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Tax reforms, economic growth and income distribution

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Our work on reforms and inequality

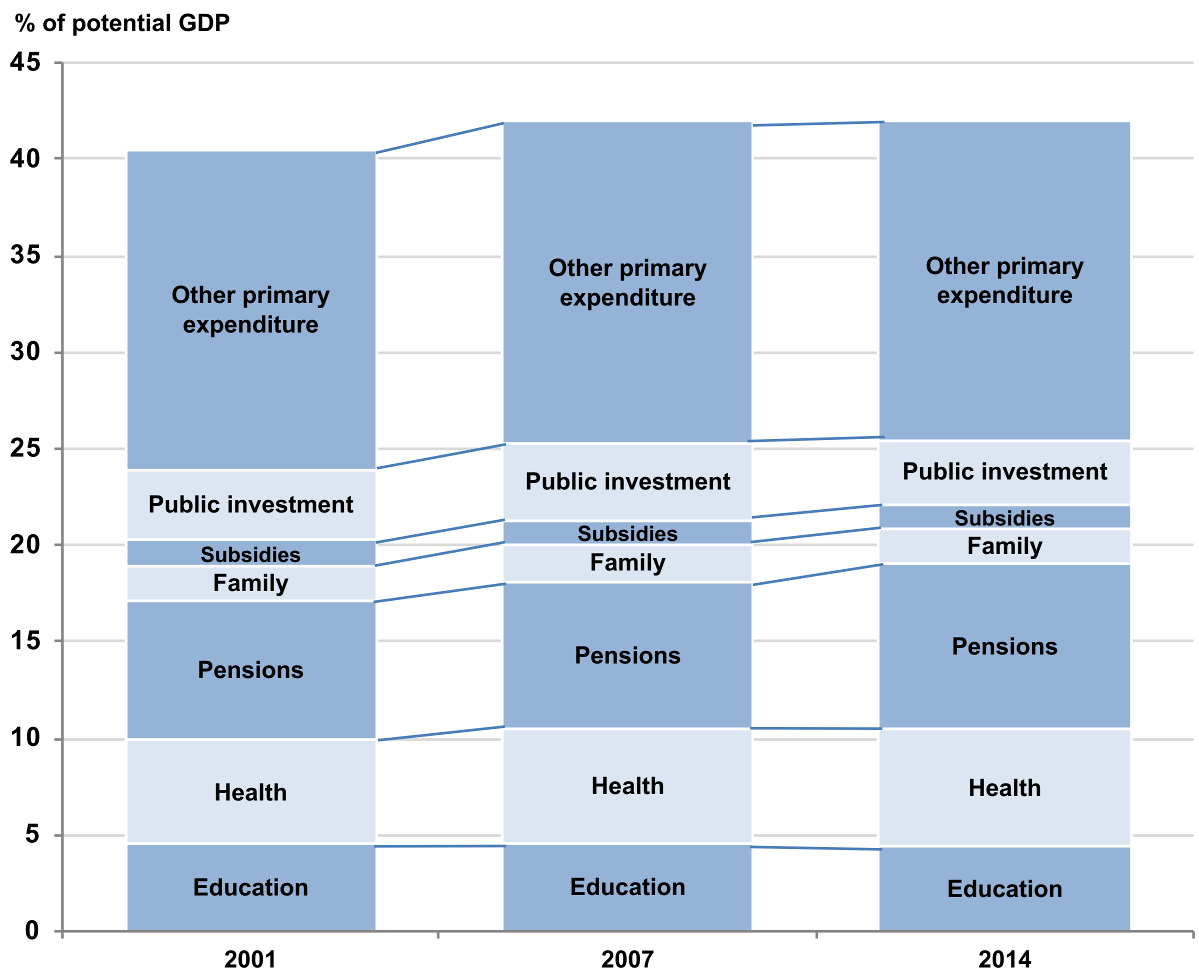
Many public sectors are large but not necessarily efficient

Tax reforms can make governments more supportive of growth or equity or both

Packages can improve the political economy of public finance reforms

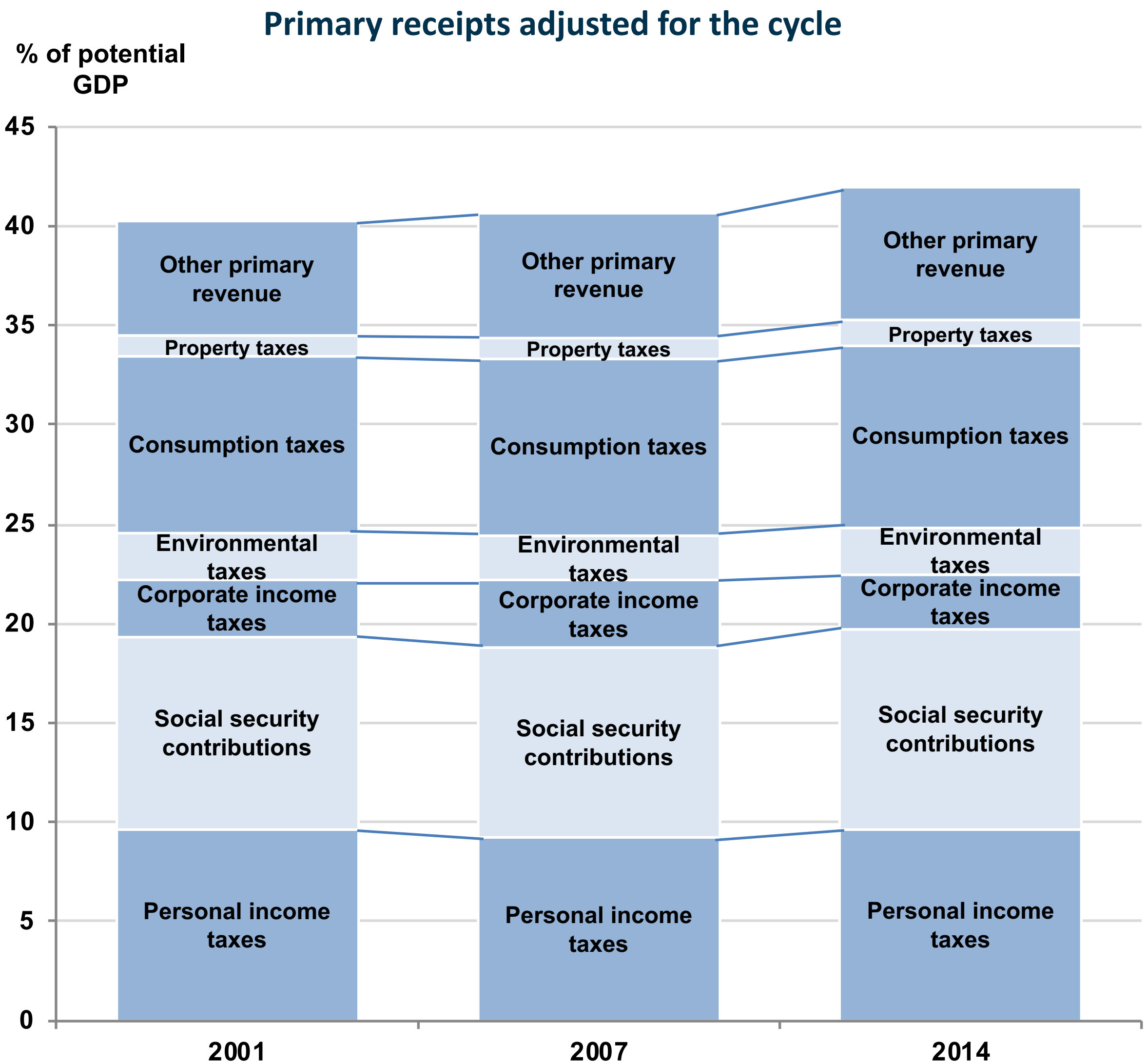
Public spending has expanded…

Expenditure excluding interest (i.e. primary) and adjusted for the cycle



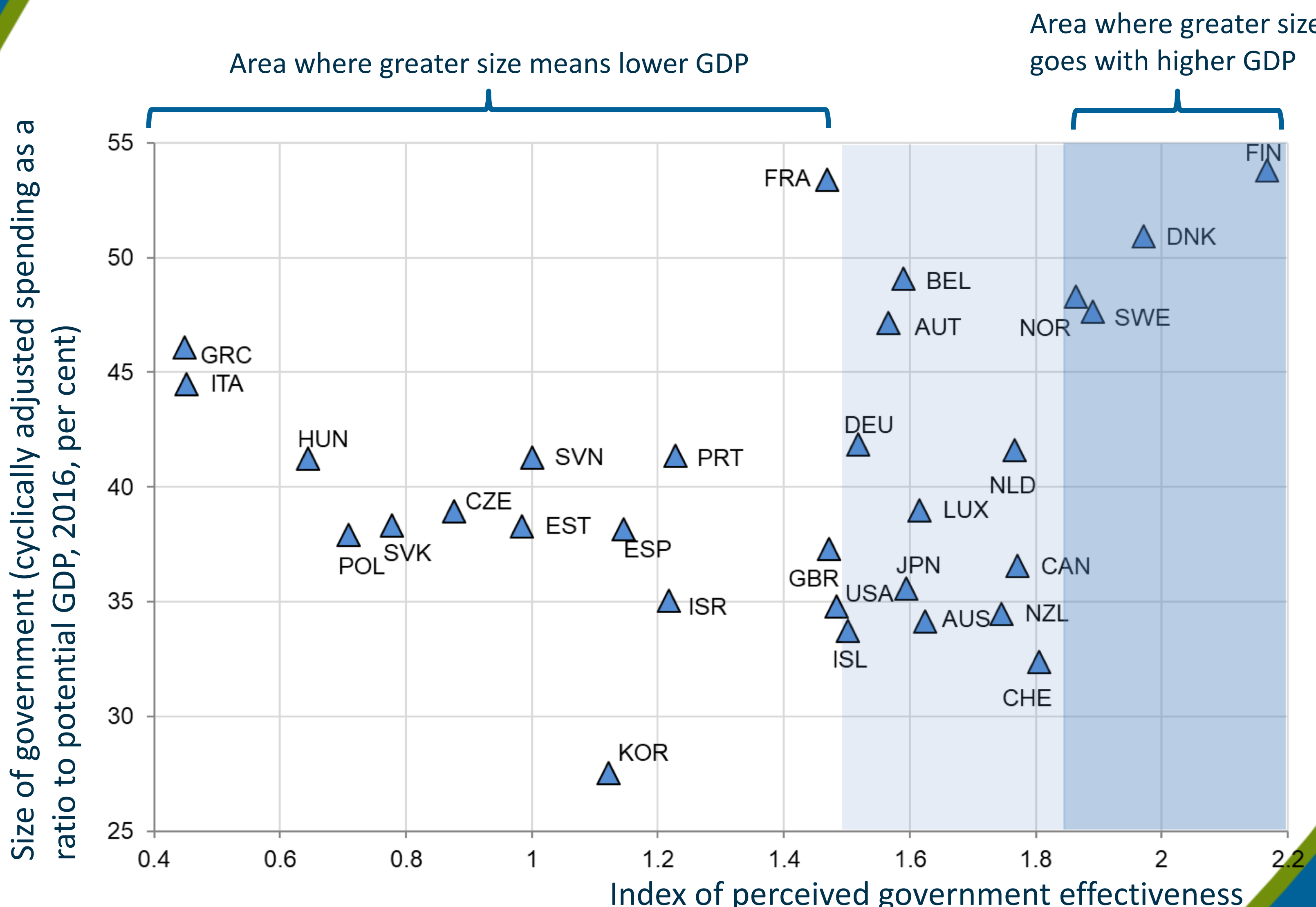
Source: OECD Public Finance Dataset (Bloch et al., 2016), 2018 update.

…as have public revenues



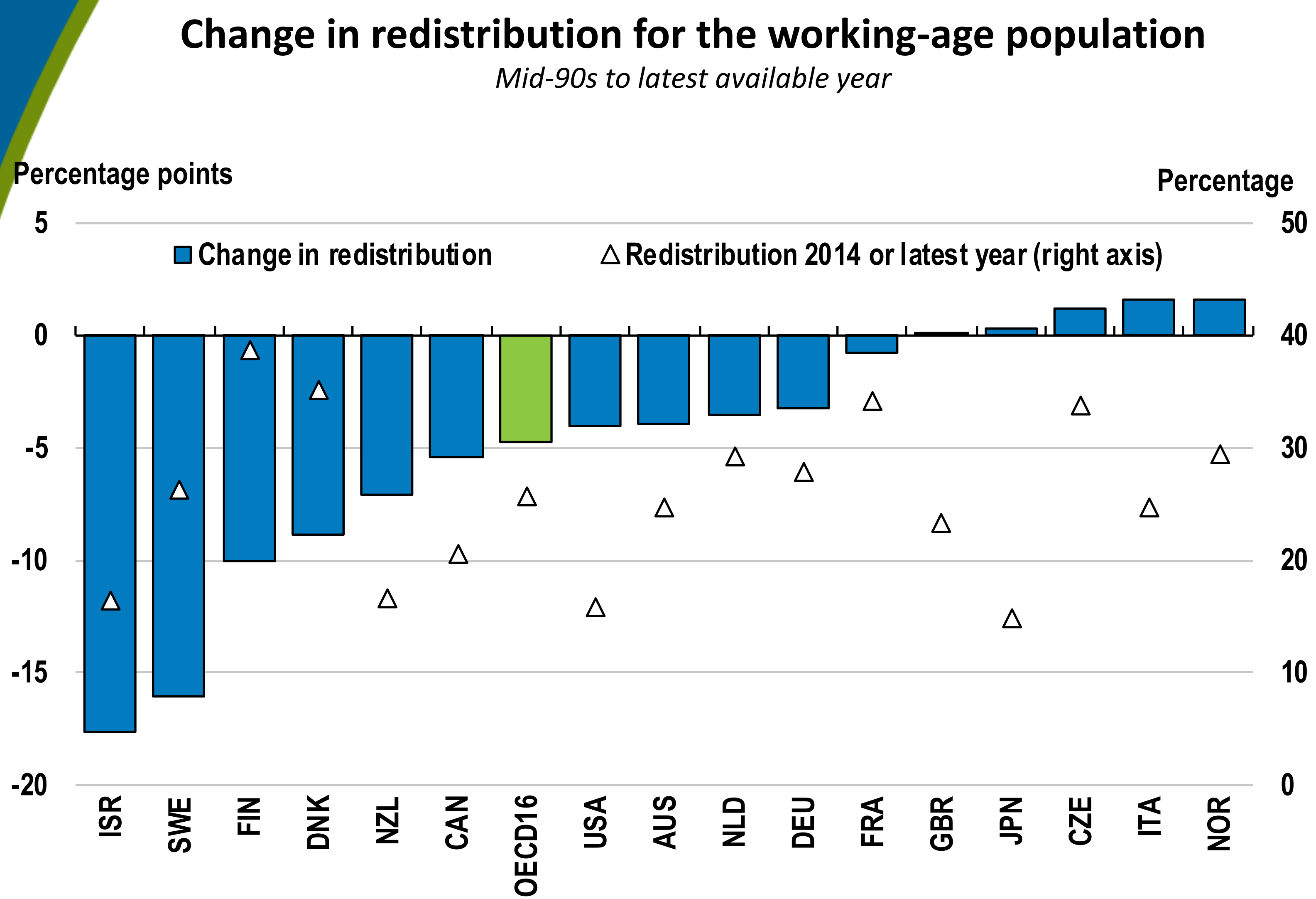
Source: OECD Public Finance Dataset (Bloch et al., 2016), 2018 update.

No link between size and efficiency



Source: Fournier and Johansson (2016) and 2018 update of Bloch et al.'s (2016) database.

Income redistribution has declined



Source: Causa and Hermansen (2017)

OECD analysis on tax reforms

Estimate long-term effects of policy reforms on

- Output per capita
- Household disposable income by decile allowing to gauge
  - Moves relative to other deciles
  - Changes in absolute income levels by decile

With econometric regressions

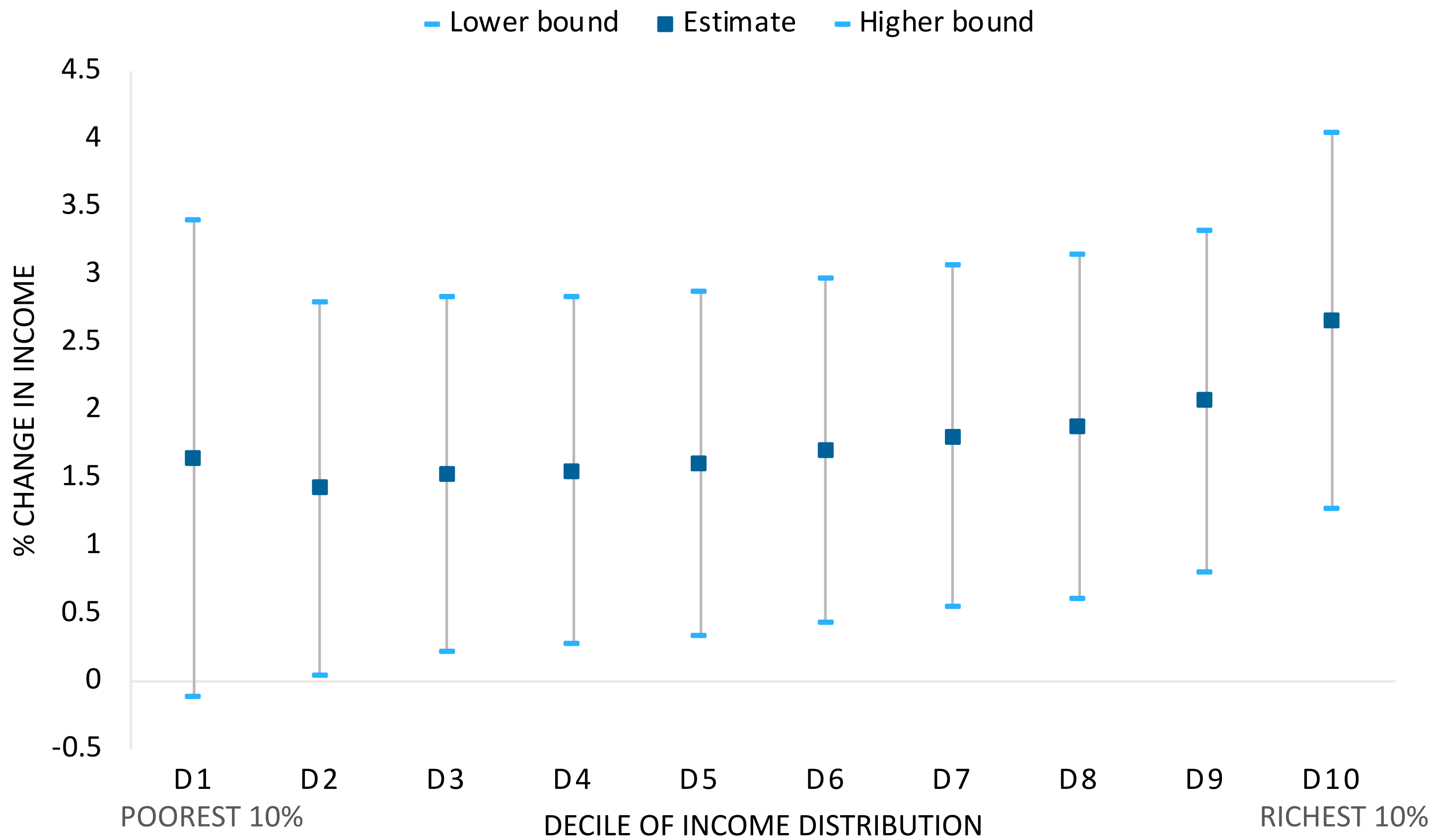
- Production function framework for output
- Estimation by decile
- Long-term effects (after cyclical impacts have played out)

On an internationally comparable dataset

- Covers 35 countries over 1985-2014
- Adjusts for cyclical effects

Reducing net wealth taxes

Estimated long-term change in disposable income after permanently reducing net wealth tax receipts by 0.1% of GDP while increasing other taxes



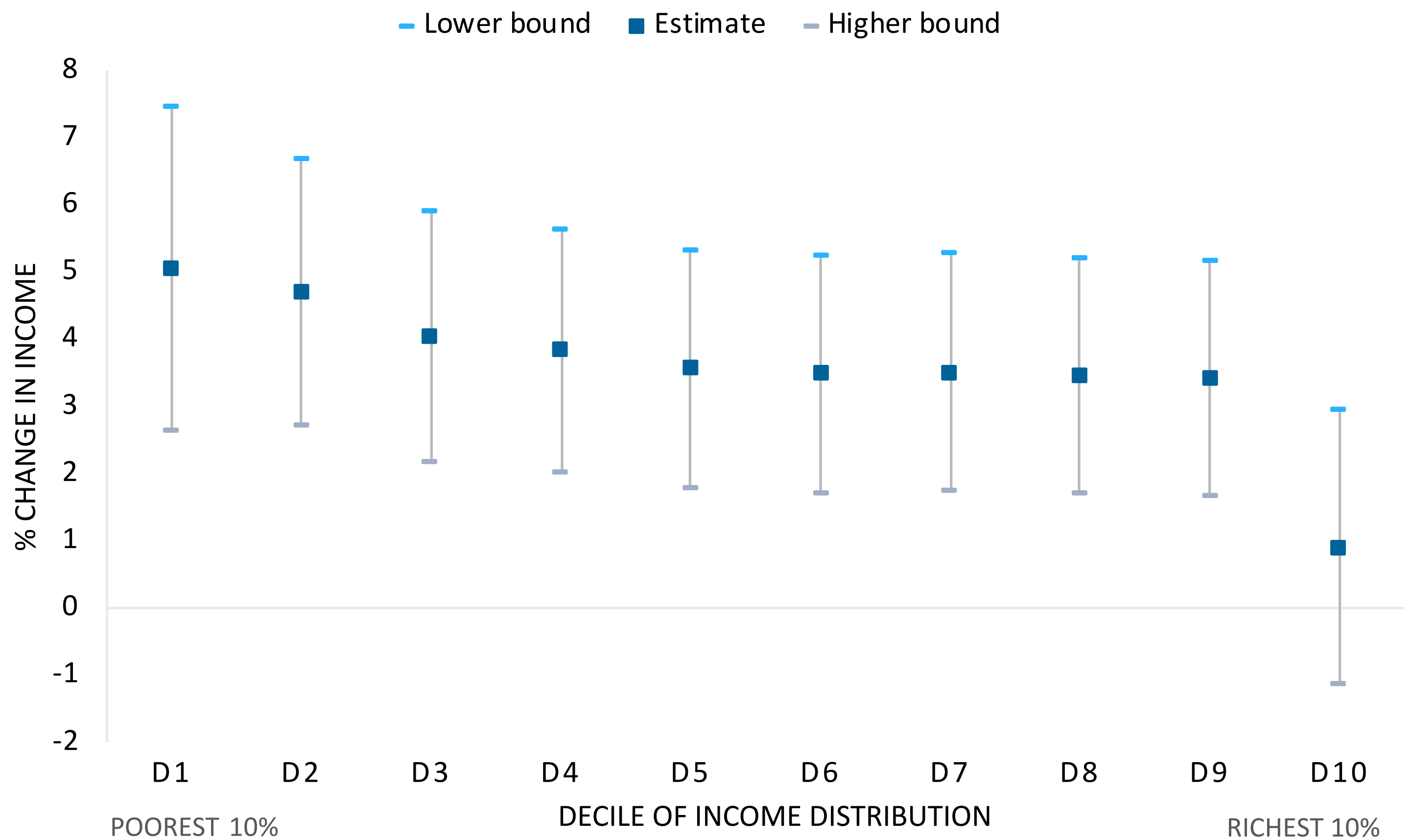
Note: the bounds delineate 90% confidence intervals.

Source: Cournède, Fournier and Hoeller (2018).

Increasing inheritance taxes

Estimated long-term effect on disposable income of a large tax-mix shift involving increases in inheritance taxes allowing proportionaly cuts in other taxes

A large tax-mix shift is defined as having a 10% probability of being observed over 20 years

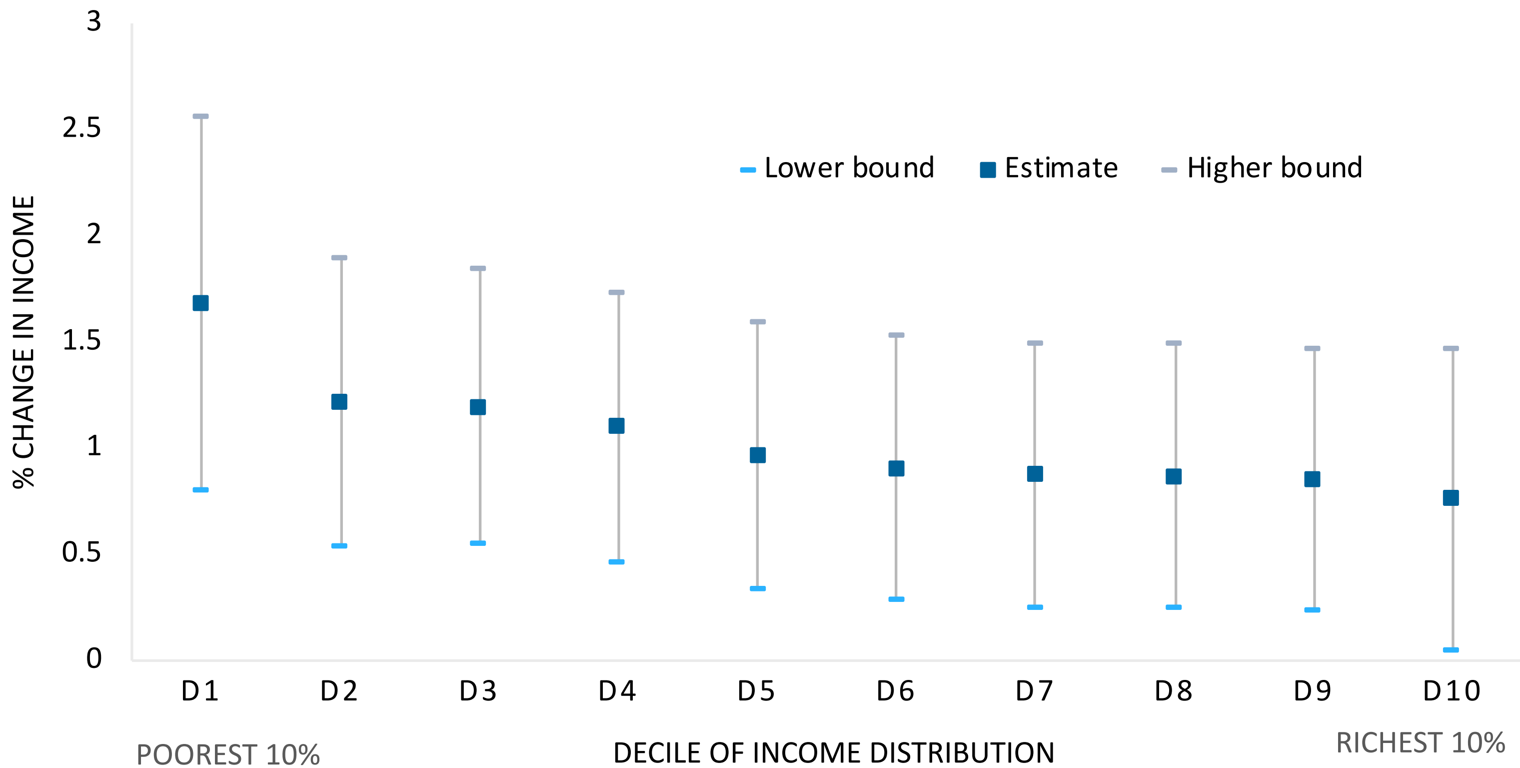


Note: the bounds delineate 90% confidence intervals.

Source: Cournède, Fournier and Hoeller (2018).

Cutting tax on low-wage earners

Estimated long-term effect on disposable income of reducing the labour tax wedge applicable at 67% of average income by one percentage point while increasing other taxes proportionally to compensate the revenue loss



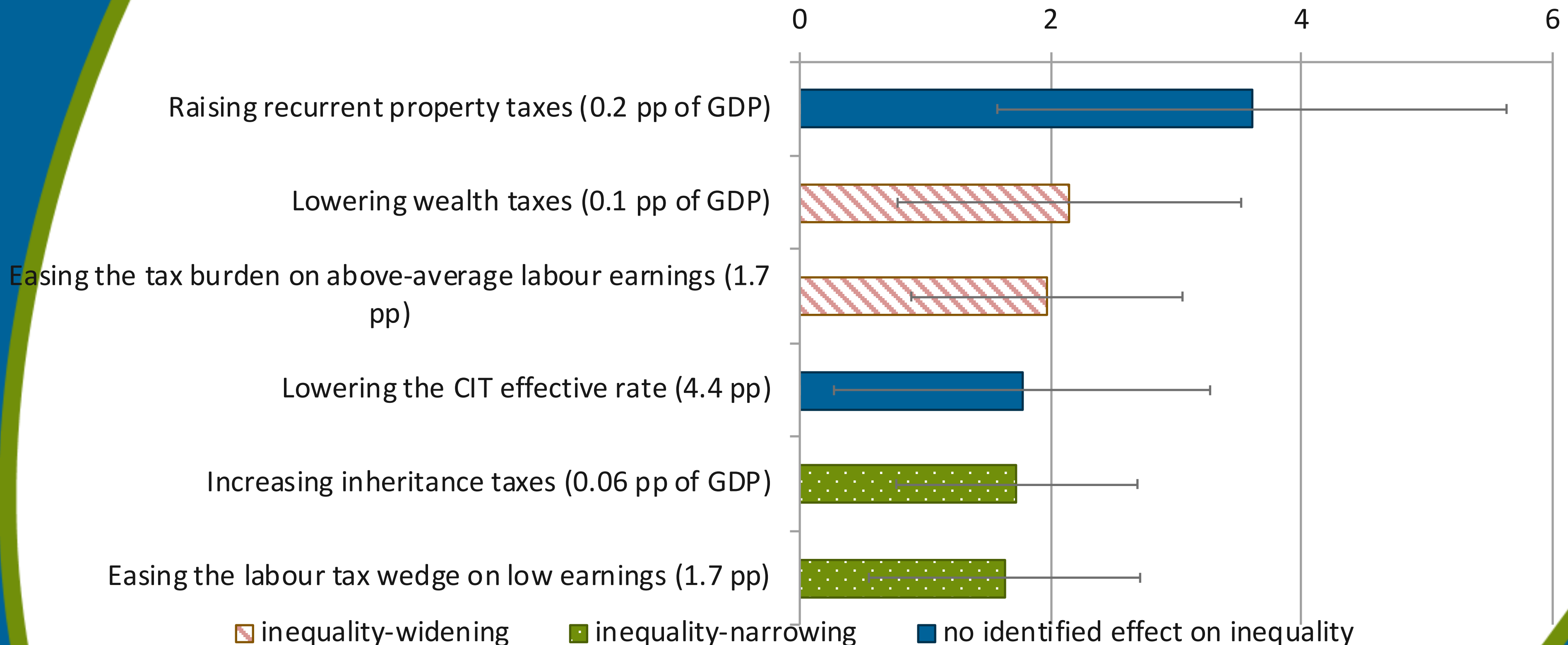
Note: the bounds delineate 90% confidence intervals.

Source: Cournède, Fournier and Hoeller (2018).

The bars show the point estimates while bracketed solid lines depict the 10% confidence intervals. Estimates come from panel regressions covering 34 OECD countries over 1981-2014 or fewer observations depending on d

A practical guide to the tax galaxy

Permanent percentage effect on output per capita of a typically observed long-term change in a public finance instrument while keeping overall government spending and revenue constant

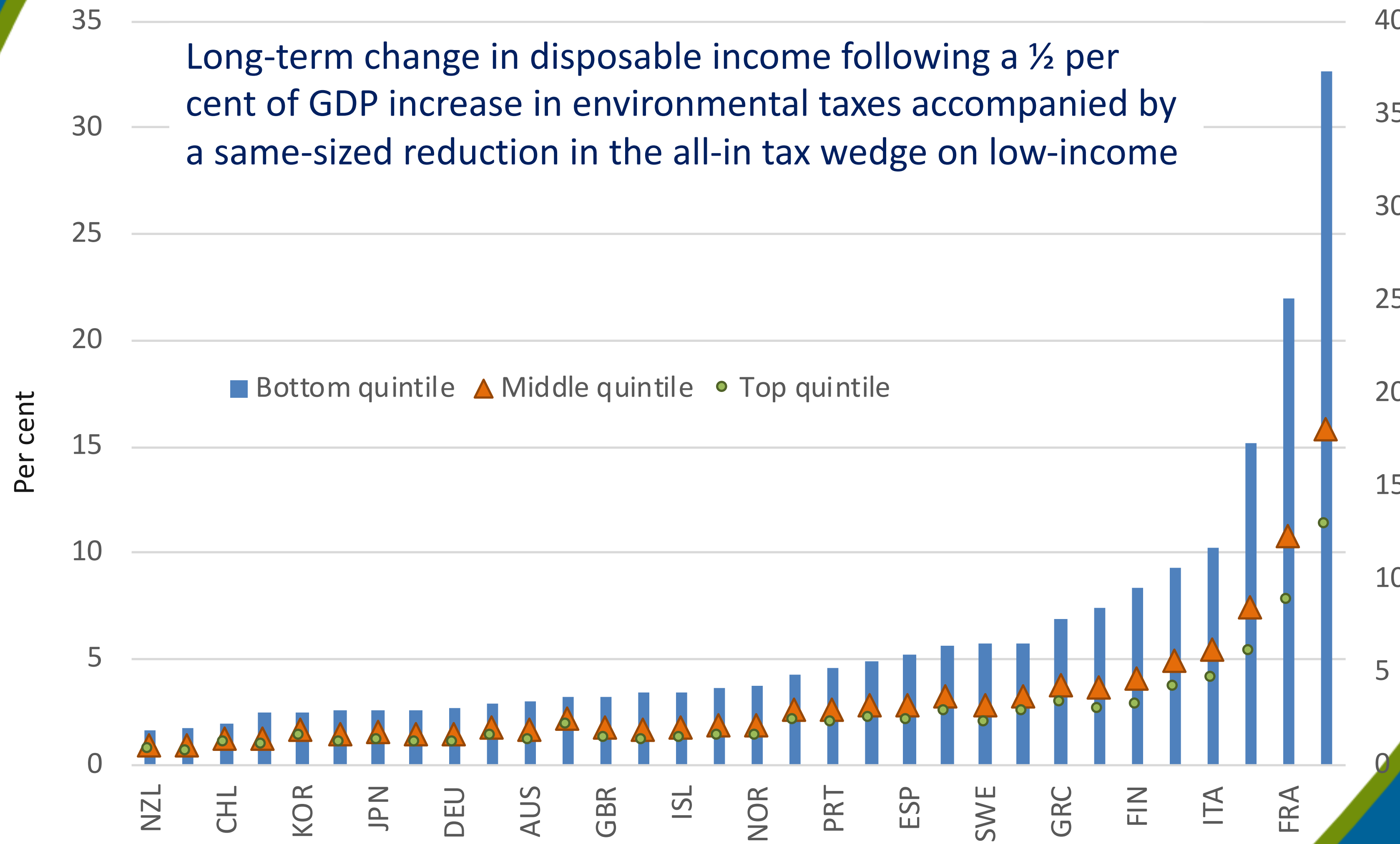


Note: A typically observed long-term change in a public finance instrument is defined as the average across countries of the within-country standard deviation in the tax or spending instrument over time. The brackets show 10% confidence intervals.

Source*:* Cournède, Fournier and Hoeller (2018).

Packages can improve the political economy of public finance reforms

Using the proceeds from increases in environmental taxes to reduce low-income tax wedges



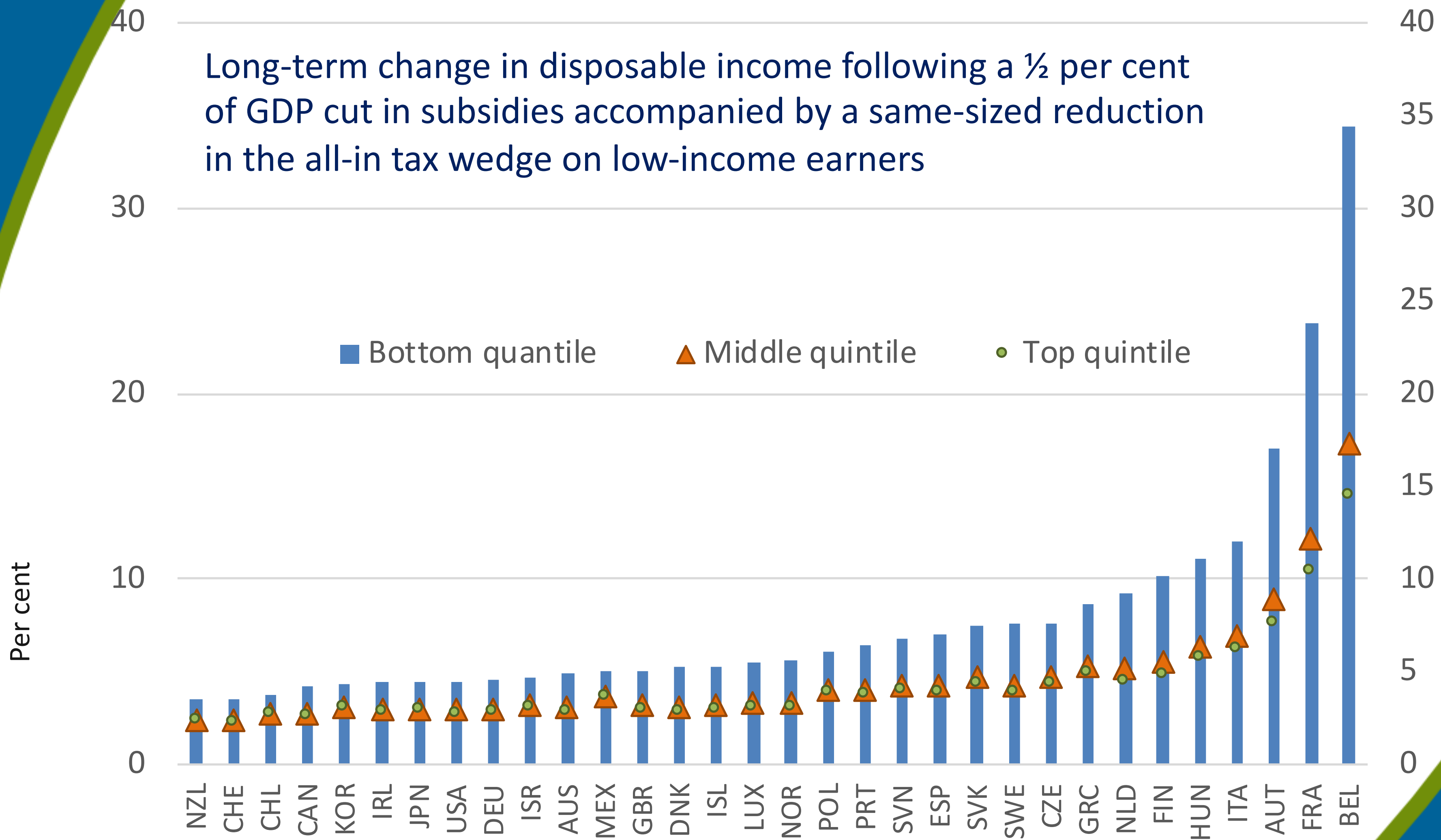
Source: Cournède, Fournier and Hoeller (2018).

Shifting the tax burden from low income earners to pollution works through two channels

A concrete example: British Columbia's 2008 carbon tax

- CAD10 per tonne of CO_2 rising to CAD30 per tonne in 2012 on all fossil fuels
  → including but not limited to motor fuels
- 5 percentage point rate reduction for the first two personal income tax brackets
- Low-income tax credit
- 2 percentage point cut in the provincial rate of corporate income tax

Coupling subsidy cuts with a reduction on the low-income tax wedge



Source: Cournède, Fournier and Hoeller (2018).

Conclusion

- Many OECD countries have very **large public sectors** that are seen as not highly effective.

- There is considerable scope for public finance reform to support inclusive growth, especially by **restructuring the tax mix**

- Some revenue-neutral tax reforms boost **both growth and equality**:
    - Reducing the all-in tax wedge on low-income earners
    - Relying more on inheritance taxes

- **Growth-friendly tax reforms typically increase disposable incomes for all income groups** (or at least leave no group worse off)

- **Reform packages**, such as coupling environmental tax hikes with cuts in effective taxes on low-income labour, offer ways to ensure outcomes that are efficient and inclusive.

These reports provide additional results and more detail on the analysis

- Cournède, B., J.-M. Fournier and P. Hoeller (2018), “Public Finance Structure and Inclusive Growth”, OECD Economic Policy Paper, No. 24, OECD Publishing, Paris.
- Akgun, O., D. Bartolini and B. Cournède (2017), “The Capacity of Governments to Raise Taxes”, OECD Economics Department Working Papers, No. 1407, OECD Publishing, Paris, http://dx.doi.org/10.1787/6bee2df9-en.
- Akgun, O., B. Cournède and J. Fournier (2017), “Effects of the Tax Mix on Inequality and Growth”, OECD Economics Department Working Papers, No. 1447, OECD Publishing, Paris, http://dx.doi.org/10.1787/c57eaa14-en.
- Fournier, J. (2016), “The Positive Effect of Public Investment on Potential Growth”, OECD Economics Department Working Papers, No. 1347, OECD Publishing, Paris, http://dx.doi.org/10.1787/15e400d4-en.
- Fournier, J. and Å. Johansson (2016), “The Effect of the Size and the Mix of Public Spending on Growth and Inequality”, OECD Economics Department Working Papers, No. 1344, OECD Publishing, Paris, http://dx.doi.org/10.1787/f99f6b36-en.

Look up you country on the dedicated website
http://www.oecd.org/XXX

Background slides

Political economy of tax reforms

Reduce disposable income disparities

- Ease effective marginal tax rates on low-income earners
- Hike inheritance taxes

Leave disposable income disparities broadly unchanged and improve absolute income levels for all

- Increase public investment
- Raise recurring property taxes
- Lower effective corporate income tax rates

Widen income disparities, but leave no group worse off in terms of absolute income

- Reduce subsidies,
- Lower wealth taxes
- Lighten the tax burden on above-average labour earnings

A number of areas offer scope to make public finances more growth-friendly in many countries

- The results allow quantifying how much potential a reform of each instrument can offer for each country

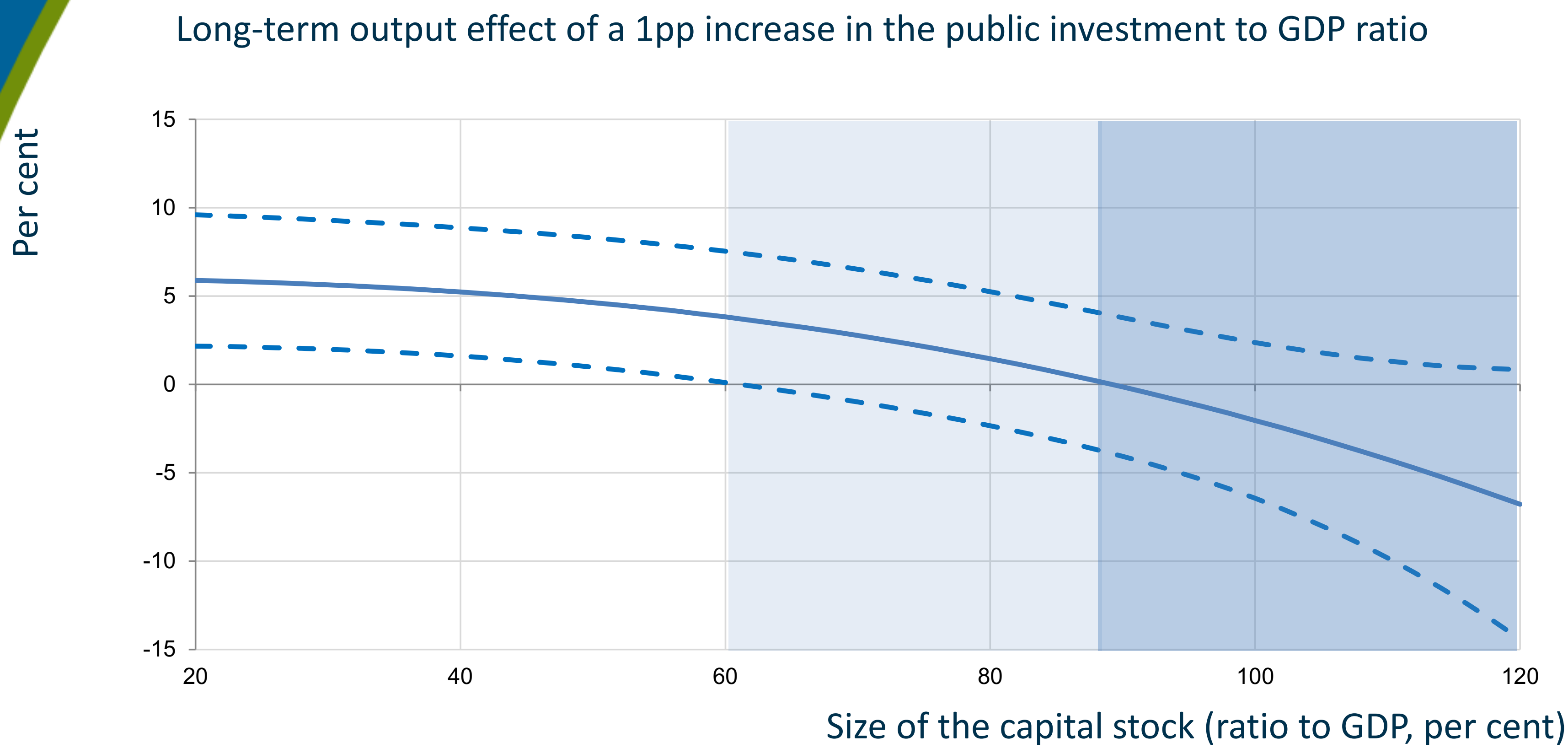
- The following areas are the four most frequent ones to arise among the two top candidate reform areas to boost output per capita:
  - Increasing recurring property taxes as part of a revenue-neutral reform: Austria, Czech Republic, Germany, Estonia, Finland, Ireland, Korea, Luxembourg, Netherlands, Slovenia.
  - Containing public pension expenditure to make room for other spending: Austria, Finland, France, Greece, Italy, Japan, Korea, Poland.
  - Expanding public investment as part of a spending shift: Germany, United Kingdom, Ireland, Israel, Netherlands, Portugal, Spain.
  - Reducing subsidies to make room for other spending: Austria, Belgium, Switzerland, Czech Republic, Denmark, Norway

Slightly different areas offer scope to make public finances more supportive for low income groups

- The results allow quantifying how much potential each reform can offer in each country

- The following areas are the four most frequent ones to arise among the two top candidate reform areas to boost disposable income of the bottom 20%:
  - Increasing recurring property taxes as part of a revenue-neutral reform: Austria, Czech Republic, Estonia, Finland, Korea, Luxembourg, Netherlands, Switzerland.
  - Expanding family and childcare support: Czech Republic, Japan, Korea, Netherlands, Spain, United Kingdom, United States.
  - Easing the effective tax burden (and benefit withdrawal) for low income earners: Belgium, France, Germany, Hungary, Iceland, Norway, Sweden.
  - Expanding public investment as part of a spending shift: Belgium, Germany, United Kingdom, Ireland, Israel, Portugal, Spain.

The benefits of public investment diminish with the size of the public capital stock



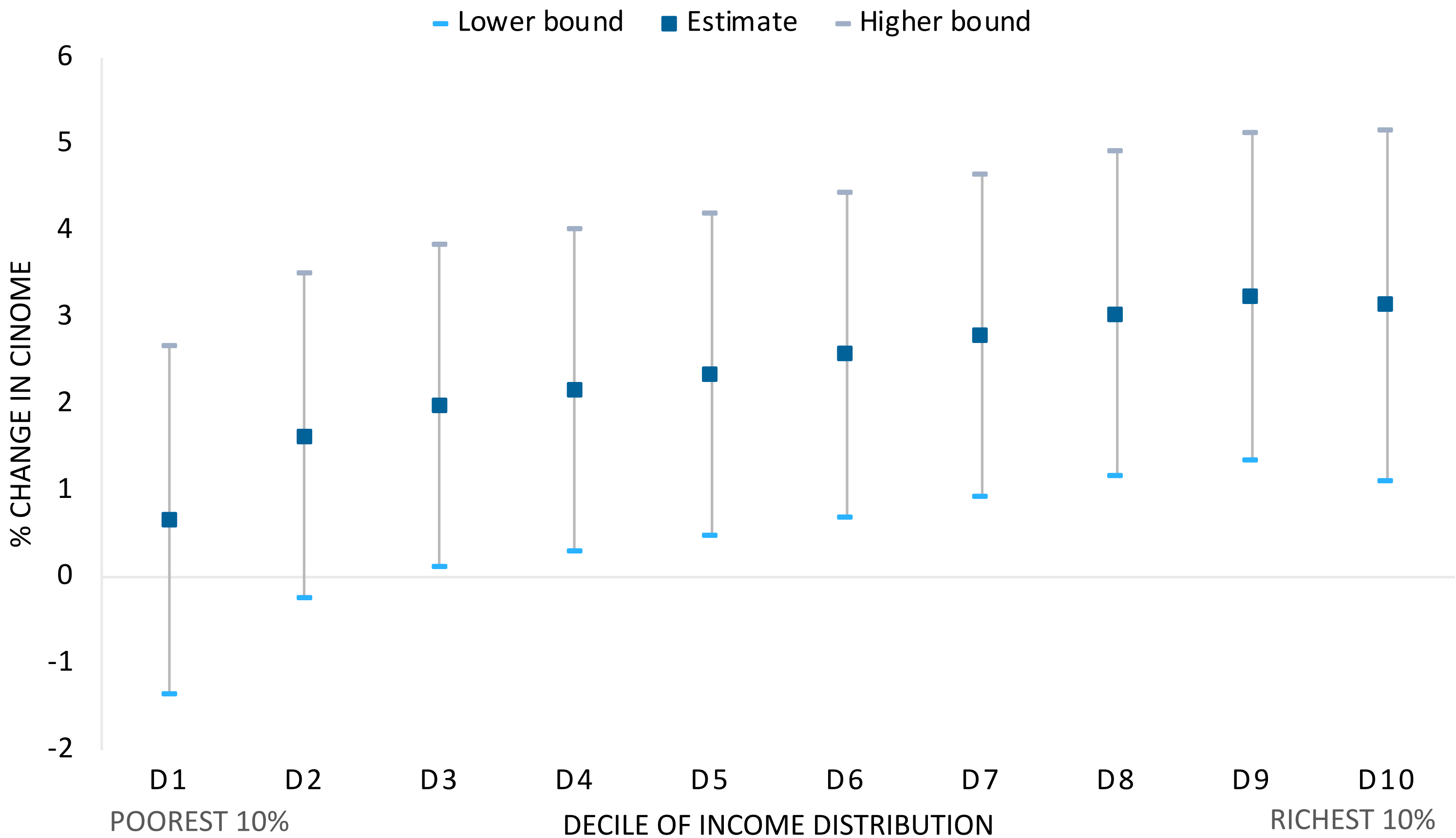
Only Japan has a public capital stock above 90% of GDP, suggesting macro benefits from expanding net public investment in all other OECD countries

Note: the dotted lines delineate the 95% confidence interval.

Source: Fournier (2016).

Shrinking governments typically involves a growth-equality trade-off but still leaves most better off

Estimated change in disposable income after permanently reducing government size by one percent of GDP in countries with median perceived government effectiveness

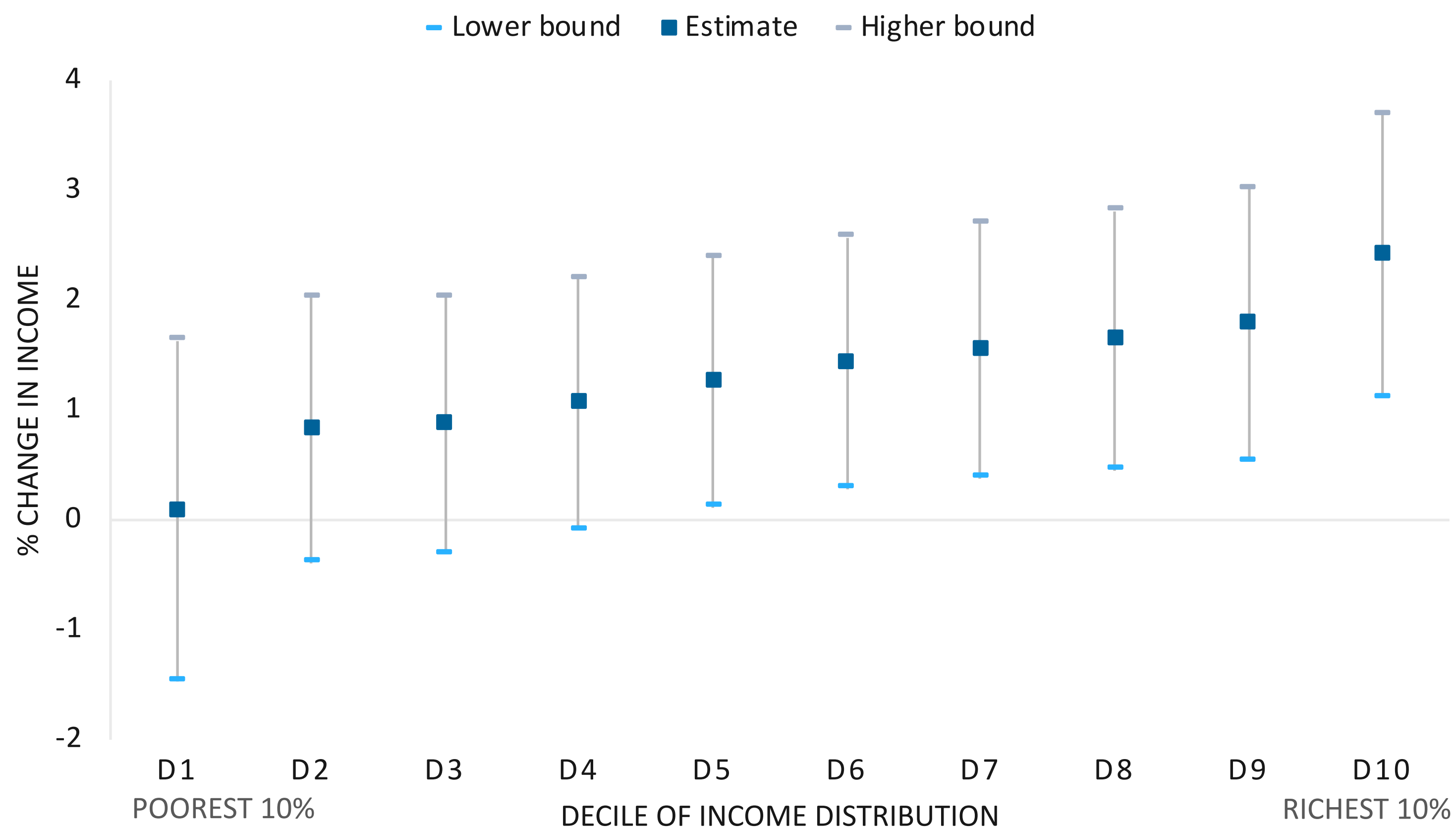


Note: the bounds delineate 90% confidence intervals.

Source: Cournède, Fournier and Hoeller (2018).

Shifting spending away from subsidies boosts output but only raises above-average incomes

Estimated long-term change in disposable income after permanently reducing subsidies by 0.1% of GDP while increasing other spending items

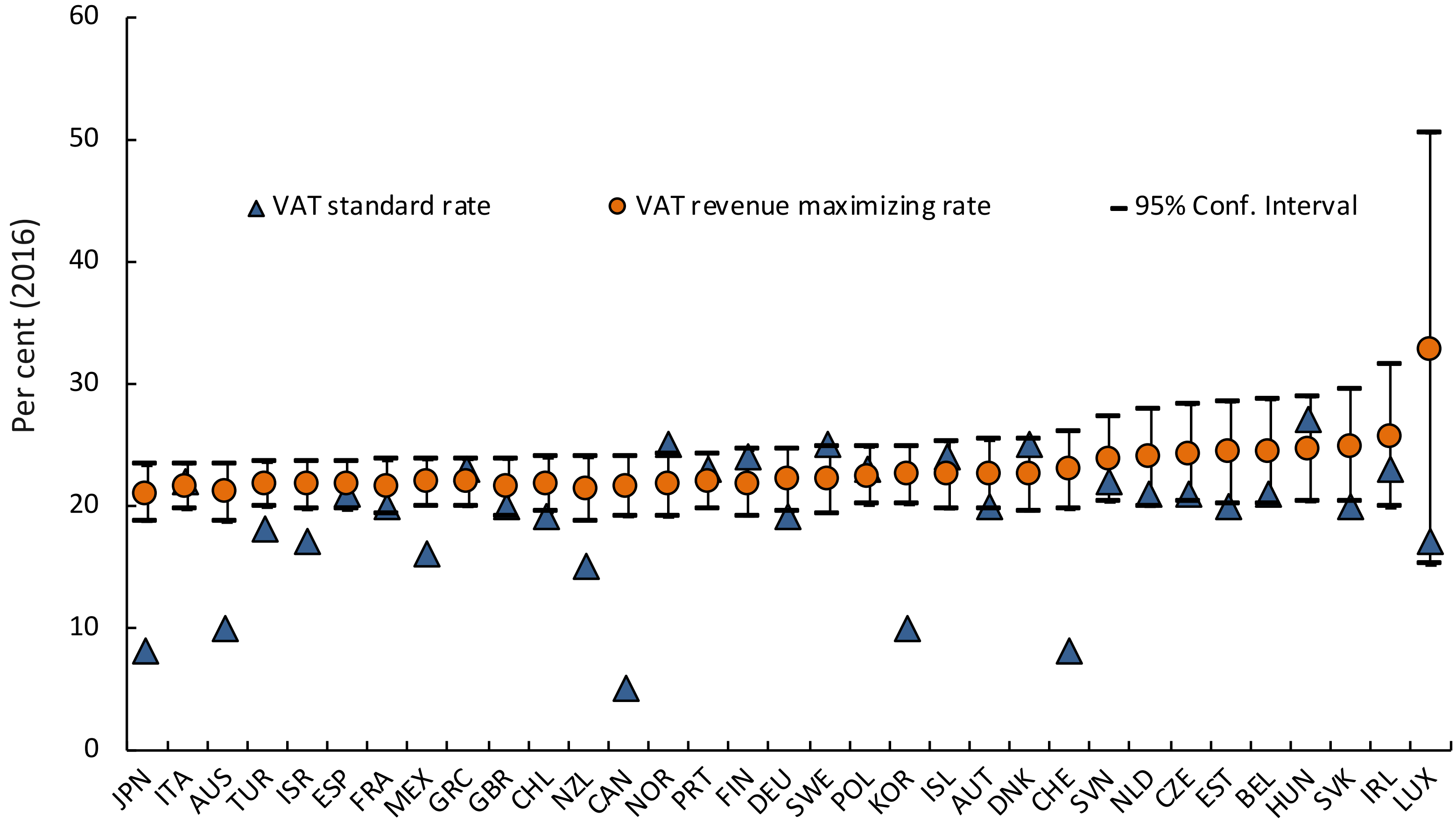


Note: the bounds delineate 90% confidence intervals.

Source: Cournède, Fournier and Hoeller (2018).

Many countries have limited room to hike VAT rates as a way of funding cuts in more distortive taxes

Panel data econometrics of OECD country experiences over the past three decades show that the revenue generated by VAT plateaus when the rate reaches a 'revenue-maximising' point, which depends on country characteristics such as openness and expenditure on tax collection



Source: Akgun, Bartolini and Cournède (2017).