TAX AND INCLUSIVE GROWTH IN A CHANGING WORLD

Bert Brys

Senior Tax Economist
Tax Policy and Statistics Division
Centre for Tax Policy and Administration, OECD

BETTER POLICIES FOR BETTER LIVES

DEFINING INCLUSIVE GROWTH

Inclusive Growth means "All on Board"

- Economic growth that delivers progress to all groups of the population (in monetary and non-monetary terms); growth dividends are shared fairly across society and increase well-being of all
- Inclusive markets: growth of not only the frontier firms but also of the firms that are lagging behind (diffusion and spill-overs)
- Inclusive labour markets not only empower the happy few but results in good quality jobs for all workers
- Broad and dynamic definition of equity (fairness):
  - life-cycle perspective
  - social mobility
  - well-being across generations
  - gender equity
- Equality of opportunity
- Growth is inclusive if it is sustainable, also from an environmental perspective
- No countries or regions are left behind

Channels through which tax policy affects inequality

Tax revenues finance expenditure which may reduce inequality

- Most redistribution occurs through transfers

Taxes can reduce disposable income inequality

- PIT progressivity is the key tool to narrow the distribution of disposable income

Taxes can reduce market income inequality

- Taxes affect pre-tax opportunities and behaviours (e.g. tax and skills)

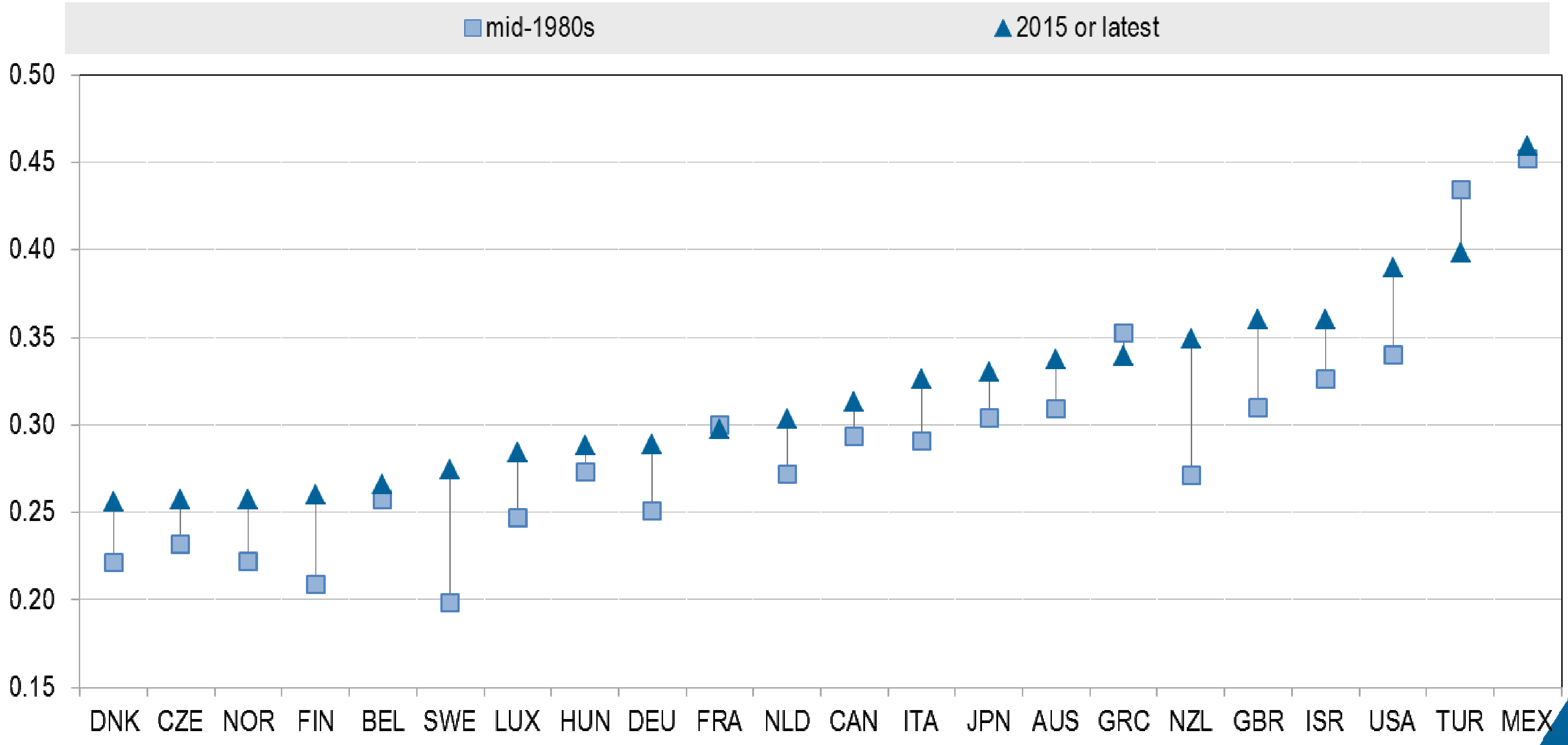
The tax system can redistribute income across the lifecycle

- Intra-personal as opposed to inter-personal redistribution, e.g. SSCs to finance future benefits

TRENDS IN INEQUALITY AND REDISTRIBUTION

Within-country income inequality has increased partly because the redistributive impact of the tax and transfer system has decreased over the last 30 years

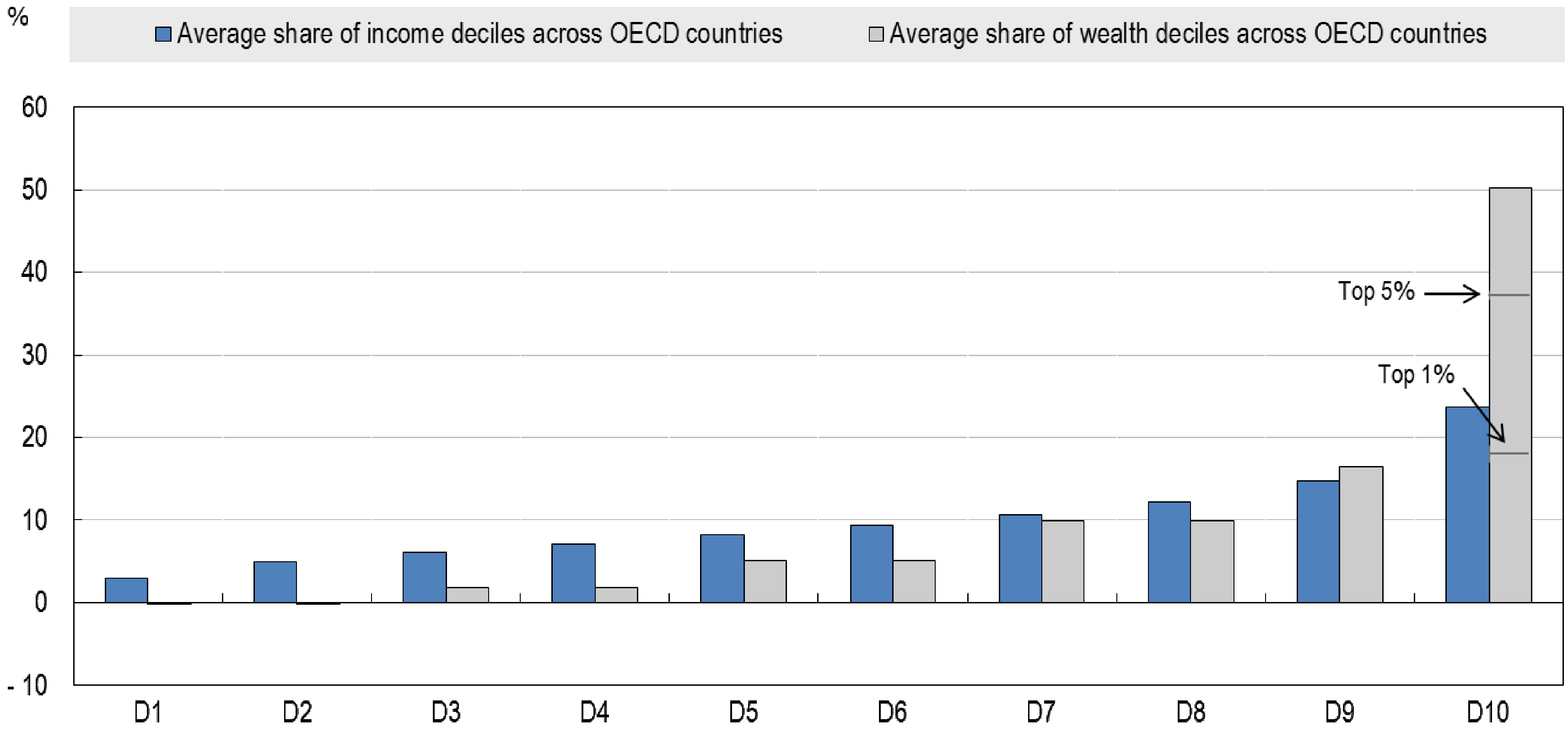
Disposable income Gini coefficients, mid-1980s and 2015 (or latest available year) in 22 OECD countries



Source: OECD Income Distribution Database.

Household wealth is much more concentrated than income

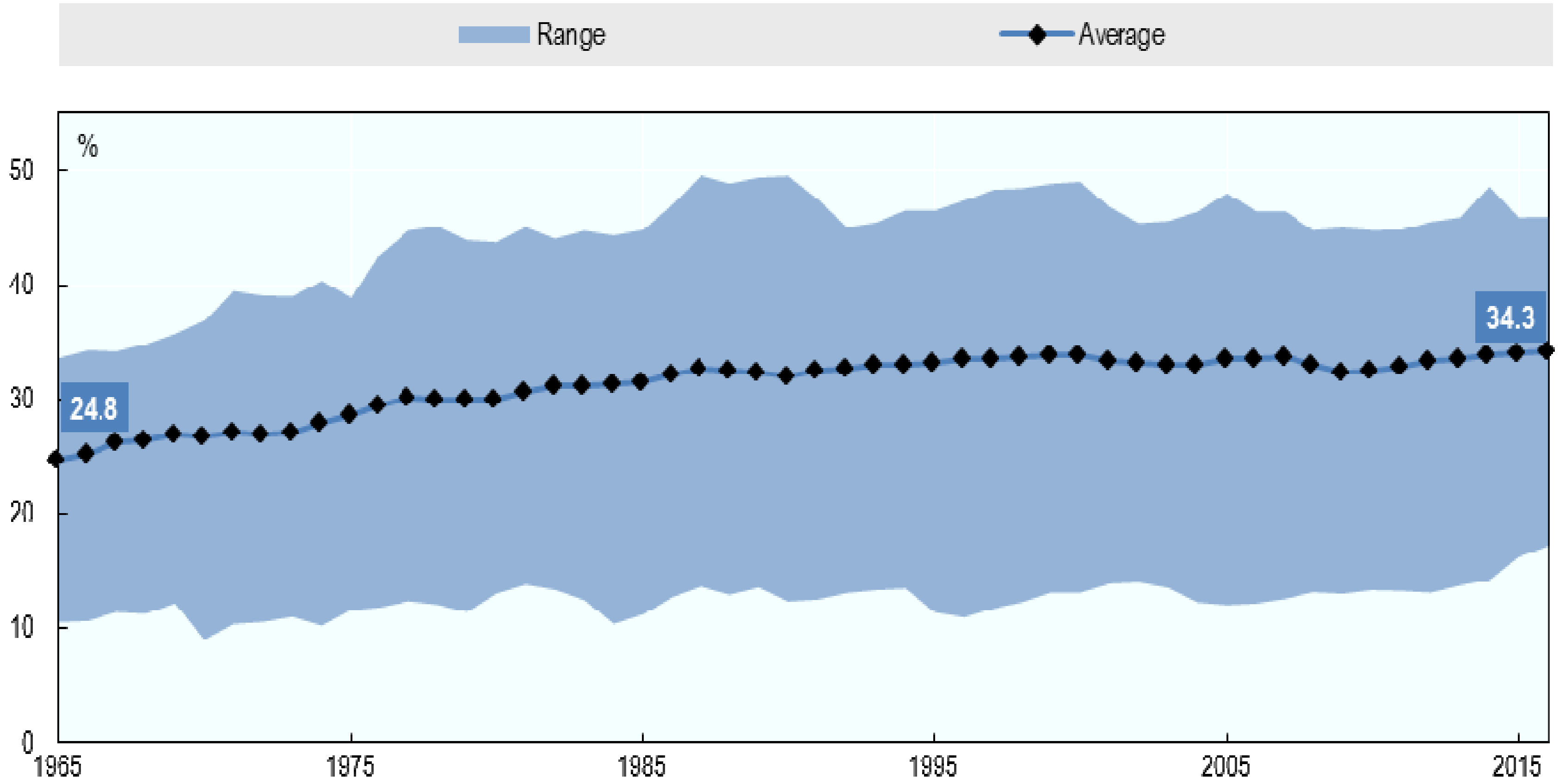
Distribution of household disposable income and wealth across income and wealth deciles – average for 18 OECD countries



Source: OECD (2015), In It Together

The OECD average tax-to-GDP ratio reached a new record level in 2016

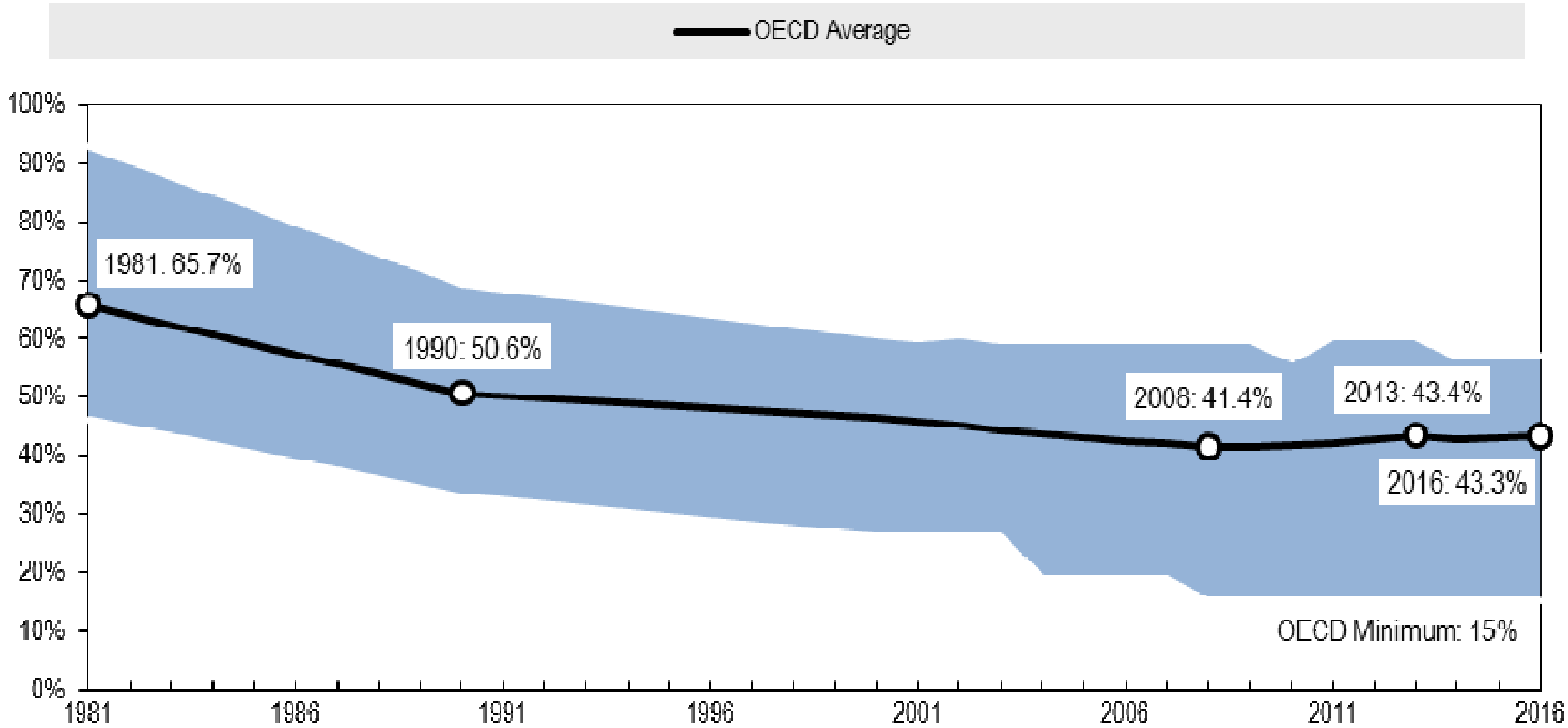
Long-term evolution of the OECD average tax-to-GDP ratio (1965 – 2016)



Source: OECD Revenue Statistics Databases

Personal income tax rates on top income earners have gone down

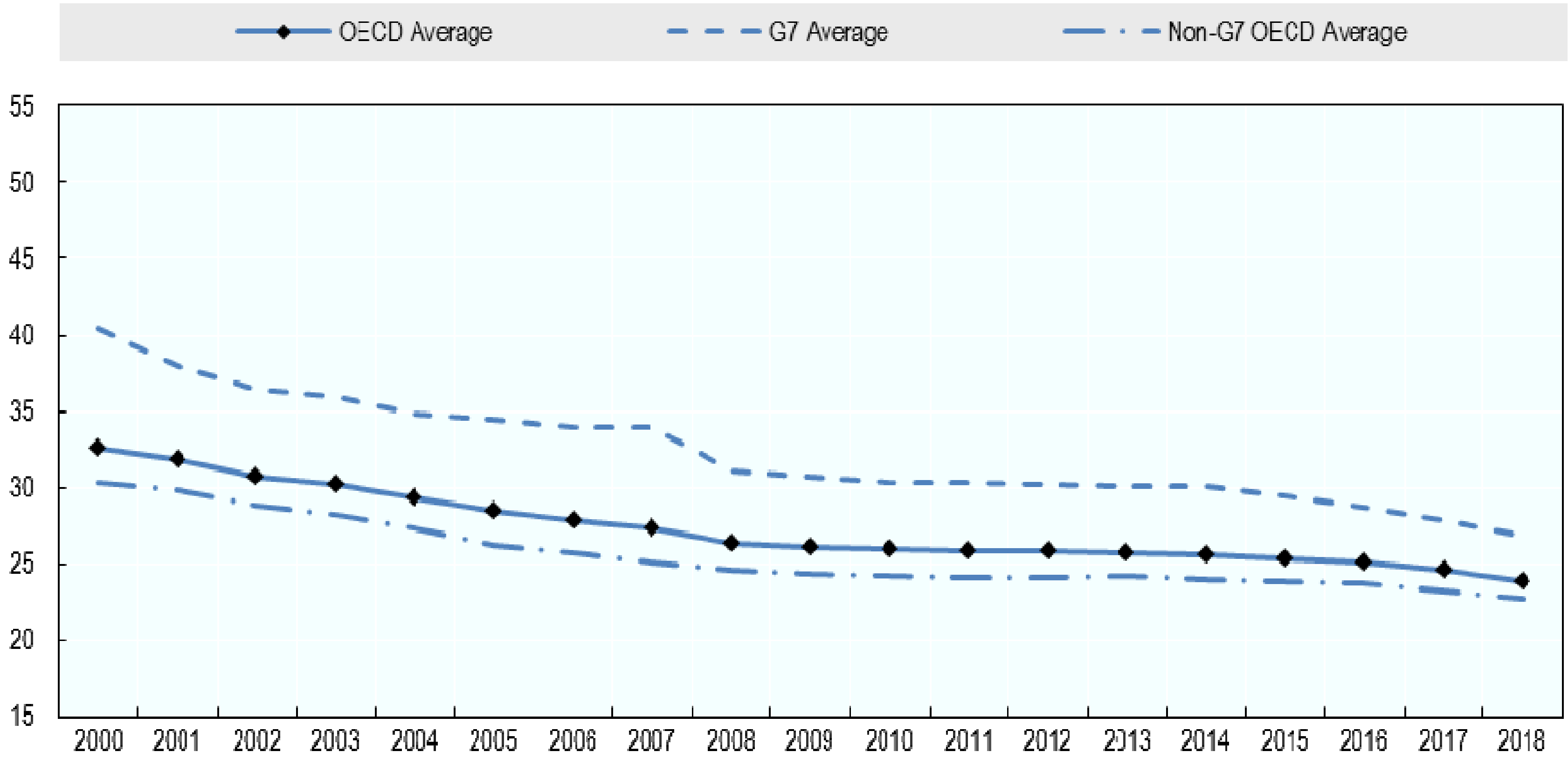
Combined top statutory personal income tax rates in the OECD area maximum, minimum and average, 1981 to 2016



Source: OECD Tax Database.

Statutory CIT rates have decreased significantly

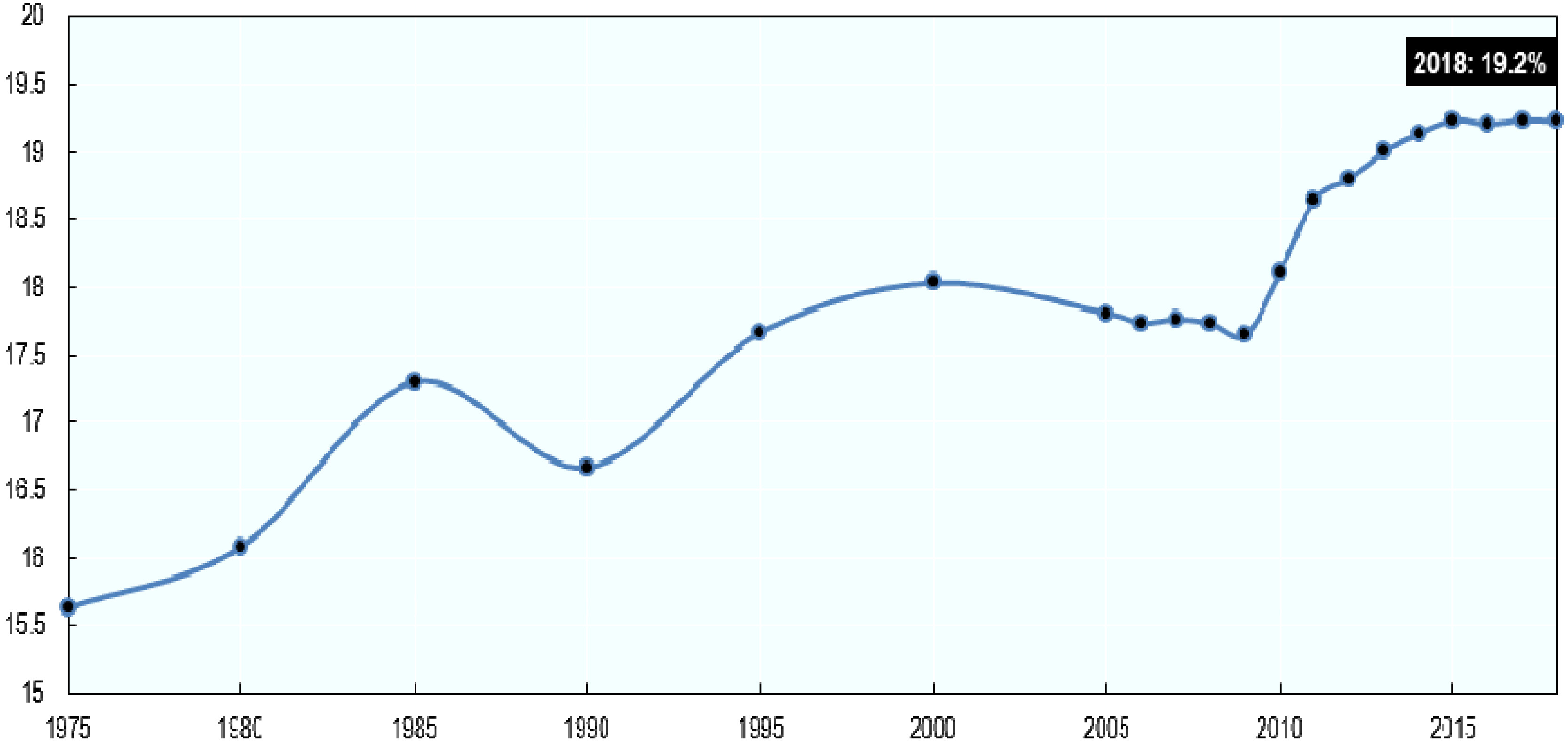
Evolution of the average CIT rates in the OECD, OECD G7 and non-G7 countries



Source: OECD Tax Database and Tax Policy Reform Questionnaire

The OECD average standard VAT rate has reached a plateau since 2015

Evolution of the OECD average standard VAT rate until January 2018

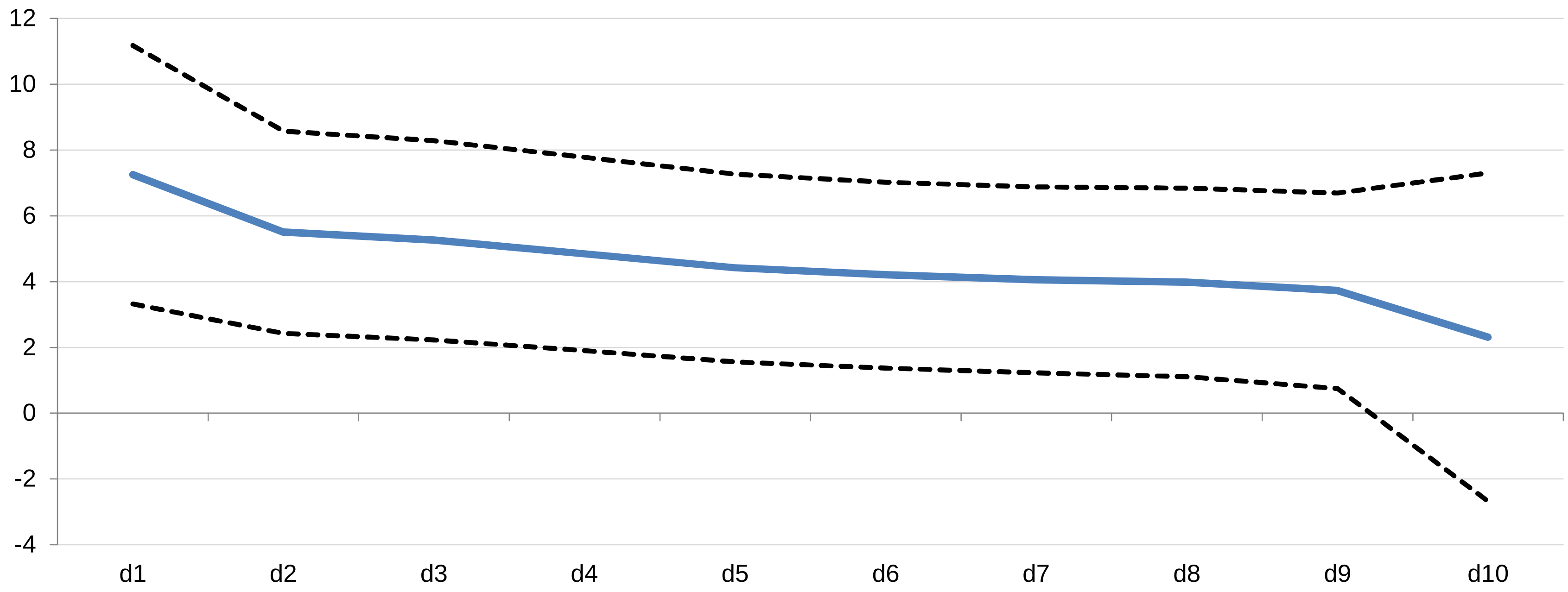


TAX & INCLUSIVE GROWTH

DON'T FALL IN THE STATIC TAX-BY-TAX DESIGN TRAP

Making governments more effective improves inclusive growth

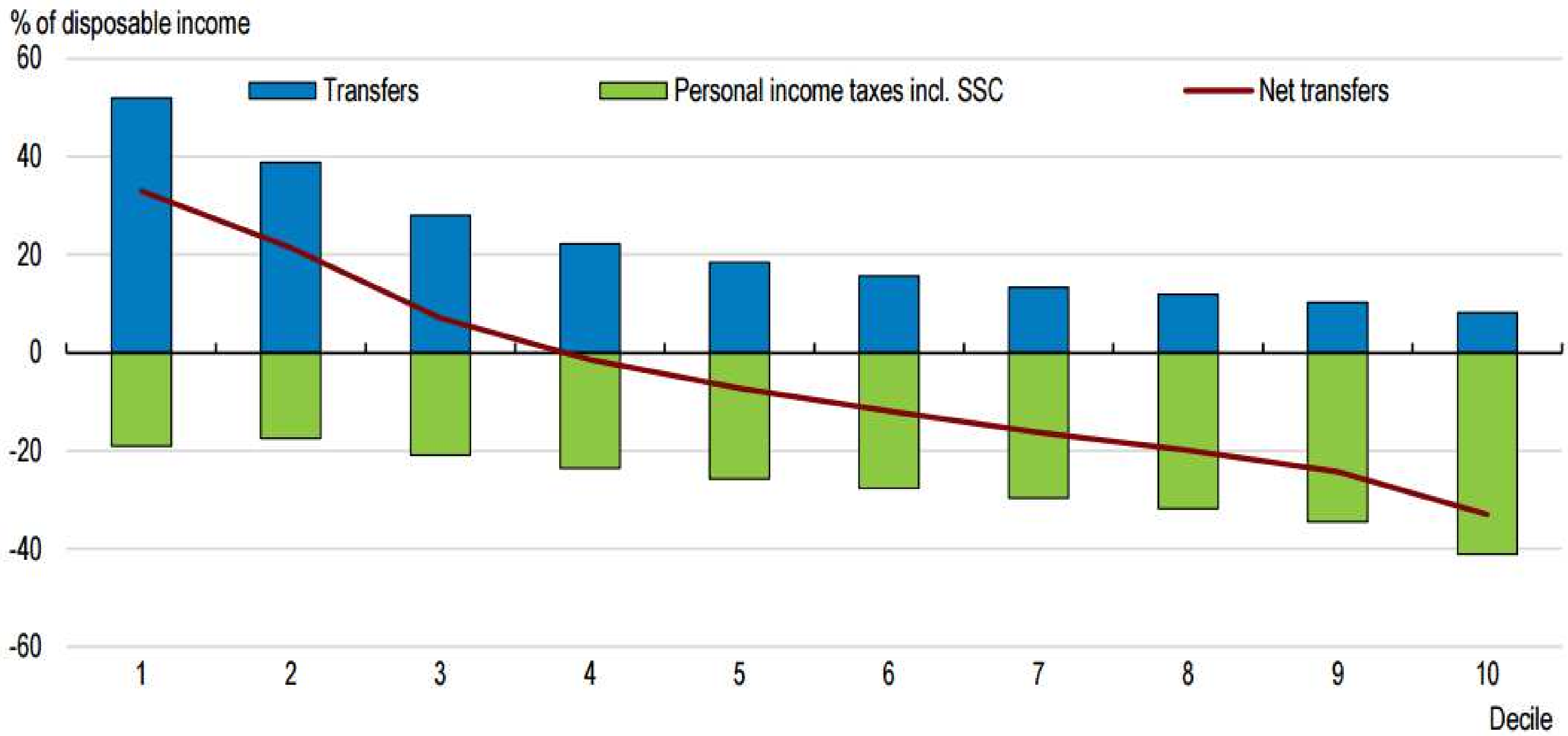
Long-term effect on income of 0.1 increase in the World Bank government effectiveness indicator in a country where public spending equals 45% of GDP



Enhancing government effectiveness can offset the distortions that large tax-and-transfer systems may generate

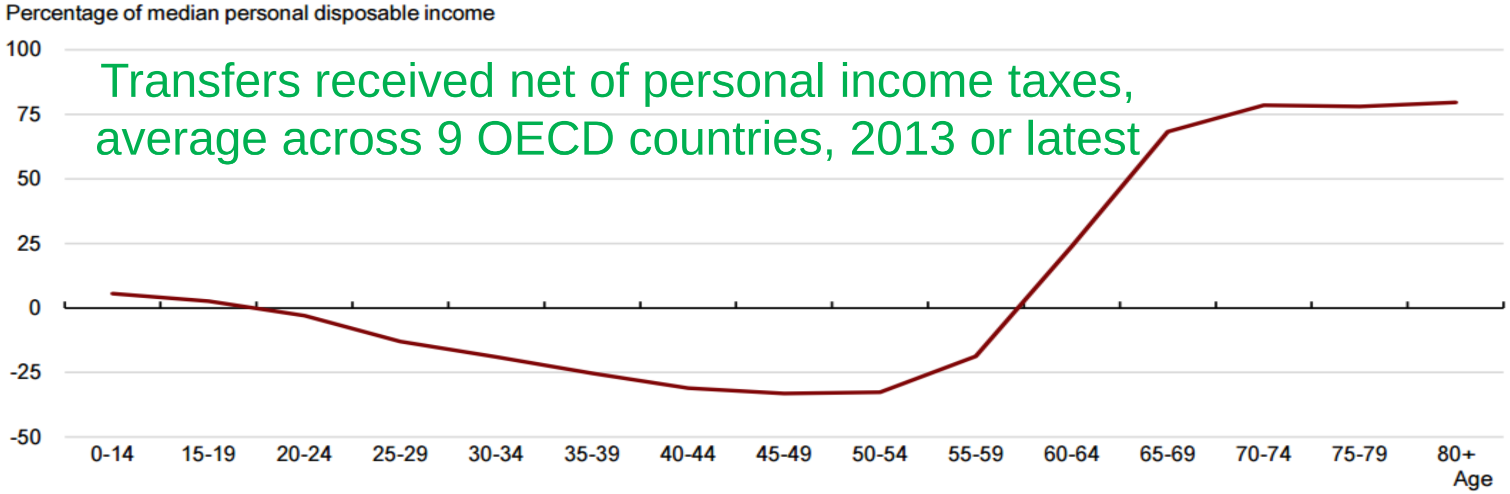
Important lesson: it's the overall tax and transfer system that matters!

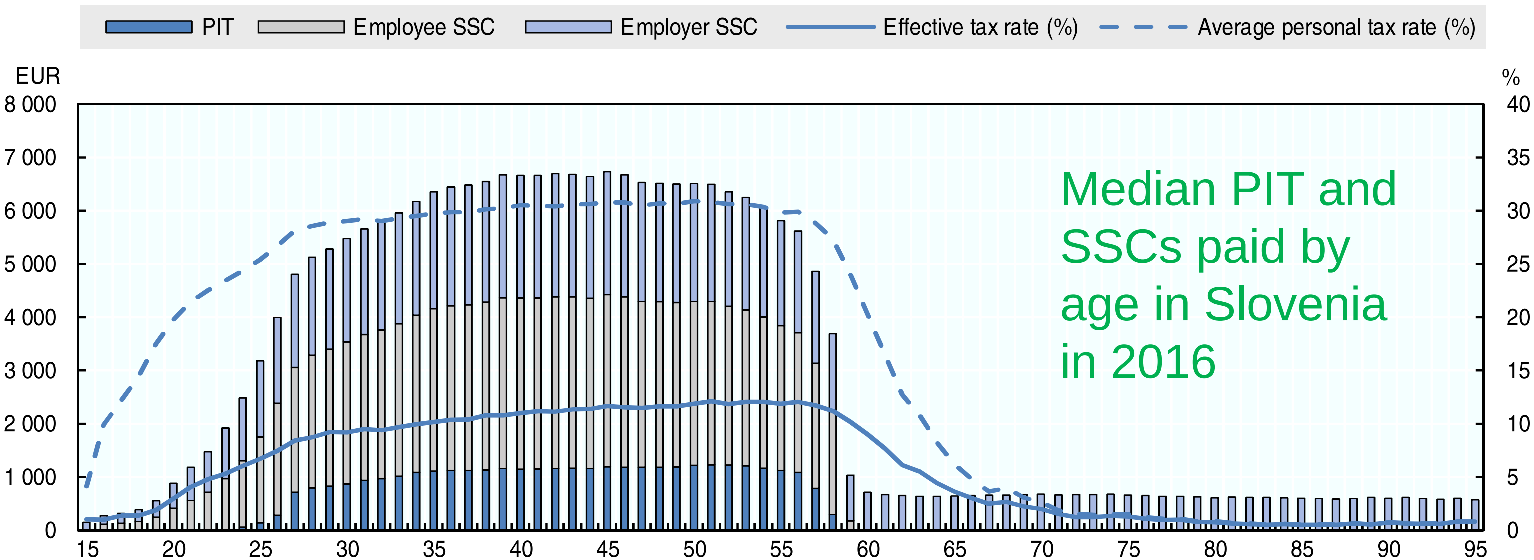
Transfers received and personal income taxes paid across deciles, Working-age population, 2014 or latest available year



Source: Causa and Hermansen (2017) based on OECD Income Distribution Database

A large part of income redistribution takes place over the lifecycle





TAX POLICY OPTIONS FOR MORE INCLUSIVE GROWTH

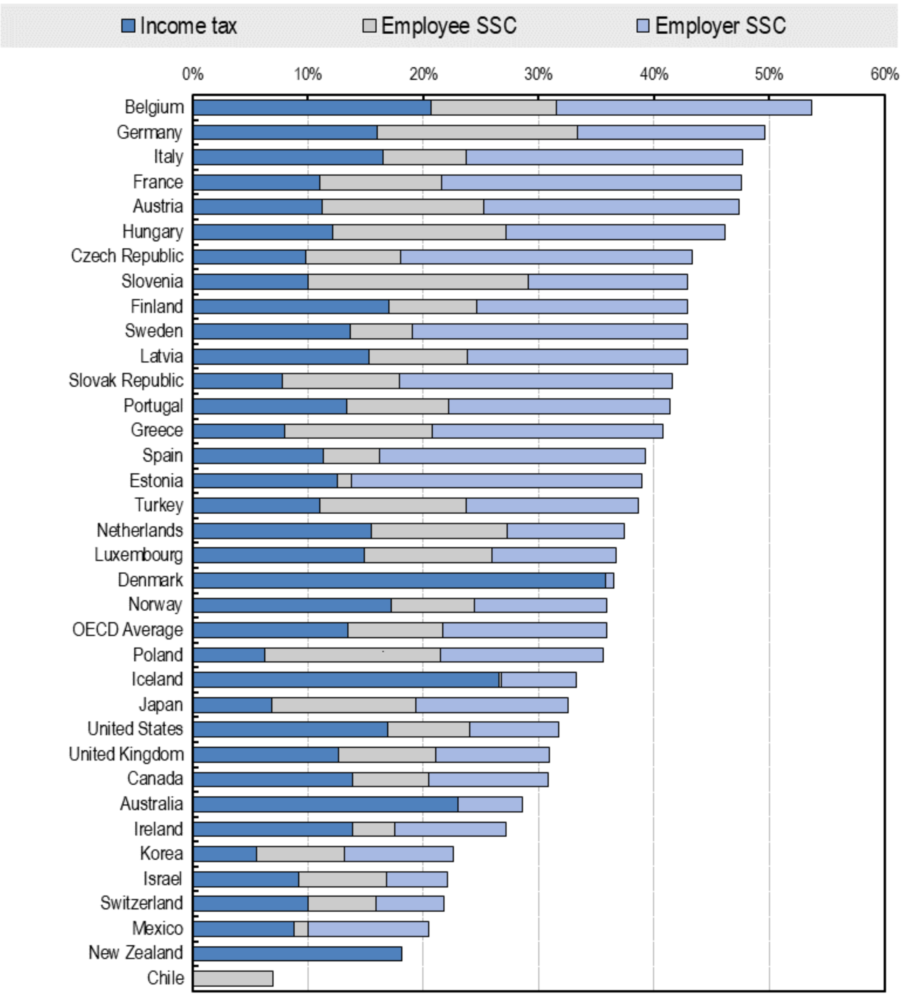
Designing tax policies for more inclusive growth

Challenge: avoid the **efficiency-equity trade-offs** and identify tax reform options which simultaneously enhance efficiency and equity

- Strengthen tax progressivity across the entire tax and transfer system
- Broaden tax bases to eradicate inefficient and regressive tax expenditures
- Make the pre-tax distribution of income more equal through tax policy
- Leverage new developments in tax administration while addressing challenges raised by the digital economy

Encourage formal labour market participation by lowering taxes on labour income

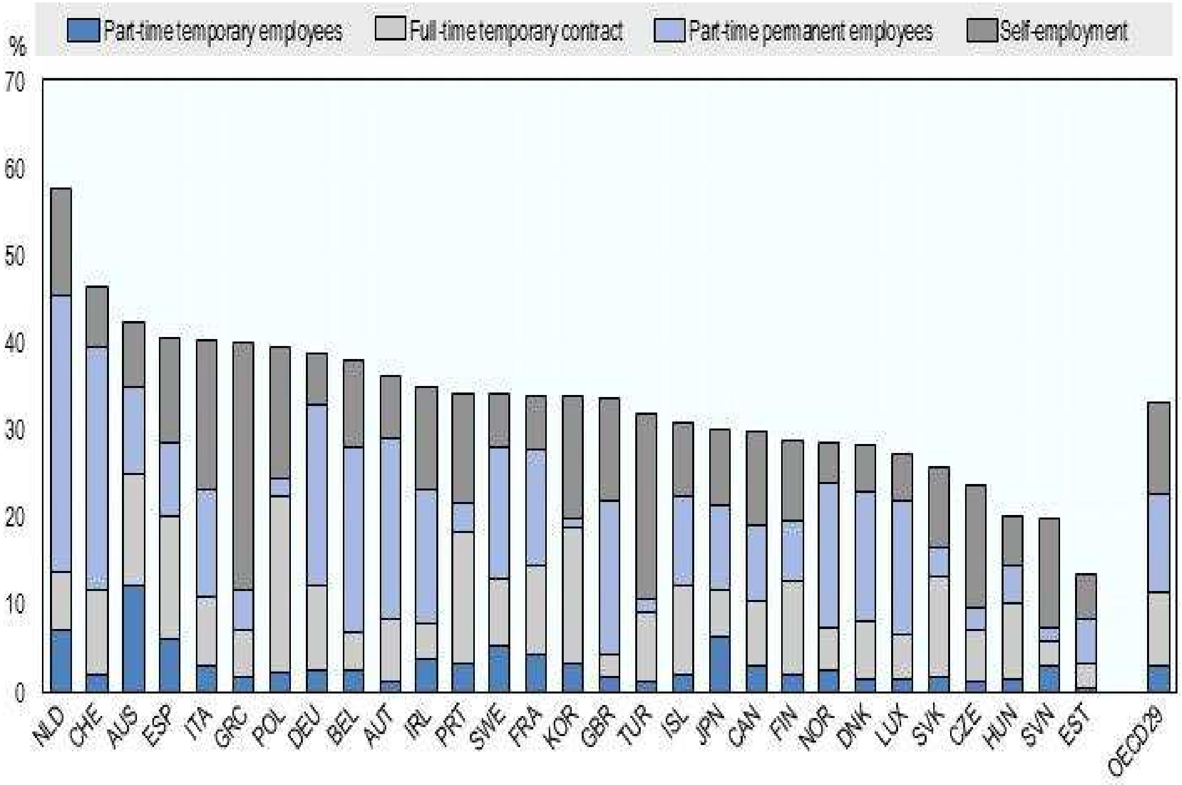
Tax wedge for employees earning the average wage in 2017, % of labour costs



- Lower labour taxes for low-wage earners, through in-work tax credits or targeted cuts in social security contributions
- Reduce the tax wedge on second earners (usually women)
- Finance social insurance from general taxation instead of SSCs in particular for benefits where link with contributions made are weak (unemployment, benefits for children)
- For emerging economies, a high labour tax burden on low-income earners is an important incentive for **informality**

Tax & social protection systems may need reform to deal with future of work

NSW forms of employment as percentages of total employment, 2013

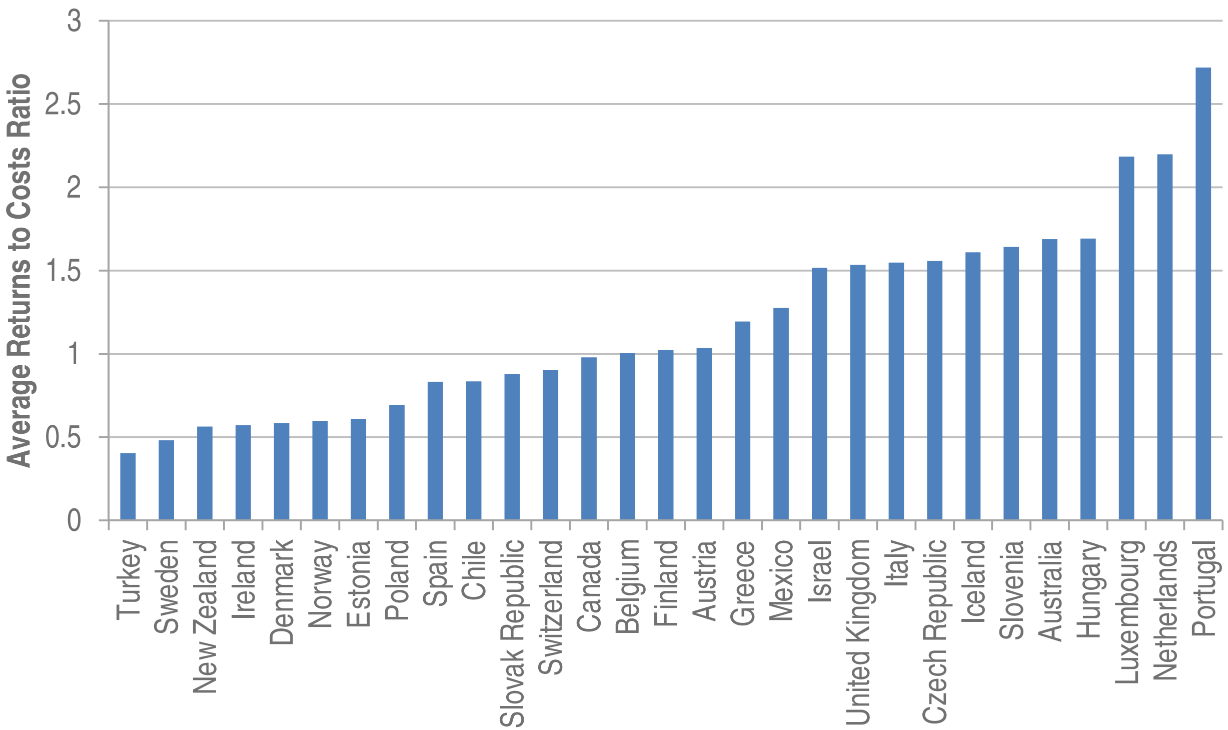


Source: OECD (2015), In It Together: Why Less Inequality Benefits All. Note: Working-age (15-64) workers, excluding employers and students working part-time. Countries are ranked from left to right in decreasing order of total NSW.

- NSW represents around one third of total employment in OECD countries
- This could include increased financing social insurance from general tax revenue instead of SSCs
- Need to address distortions in tax systems that lead to workers & firms choosing one kind of employment contracts
- Also need to strengthen social protection for those in non-standard work

Incentivising skills investments

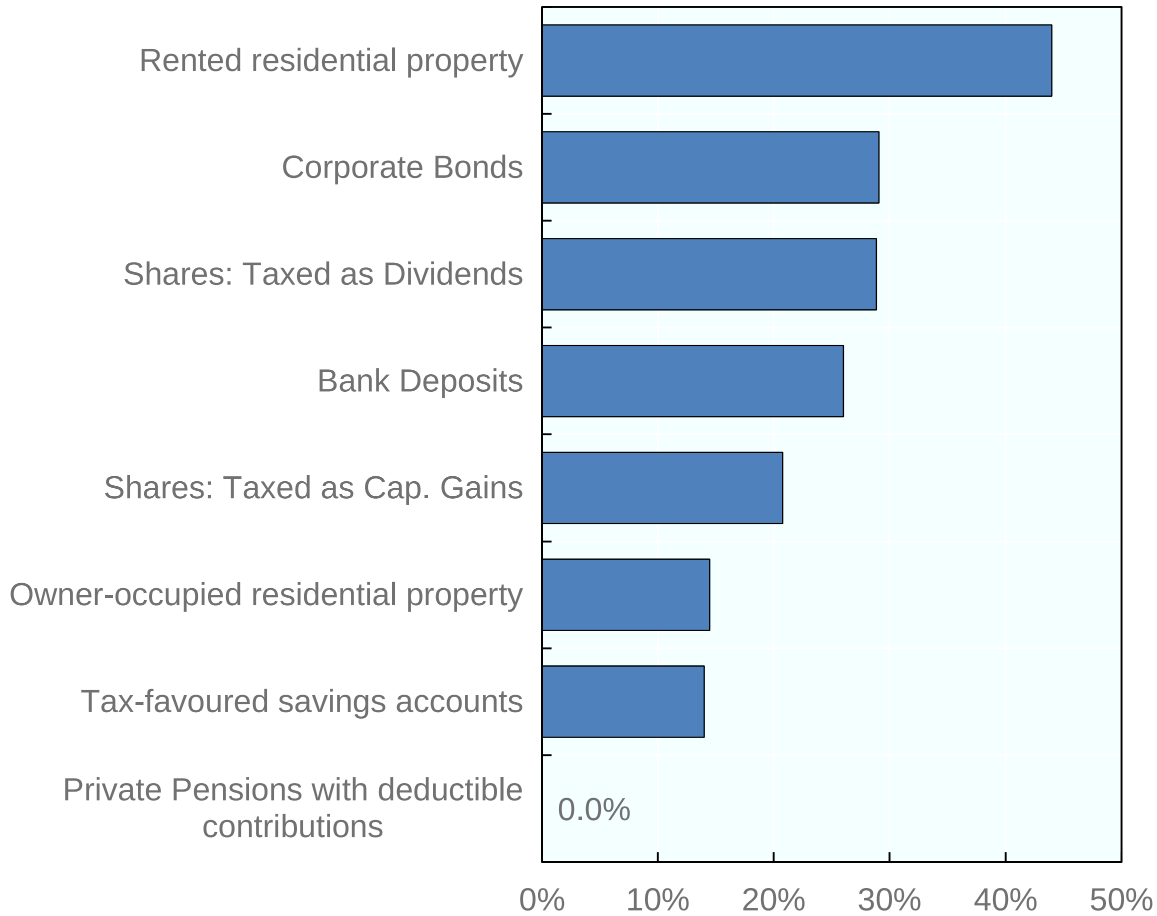
The ratio of government returns to government costs of investment in tertiary education



- Skills investments yield substantial returns to governments.
- Taxation of human capital as well as physical capital needs to be given more attention.
- Skills investments raise growth and equality
  at the same time.

Rising capital share of income highlights need to ensure efficiency of capital taxes

Marginal effective tax rates across asset types, average across 40 countries (OECD & G20)

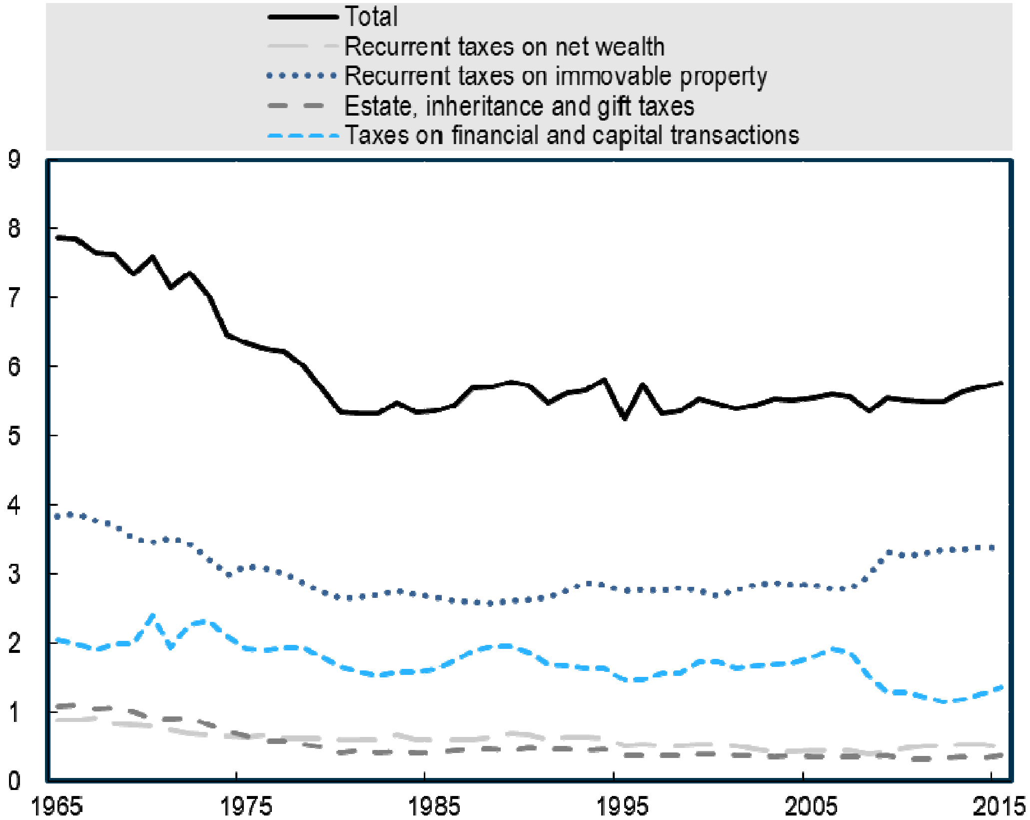


Source: The Taxation of Household Savings, OECD (forthcoming)

- Tax systems tax different forms of saving in different ways
  - Pension funds tend to be the most tax-favoured
  - Owner-occupied residential property also often tax-favoured
  - Dividends taxed higher than capital gains
  - Bank accounts relatively heavily taxed
- Different taxes for different assets incentivizes tax planning and is often regressive

Better exploiting the potential of property taxes

Evolution of property tax revenues as a share of total taxation in the OECD



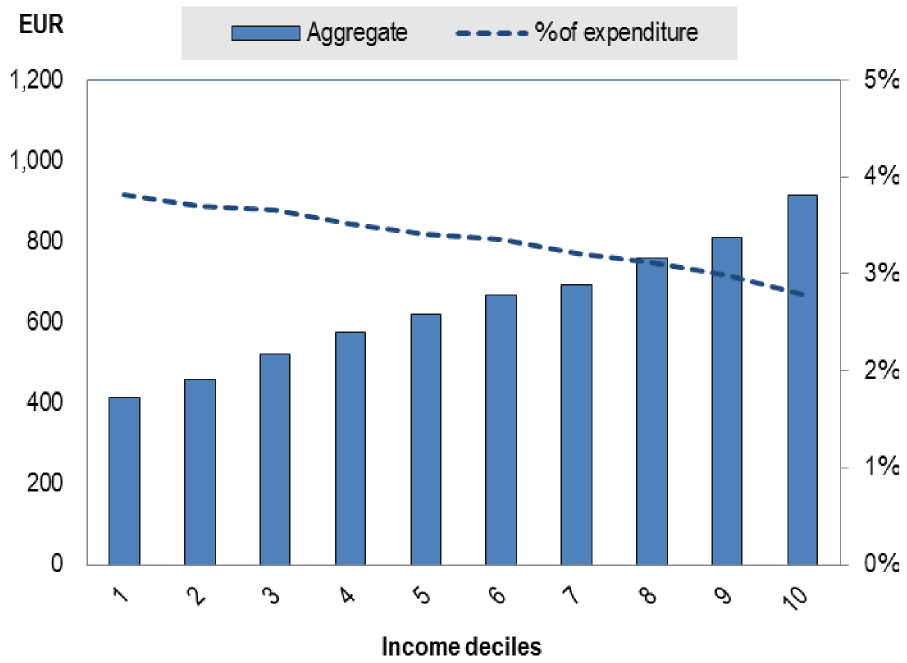
- Immobility of the tax base means less vulnerable to tax avoidance/evasion
- In emerging markets where PIT plays a limited role, property taxes could enhance progressivity
- Also a case for inheritance taxes to enhance equality of opportunity

Note: OECD average since 1965 .
Source: OECD Revenue Statistics Database

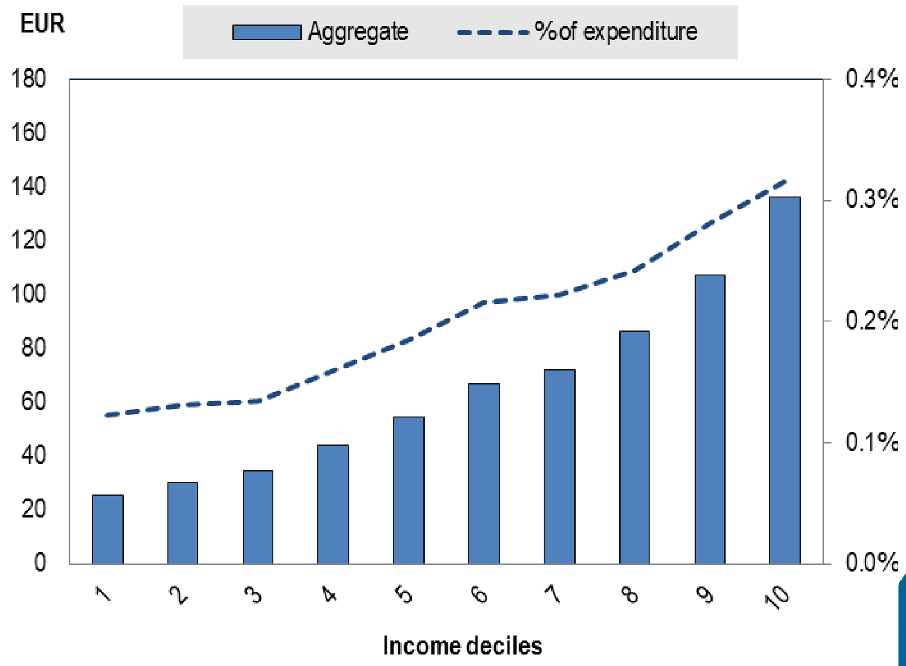
Broadening tax bases by scaling back regressive tax expenditures

The value of VAT tax expenditures across the income distribution

Average tax expenditure per household from all reduced rates (all-country average)



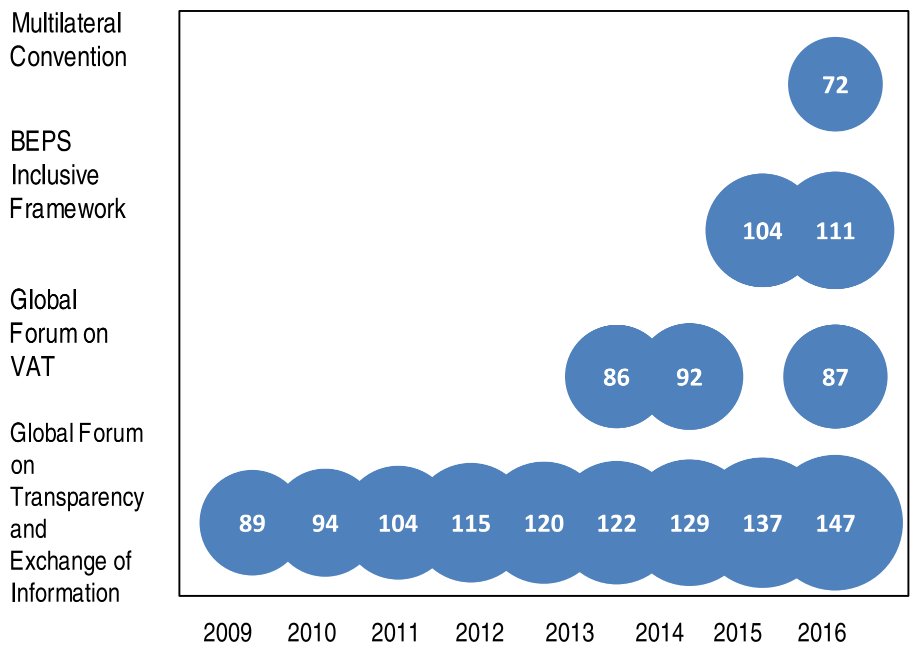
Average tax expenditure per household from reduced rates on restaurant food (all-country average)



Source: OECD/KIPF (2014), The Distributional Effects of Consumption Taxes in OECD countries

Continuing progress in international tax cooperation and administration

Membership of countries in platforms for international tax cooperation



New technologies can be leveraged for better tax administration

SUMMARY

TAX DESIGN GUIDANCE FOR INCLUSIVE GROWTH

Some tax policy design principles for inclusive growth

1 Broadening tax bases	2 Taking into account overall tax system progressivity	3 Affecting pre-tax behaviours and opportunities	4 Enhancing tax administration and policy
Keep bases broad and rates low	Equitable taxation of capital income	Provide incentives for formalisation	Fight against tax avoidance and evasion
Remove inequitable tax expenditures	Horizontal equity to enhance vertical equity	Promote equity of market income	Increase value for tax money
Broadening social security financing	Strengthen link between lifetime taxes & benefits	Align private & social costs and returns	Monitor income & wealth distribution
	Compensate losers of reforms		

Key “tax design for inclusive growth” insights

- **Making tax systems fair – tax progressivity and raising tax revenues to spend in fair ways –** also proportional tax rates can be redistributive if the money is spend pro-poor
- **Do not implement progressivity on a tax-by-tax basis**
- **Broaden tax bases** by removing inefficient tax expenditures that disproportionately benefit those on higher incomes
- **Keep tax rates low in particular for mobile tax bases**
- **Tax bads and subsidise goods**
- Make the **pre-tax distribution of income** more equal,
- Take **tax incidence considerations into account** – who pays a tax is not necessarily the agent who bears the burden of the tax,
- The impact of the introduction of a tax relief might be different from the impact when the relief is abolished as **taxes can be capitalised in asset values**
- **“Systems” approach to tax design –** tax policy, tax administration and international tax rules are an integral part of an inclusive growth “tax system”.

Contact details

Bert Brys, Ph.D.

Senior Tax Economist

Head of the Country Tax Policy Team

Head of the Personal and Property Taxes Unit
Centre for Tax Policy and Administration

2, rue André Pascal - 75775 Paris Cedex 16
Tel: +33 1 45 24 19 27 – Fax: +33 1 44 30 63 51

Bert.Brys@oecd.org || www.oecd.org/tax