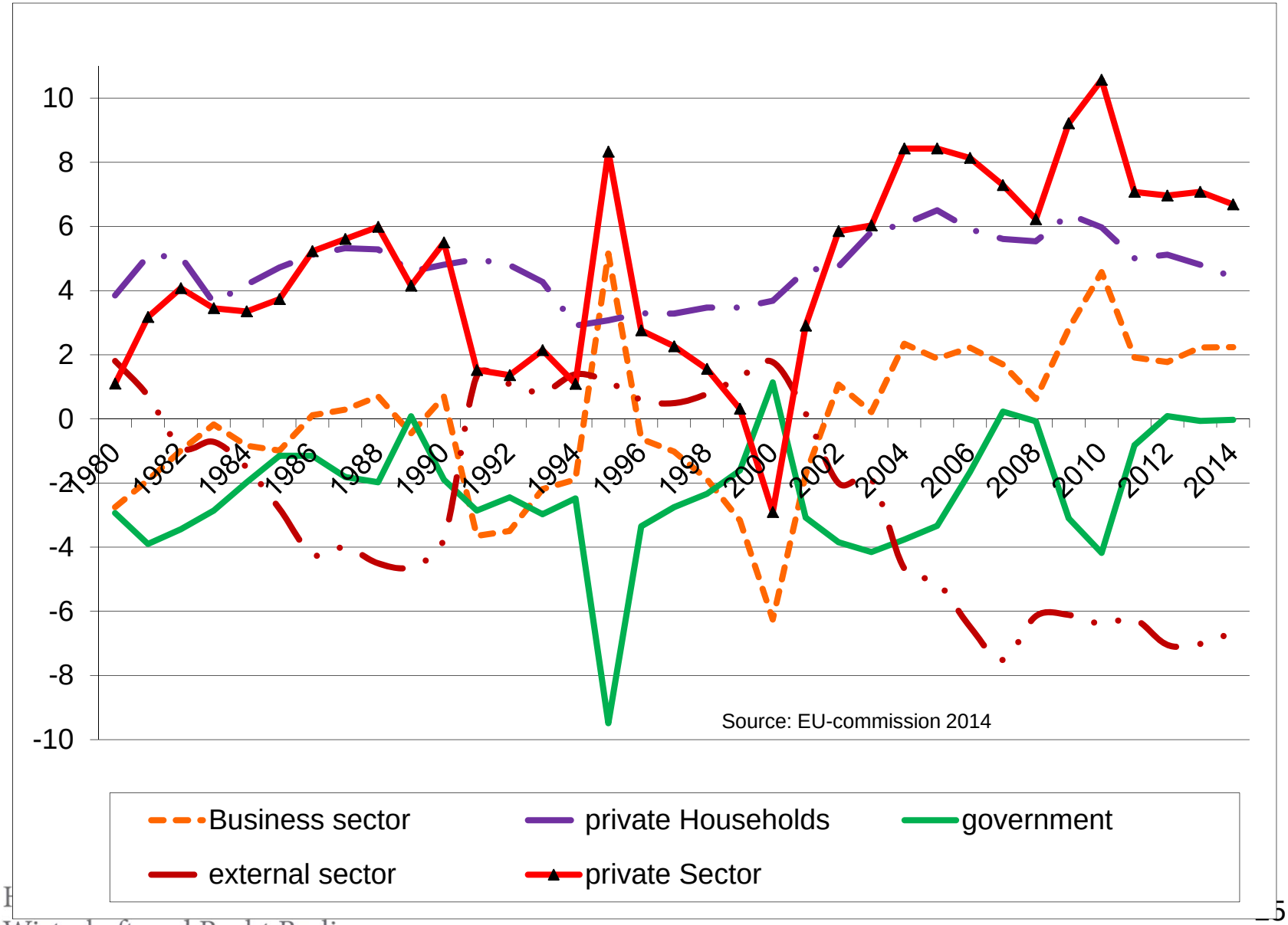


Source: Federal Statistical Office, IMK.

Nominal growth rates of government expenditure and revenue categories and GDP trends in %, 1996-2014 (2012-14 forecasts), Germany



Sectoral financial balances in % of GDP, Germany 1980-2014



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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!