ActionAid's Progressive Taxation Briefings

Progressive taxation

Introduction

What is progressive taxation?

Progressive taxation means higher tax rates for those with higher income or more wealth, so that those who earn or have more are taxed at a higher rate. Personal income tax based on graduated scales where the tax rate goes up as income level rises is probably the clearest example of progressivity. Regressive taxation means the poor pay a greater proportion of their available resources than the rich. Consumption taxes which employ a flat rate are the clearest example of regressive taxes.

Taxes can be made more progressive with well-designed thresholds (on who earns or has enough to pay a particular tax) and exemptions. What matters for the overall progressiveness of a tax system is the mix of different types of taxes and the rates applied to them. A mix of progressive taxes such as those detailed in these briefings, with high rates and relatively low-rated consumption taxes, is likely to produce a more progressive overall system.

ActionAid's briefings on progressive taxation

These briefings cover both generally-regressive taxes that can and should be reformed – consumption taxes such as **value-added tax (VAT), excise taxes, international trade taxes, and taxes on the informal sector** – and taxes that are usually progressive – **property tax, capital gains tax** and **wealth taxes** (such as inheritance tax). In each briefing, we offer a working definition of the type of tax, a discussion of its current application, an outline of its challenges and benefits, examples of how it has been used, and recommendations for how it could be reformed and/or better implemented.

The taxes covered by our briefings are, with the exception of consumption taxes like VAT, generally not the subject of much attention by activists. And they are all best addressed at the national level. With the conclusion of our five-year Tax Power Campaign, ActionAid's work on tax justice is now primarily carried out at the national and local levels. We hope these briefings will equip our country offices – and our allies and partners around the world – to advocate more strongly for progressive taxation.

The need for increased tax revenue

The need to raise more tax in most countries, especially developing ones, is widely recognized. Taxes are used to fund many government activities. ActionAid is most concerned to see that *gender-responsive public services*, including health care, universal public education, provision of safe water, provision of safe public transport, lighting in public spaces, and other factors in keeping women and all people safe, get the funding they require. The Sustainable Development Goals (SDGs) developed by the UN for its Agenda 2030[1] aim for sharply reduced inequalities but are dramatically under-funded, to the tune of trillions of dollars,[2] and domestic resource mobilization (with tax at its centre) has been repeatedly highlighted as the key to sustainable and democratic financing. We also need to track the way governments spend the tax revenue they raise, to ensure it goes to those services. However, that is beyond the scope of these briefings.[3]

How taxes are raised matters

How should essential tax revenue be generated? Different types of taxes can have different impacts on businesses, labour markets, and the environment, as well as economic and gender equality.

VAT and other consumption taxes such as goods and services taxes (GST) and sales taxes are increasingly relied upon, especially by developing country governments, despite increasing evidence of their regressivity and disproportionate impact on women.[4]

At the same time, the world has become increasingly aware of the massive scale of corporate tax avoidance and tax evasion by corporations and wealthy individuals, which severely undermine revenues from corporate and personal income tax – both generally very progressive - effectively shifting the balance of contributions towards those earning less.

Because the impact of various taxes depends on the national and local economic and social contexts, there is no one-size-fits-all solution for a progressive tax system. But governments should ensure that their tax systems contribute to greater gender and economic equalities rather than undermine them. Progressive taxation is crucial for achieving social justice at the local, national, and global levels.

Progressive taxation or progressive spending

A common question raised around progressive taxation is what matters more in the fight against inequalities – raising the revenue in a progressive manner or spending it progressively. Research has shown that both taxation and spending have a positive impact on reducing inequality.

The World Bank argues that efficient collection of regressive taxes (e.g. VAT) can result in an overall equalizing fiscal system, if it is combined with progressive spending (e.g. well-targeted social transfers). At the same time, however, it warns that regressive taxes risk pushing people into poverty, regardless of how the revenue from them is allocated.[5] While social spending, public services and other factors, such as labour policies, can have a strong impact on gender and economic inequalities, tax policies are central to the discussion and regressive taxation can have a highly negative impact on both inequality and poverty levels.

Rather than choosing between progressive taxation and progressive spending, ActionAid has chosen to work on both. How tax is raised matters because progressive redistribution and greater economic equality are overarching goals of ours. And of course, it is crucial that the revenue is well spent, contributing to further reduction of inequalities through better-quality and broadly-accessible public services and equitable development.

Vigilance will always be required to make revenue raising and spending progressive. But the need for ActionAid and its allies to focus on both progressive taxation and public services in developing countries is particularly acute since a shift in global economic orthodoxy in the 1980s. Led by the UK and US governments, economic policy in capitalist countries rapidly abandoned Keynesian economic policies, which advocate government intervention, and promoted a "neoliberal" approach which prioritizes economic growth, "free markets", "free trade", and privatization. This has accelerated inequality and led to less progressive tax regimes and reduced government capacity to provide public services. Developing countries were steered in this direction by donor governments and the International Monetary Fund (IMF) and World Bank. The IMF has in recent years begun to re-think some of its policies, but neoliberalism continues to be the fundamental guiding philosophy in finance ministries around the world, leading many developing countries to be more active in seeking foreign direct investment (FDI) rather than supporting domestic economies and the poor. Progressive taxation can be a crucial tool to moderate the negative impacts of the reigning orthodoxy.

Recommendations

We note here a few recommendations that apply to all the taxes covered in our briefings:

- *For all tax and other fiscal policy decisions, **impact analyses** are key. How a particular tax or spending measure will affect different components of society will differ from country to country, and even in different parts of a given country. Policy-makers need to know, especially, how implementation of a specific tax will affect women, children, the impoverished, and other marginalized segments of society. And they need to use that knowledge to make taxation as broadly progressive as possible.*

- *Governments, whether local or national, need to **communicate clearly and transparently** what various taxes are, who needs to pay them and how, and how they are being spent -- what public services and development benefits the resulting revenues will fund. This communication needs to be both consistent and continuous, and updated regularly as policies are adjusted.*

- *Virtually all taxes are the subject of attempted **evasion or avoidance**, often through exploiting loopholes and international mismatches in tax law and/or fraudulent schemes involving mis-reporting, under-reporting or non-reporting. Governments need to maintain **well-resourced and trained tax administrations** which can effectively enforce the tax codes. The gains from improved compliance can be very significant.*

- *Opacity is the one of the key facilitating factors of tax avoidance and evasion. Governments should adopt the **highest standards of transparency**, engaging in effective and inclusive international tax information exchange systems, as well as ensure a high level of transparency to the public, including public beneficial ownership registers and requiring large companies to publicly disclose key information about their tax liabilities and compliance.*

This is the introduction to a series of briefings on Progressive Taxation published by ActionAid International in October 2018. You can find them at www.actionaid.org/taxpower

Endnotes

1. https://www.un.org/sustainabledevelopment/development-agenda/
2. https://www.globalpolicywatch.org/blog/2017/05/29/funding-needs-for-uns-2030-development-agenda/
3. For more on this, see ActionAid's *Framework 2018: Gender-responsive public services,* http://www.actionaid.org/publications/framework-2018-gender-responsive-public-services
4. https://www.ey.com/gl/en/services/tax/vat--gst-and-other-sales-taxes/ey-indirect-tax-developments-in-2018#accordion-3
5. http://blogs.worldbank.org/developmenttalk/how-do-taxes-and-transfers-impact-poverty-and-inequality-developing-countries

ActionAid is a global movement of people working together to achieve greater human rights for all and defeat poverty. We believe people in poverty have the power within them to create change for themselves, their families and communities. ActionAid is a catalyst for that change.

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