An examination of tax shifting and ‘harmful taxes’

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Background analysis 2015.01
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Introduction

This paper is an overview of the current state of the debate on ‘tax shifting’ and ‘harmful’ taxes. It will highlight the ambiguity and ideological perceptions which these two terms contain.

Taxation has become very topical and is back at the centre of the political agenda because of the aggressive tax avoidance of many profitable firms, the international exposure of evasion and avoidance and the efforts of G20 and OECD and many states to finally act together to curb tax avoidance, tax evasion, and to implement tax reform. Regrettably ‘tax shifting’ and the concept of so called ‘harmful taxes’ are being promoted as tax reform when the opposite is true.

This paper examines the concept of tax shifting and makes a critical assessment as to what ‘tax shifting’ aims to achieve and how this squares with recent literature. Tax shifting means reducing taxes on profits and on incomes and shifting or moving taxes to consumption and other forms of taxation. This is advocated by OECD and others as they perceive direct taxes on profits and incomes as ‘harmful’ to economic growth and employment. However, this viewpoint raises questions on the impact of such tax shifting on equity and indeed economic growth.

This analysis of tax shifting and harmful taxes provides an overview of ‘tax shifting, sets out what a good tax system might look like and then provides a brief overview of the development of both tax rates and tax revenues for the past decades, which shows a downward trend in tax rates. The next section discusses the arguments put forward to promote ‘tax shifting’ which is mostly embedded in a narrow understanding and concept of ‘harmful taxation’, it then moves on to provide a more broad framework for assessing what a good tax system is and to provide a counterview on ‘harmful taxation’. The paper then discusses the link between taxation, more equitable societies and efficient economies. Finally the paper draws some conclusions and sets out recommendations for reform of tax systems which are both equitable and efficient.
1. **Main issues on tax shifting and ‘harmful taxes’**

The dominant consensus is that progressive taxes on personal and corporate incomes are ‘harmful,’ that is, detrimental to growth and to employment. This view prioritises one key principle of taxation over others. In particular, it prioritises efficiency over equity. It is also a political view, which benefits those with high incomes, wealth and also profitable large multinational corporations (MNCs). However, it is also a contested viewpoint both from a principles of taxation viewpoint and on its main assertion of economic efficiency. The clearest practical contradiction to this theoretical argument that high direct taxes are a brake on efficiency is the performance of higher tax Nordic countries which have higher incomes and are at the top of the competitiveness leagues.

In practice, the argument suggests a concerted ‘tax shifting’ drive from progressive to more regressive taxes.

The growing public unease with increasing secular inequality means that those policymakers and bodies who describe progressive taxes as ‘harmful’ have been fundamentally challenged. For if such policymakers fail to change to reflect increased public interest in inequality, that is if they fail to take a broader view of taxation, then public support for the European Union and institutions, already at historical low levels, will be further undermined. Several of the so-called ‘harmful’ taxes like those on profit and incomes, are the more progressive taxes, and further reductions in these with a consequent shift to more regressive taxes like VAT would be likely to exacerbate inequality.

Many international institutions have been remiss, slow and responded poorly to the Recession which began in 2008. Public support for the European Union (EU) is at an all time low and similarly, democratic politics has lost much support. The failure of European leaders in dealing effectively with the Recession is now clear with the lack of growth and sustained high unemployment in Europe. As Richard Portes said ‘rather than face the reality of stagnation, Mario Draghi, president of the European Central Bank seems to have adopted the leitmotif of Olli Rehn, the former EU economic and monetary affairs chief, who for the past three years has asserted in defiance of all evidence that a turning point was in sight.’

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1. Financial Times, 20th August 2014, *Draghi has to do, as well as say, whatever it takes*; Richard Portes. Mr Draghi appeared to move away from austerity in a speech in the US just after this on 22nd August, encouraging governments to boost demand and said policymakers were ready to add fresh monetary stimulus to prevent Japanese-style stagnation.
Tax shifting and ‘harmful taxes’

The designation of some taxes as ‘harmful’ to economic growth may appear to be based on objective analysis, but in fact, it is political. Some policy people in international bodies and some tax practitioners have taken to routinely describing certain taxes as ‘harmful.’ They argue that most harmful is taxing of profits of corporations; next is taxing income and social charges on labour; (with the ranking unclear) with consumption taxes lower down the ladder of harm; and property taxes as the least harmful to growth. Taxes on wealth and gains should be very low in the hierarchy of harmful taxes, (though it is difficult to find these taxes on a ranking from the proponents of the harmful taxes argument).

It is argued that because these taxes are ‘harmful’ there should be a shift from them to other taxes, by their reduction or perhaps even eliminated. In short, taxes should be shifted to what are purported to be ‘less harmful taxes’ such as consumption (VAT and excise) or property taxes. The basis of their analysis is based on one factor - efficiency as they define it, and the impact of taxes on equity, revenue etc. is ignored.

*Cui bono* – who benefits from this line of argument? The answer is companies and high income people.

The sophisticated hostility of a few policy people in some international bodies to progressive taxes with their argument of ‘harmful taxes’ comes at a crucial time. Globalisation is facilitating the payment of little or no taxes by some of the richest people in the world and there is now widespread, blatant tax avoidance by some of the world’s most profitable and powerful multinationals. This is finally being addressed and will help restore a measure of faith in these international institutions.

This ‘harmful tax’ view is probably a reflection of the continuing dominance of neo-classical economics. Neo-classical economics, with its eloquent theoretical models is still very dominant, in spite of its many failings in accurately reflecting the real world and being aware of the role it gave to the financialisation of economies with de-regulation and shifting from direct to indirect taxes. It is also an indication of the power of lobbyists in the big accounting and legal firms. These firms and their professional bodies are taking increasingly political roles in lobbying politicians and policymakers on the complex issue of taxation. The alternative viewpoint is poorly funded and organised by comparison.
The design of a good system of taxation

The design of a good system of taxation is complex because there are trade-offs between competing objectives. The main objectives of a good taxation system are raising revenue, efficiency, equity, neutrality and consistency. Other objectives would include simplicity and minimisation of exemptions.

The Mirrlees Review (2014: 36) defines ‘optimal tax theory’ as ‘the choice of a system of taxation that balances efficiency losses against the government’s desire for redistribution and the need to raise revenue. It provides a way of thinking rigorously about these trade-offs, and ensuring that value judgements reflecting concerns about income distribution and well-being are made explicit while the efficiency costs of achieving that redistribution are properly taken into account’. The Mirrlees Review says that this is technical and abstract. It does not examine it in detail although it had done so in an earlier study in 1971. It points out that it is important to be aware of the trade-offs and to set out the objectives of tax policy and then identify the constraints under which the system operates.

Taxation systems do distort markets. A good tax system should seek to minimise distortions which impose inefficiencies, but it is erroneous to focus only on one of the principles of taxation. The prioritization of one objective over another is a political decision, and it and the consequent outcome should be as transparent as possible.

The design of national systems of taxation are a product of historical, cultural political economy. They have typically evolved haphazardly over time, under political influence from electorates, competing governments and more recently global pressures and thus are seldom anywhere near perfect. In so far as it possible, tax systems should be developed in ways which minimise inefficiency, inequity and raise the amount of revenue so desired by governments. Tax systems are the main source of funding for a state and importantly for redistribution.

Diamond and Saez (2011) make three strong recommendations on the design of a good tax system. First, they recommend that very high income earners should be subject to high and rising rates, secondly, the earnings of low income earners should be subsidised and thirdly, capital should be taxed. This view is in deep conflict with the dominant ideology of low taxes on direct incomes and privileges for owners of capital. Yet it demonstrates that there is an alternative and it is one which would be beneficial for the vast majority of people.

The current attempts to reduce the design of taxes into a purely ‘technical’ analysis, as the hierarchy of taxes argument does, especially when it is one-dimensional, lacks transparency and is incorrect. This is particularly so when it is promoted as a ‘truth’ or an ‘economic law.’ For even if the viewpoint is based on prevailing economic data and analysis, it is ultimately the result of political choices.
This hierarchy of harmful taxes viewpoint has become such an ‘economic law’ for some policymakers. For example, the European Commission in its Country Specific Recommendations (CSRs) (2014: 24, 30) under the European Semester Cycle demanded the reduction of what it calls the ‘effective tax and social security burden on labour’ and to ‘shift taxes from labour to less growth distorting taxes,’ in many member states. Its CSRs recommendations have become increasingly ideological and are based on a biased understanding of taxation, and on its perception of one principle of taxation.

This ‘economic law’ of the ‘hierarchy of harmful taxes’ is where certain taxes are promoted as being ‘harmful’ to economic growth and employment. The most ‘harmful taxes’ are listed as those on the profits of companies and all taxes or charges on personal incomes. Next are taxes on consumption (which appear to be favoured) and the least ‘harmful’ are recurrent taxes on immovable property. Taxes on inheritances and wealth appear to be less harmful too, but do not feature as important by the promoters of this idea. All taxes are described as ‘burdens’ and by implication ‘harmful’ too. These views will be challenged in the paper.

There are a number of principles in the design of a good system of taxation – raising revenue, re-distribution, encouraging economic efficiency, certainty, transparency and neutrality. There is widespread acceptance in developed countries over the desirability of the last three. However, transparency is difficult to achieve as lobbyists generally persuade policymakers to implement complex exemptions, which cloud this principle in opaqueness. The dominant theory of perfect markets is hostile to the second principle of taxation – equity - and views taxation, per se, as always distorting the perfect market, placing all emphasis on its view of efficiency. Indeed taxation should also deal with externalities, with cost impositions. Taxes are not a cost – a burden - to an economy but a transfer within it.

Over the past 30 plus years, income tax and corporation tax rates have been cut dramatically, as will be demonstrated. Yet the dominant economic view today is arguing for even lower taxes on high income earners and on companies. This has major implications for individuals, households and society.

This paper will argue that there are very strong reasons to revert to the previous higher tax rates prevailing on high incomes and profits and reduce exemptions on companies (and individuals) which were common no long ago, because this will increase economic performance. It is not suggested that income taxes and social charges on low, average or above average incomes be

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2. There is general agreement on these principles which were first set out by JS Mill in 1848 but have been developed since. http://www.econlib.org/library/Mill/mlP64.html
increased – only on very high incomes. Since the Recession began in 2008, the key economic problem has been insufficient aggregate demand. Therefore increasing taxes on consumption (demand) as some countries have done and as OECD and others favour through their ‘hierarchy of taxes’ argument, is counter-productive, as it reduced demand.

Companies in the US, Europe and Japan have immense cash and savings. Yet, in spite of historically low interest rates, new capital investment (net of depreciation) is very weak. The low interest rates should spur investment. On top of this lack of investment, there has been a vast buy-back of their own shares by companies, to artificially boost their price in the short run. This simply puts money in the hands of wealthy people and other companies, who have a low propensity to consume or invest. These share-buybacks do nothing to stimulate the economy. There is thus a clear case for higher taxes on corporate incomes and savings which are clearly not being invested. Higher capital gains taxes on share buy-backs might deter such activity.

Thomas Piketty, possibly the most famous living economist and advocate of greater equality though taxation has said: ‘We view the large gap between optimal capital tax theory and practice as one of the most important failures of modern public economics’ (Piketty and Saez 2012: 1). Piketty and Emanuel Saez put this argument succinctly – ‘The key argument against redistribution through taxes and transfers is efficiency. Taxing the rich to fund means-tested programs for the poor reduces the incentives to work both among the rich and among transfer recipients’ (2012b: 8). Thus while conceding that there are trade-offs, Saez and Piketty call for confiscatory rates of taxation.

In many states it has become official policy to reduce progressive income tax, employers’ social contributions and employers’ corporation taxation. Taxes on high incomes and profitable companies have been steadily reduced, as will be demonstrated. This downward shift in tax rates is now being challenged by proponents of greater equity. It appears that the ‘hierarchy of taxes’ paradigm is being used to reboot this trend of downward progressive taxes.

For it is taxes which fund civilisation, the police, the arts, education and health care. This anti-direct tax view is being driven by the official OECD depiction of some of the most progressive taxes as ‘harmful taxes’ and by the pejorative, Tea-Party description of tax as a ‘burden’ by others. This is such a powerful and virulent anti-tax, anti ‘big government’ political campaign that it has been internalised by many, including even public policymakers.

However, the IMF appears to be increasingly against this view, as will be seen. There is growing concern about secular inequality of income and wealth which cannot be addressed without a radical change in taxation policy towards higher

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3. Transfers refers to welfare or subsidies paid by the state to persons or firms. The conventional view is that they make up around three-quarters of all redistribution with the balance made up through taxes. A more comprehensive view might also include childcare, education and other elements of the ‘social wage’ as transfers.
taxes on very high income earners and profitable corporations (see figure 7 and discussion on this below).

This anti-progressive tax campaign is proceeding at a gallop in spite of growing recognition by the same official bodies of first, a growing inequality of income and wealth for decades and secondly, the secular decline in the labour share of nation income in most countries. Both phenomena are, of course, related. If it is a contest between equity and low taxes within these bodies, low taxes always appear to win.
2. **Trends in taxation**

It is worth briefly examining major trends in taxation internationally. There has been a very big push to reduce rates on higher incomes and on corporate profits. It has been successful. The idea that some taxes, especially progressive taxes like those on incomes and on profits are ‘harmful’ is a new way of driving this agenda further. It seeks to counter the growing awareness of inequality and the resulting need to increase progressive taxes on high incomes, wealth and profits.

While marginal or top taxes rates on high incomes, on wealth, on inheritances and on corporate profits have been greatly reduced by most governments over the past three decades, overall tax revenues on personal incomes and on profits have not fallen substantially.

The cuts in the top income tax rates have been dramatic in some countries. Piketty shows (Figure 3 below) that they were over 90 percent on very high incomes in the US and UK for some decades and also high in Germany in France in the past. As recently as 1995, the top rate averaged over 47 per cent in Europe and this was cut to average 40 percent in the EA18 and even lower at below 38 percent in the EU27 by 2008. It increased since the Crash of 2008 to 44 percent in the EA18 in 2013/4 but is lower in the EU28 (EU: 2014).

Personal income tax revenues have remained largely stable, reducing only from 26 per cent of all taxes in 1965 to 24 percent in 2011 in spite of the major reductions in top income tax rates. This indicates that the majority of taxpayers picked up the tax bill for the cuts for high income earners. The proportion rose in 8 of the EU15 states, fell in 6 and was stable in one in this period (OECD tax database).

In spite of major rate cuts in corporation tax in virtually all states, revenue from companies remained stable in this period, remaining at 8.7 per cent of all taxes while total taxes as a percentage of GDP have also been stable in OECD countries since 1995 at 34 per cent (OECD 2014, table A). This may reflect rising profit levels, but most probably reflects the rising share of national income going to capital, to the corporate sector, along with some base broadening. Corporations, along with the very rich have been extracting vastly

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\text{4.} \quad \text{The share of the corporate income tax in total tax revenues is wide from only 3 per cent (Hungary) and 4 per cent (Estonia) to 20 per cent (Australia) and 25 per cent (Norway) where corporate taxes raise much from mineral exploitation.}
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increased incomes as their (capital’s) share of national income has risen over
three decades, as those of labour has declined.

Figure 1 below shows that while revenue from corporate income (profits)
fluctuated since 1995, (it is a percentage of GDP here, not of total tax revenue,
which is around 8%) it has not fallen in the way that the cuts in the rates would
indicate. The nominal rates of corporate tax fell from 34 per cent in this period
to 2 per cent in 2012 according to the EU’s Trends in Taxation.

In short, the argument of the advocates of the ‘hierarchy of taxes’ in attempting
to shift taxes from personal incomes and from profits to other taxes and to
consumption tax in particular has not been very successful at one level. But it
has been successful in reducing the rates on top incomes and corporations.
Other income tax payers, the majority, have picked up the bill for these cuts.
For the OECD a similar trend can be observed in Table 1 below where the rates
since 1965 have been broadly stable, rising in 2007/8 and falling back to 1990
and 1965 levels.

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With globalisation, if their boards so determine, the most profitable MNC
companies no longer have to pay tax. Recent public anger spurred action and
steps are being taken to attempt to curb this loss of revenue internationally.
Today, many modern company boards see all taxes as a ‘cost’ or ‘burden’ to be avoided, rather than the quaint idea that they are payments for public services from which they and others benefit. In addition, the accounting and legal professions are less concerned with professional ethics than their bottom line and many are now the militant storm troopers of avoidance (legal) for corporates and the mobile rich and some may be perhaps facilitators of evasion (illegal). Thus policymakers and tax authorities need to be extra vigilant in this rapidly mutating, stateless, globalised world of no taxes.

Some argue that corporations should not even be taxed, that some tax will eventually be paid by individual shareholders on dividends. The reasons there are taxes on corporations are that they are legal entities which use public services and benefit from employees educated by the state etc. Some wealthy individuals and many companies manage to avoid paying any taxes on dividends and the owners of many companies today do not live in the state in which the companies operate. Some small and developing states may not have any opportunity to levy taxes on MNCs if there were no such a tax because the owners/shareholders reside elsewhere. Importantly, wealthy people would incorporate to avoid paying any taxes, as some already do to minimise taxes in low corporation tax jurisdictions, if there were no taxes at all on corporates.

‘The tax burden’ as payments of taxes are pejoratively described by Eurostat (2014: 16) ‘varies significantly between Member States, ranging in 2012 from less than 30% of GDP in Lithuania (27.2%), Bulgaria and Latvia (both 27.9%), Romania and Slovakia (both 28.3%) and Ireland (28.7%), to more than 40% of GDP in Denmark (48.1%), Belgium (45.4%), France (45.0%), Sweden (44.2%), Finland (44.1%), Italy (44.0%) and Austria (43.1%).’

The largest source of tax revenue in the EU28 is what Eurostat terms ‘labour taxes’ (income tax and employers’ and employees’ social contributions and other charges), which are slightly over half of total tax receipts in 2012 (51.0%). These are followed by consumption taxes (28.5%) and taxes on capital (20.8%). ‘Labour taxes were the largest source of tax revenue in 2012 in twenty four Member States. Indeed, in the countries with high personal taxes, they accounted for more than half of total tax revenue. The highest shares of taxation from labour were observed in Sweden (58.6%), the Netherlands (57.5%), Austria (57.4%) and Germany (56.6%)’ (Eurostat 2014: 40).

The fact that these high income, high growth states are where there are high direct personal taxes, demonstrates that such high personal taxes are not the disincentive purported by the conservative economists and others. Personal income taxes and taxes on profits are more progressive than taxes on consumption.5

At the other extreme, an examination of the Eastern member states where low personal direct taxes on incomes and profits and high taxes on consumption

5. There can be disagreement on the incidence of tax, i.e. who actually pays the tax, but that is another issue.
has been achieved but this does not demonstrate resultant success when it comes to growth and economic efficiency. Consumption taxes were the largest source of tax revenue in 2012 in Eastern Member States: with the highest shares in Bulgaria (53.3%), Croatia, (49.1%, joined in 2013) and Romania (45.1%), all poor countries with low rates of growth. Consumption taxes have been reduced from 36 to 31 per cent in the period 1965 to 2009 (unweighted average for all OECD), falling in most of the EU15, but stable in other original members. Most of this fall was in specific taxes and not VAT.

Implicit tax rates (ITRs) give a measure of the effective average tax 'burden' or share of total taxes on labour as a percentage of the total tax base. It can be seen from Appendix 1 that the average share of effective taxes on labour in the EU did not change much in the period from 2000 to 2012. In most member states it was relatively stable, but with big decreases in Bulgaria (-13.5%), Lithuania (-9.3%), Cyprus (-7.2) and interestingly, Sweden (-8.2%) and Denmark (-6.6%). The very high rates existing in 2000 for the latter two states have been reduced to close to the EU average. The overall stability of income tax as a proportion of the overall tax base is of interest, considering the concerted policy agenda of some to shrink income tax as part of their tax ‘reform’ (direct tax reduction) agenda. Their success has only been wins for those on high incomes. The shortfall has been made up by others.

It is interesting that in most Member States, ‘social contributions account for a much greater share of labour taxes than the personal income tax’ (Eurostat 2014: 28).

Taxes on personal income used to be the most important source of revenues for OECD countries, accounting for about 30 percent of total tax revenues in the 1980s. Since then, their relative importance has declined to about 24 percent while the weight of social security contributions has increased (OECD 2012a: 23).

In the 1970s, the top marginal personal income tax rates in some countries were higher than 70 percent. In 1981 the top combined statutory personal income tax rate in OECD countries was on average 65.7 percent. Looking only at those countries which were already included in the dataset from 1981 the average rate declined to 50.7 percent in 1990, to 48.9 percent in 2000, and to 45.8 percent in 2010 (OECD 2012b: 33).

Figure 2 below illustrates how average income tax has been reduced for average income earners from 1985 to 1996.

6. The ITR on labour is calculated as the ratio of taxes and social security contributions on employed labour income to total compensation of employees and payroll taxes.
7. OECD has a different membership than EU and uses different data and some definitions than EU, hence some differing figures.
Eurostat (2014: 31) found that the EU average top rate of tax on corporate income has remained more or less stable since 2010, but this follows ‘a trend of steadily falling rates from 1995 to 2009. The EU-28 average in 2014 is 22.9 \%, compared with 35.0 \% in 1995.’ It claims that effective rates (cash tax payments by companies) have fallen, reflecting the cuts in the nominal rate, and that it stabilised for the EU at 21 per cent since 2010 after the Crash. Some would question the methodology used for this estimate of ‘cash tax paid’ by companies as it appears to be overstated. Some of the most profitable companies now do not pay any tax, using aggressive avoidance and tax havens. ‘The EU remains a high tax area’ says Eurostat in its 2014 report (p. 16), which is both political and partisan that is, written as if high taxes (and corresponding high public expenditures) are bad ie a ‘burden.’ Yet it admits in the Preface (p. 3) that ‘Taxation is at the heart of citizens’ relationship with the State’ jointly signed by the head of Eurostat and the DG of Taxation. It says ‘In 2012, the overall tax ratio, i.e. the sum of taxes and compulsory actual social contributions in the 28 Member States (EU-28) amounted to 39.4 \% in the GDP-weighted average, nearly 15 percentage points of GDP over the level recorded for the USA and around 10 percentage points above the level recorded by Japan’ (p. 16). The arithmetic average is lower, at a still substantial 36.3 per cent. The relatively high taxes in Europe fund the very best public services in the world.

Figure 2  The cut in average income taxes, 1985, 1996 and 2004

3. The dominant view on ‘harmful taxes’

Some international bodies, including OECD, Eurostat, sections within the European Commission and some governments and to an extent the IMF, are now promoting a very political anti-tax policy. They describe tax pejoratively as a ‘burden,’ call progressive taxes ‘harmful’ and are campaigning to shift from direct taxes on profits and personal incomes to taxes on consumption and user charges.

Johansson et al. (2008: 2) in the influential OECD paper establishing the hierarchy of harmful taxes assert that ‘Corporate taxes are found to be most harmful for growth, followed by personal income taxes, and then consumption taxes. Recurrent taxes on immovable property appear to have the least impact.’

It claims that empirical work suggests a ‘tax and growth ranking’ with recurrent taxes on immovable property being the least distortive tax instrument in terms of reducing long-run GDP per capita. This is a point on which there can be agreement as property tax, if structured properly, is also generally an equitable tax. Such taxes, if in place, are hard to avoid and have the advantage of an immovable tax base. Yet in this era of globalisation, few countries have managed to raise substantial revenues from property taxes, with returns on housing generally taxed more lightly than returns on other assets.

The OECD Johansson et al. (2008: 15) study says that over the past decades many OECD countries have undertaken structural reforms in their tax systems and most income tax reforms have ‘tried to create a fiscal environment that encourages saving, investment, entrepreneurship and provides increased work incentives. Likewise, most corporate tax reforms have been driven by the desire to promote competition and avoid tax-induced distortions.’

There is agreement that there is a need for income and corporate tax structures to move in line with market changes and to avoid distortion, except where it is a policy choice to attain such an objective to favour one sector or to raise revenue for redistribution.

Johansson et al. (2008: 5) also claims that ‘almost all of these tax reforms can be characterised as involving rate cuts and base broadening.’ There is no doubt that income tax and particularly corporation tax rates have been greatly reduced in recent decades and that many income tax exemptions have been reduced. Many dubious income tax exemptions on pensions and other areas have been curtailed and this is welcome both for reasons of equity and performance. However, the claim that there has been broadening of the...
corporate tax base is of little point when there is wholesale tax avoidance, inversions, profit-shifting by so many profitable firms. This is why the G20 and OECD are finally addressing the issue of ‘base erosion.’

The Johansson et al. (2008: 7) study found a move to flatter and less progressive personal income taxes ‘with one of the most pronounced changes in personal income taxation being the reduction in the top statutory income tax rates. In contrast, average workers have not seen their taxes being cut to the same extent.’ In short it is admitting that high income earners pay less tax while the average pay much the same or are making up the loss.

The IMF (2014) also showed that taxes on consumption had risen in the past five years in both developed and emerging countries with increases in VAT rates in particular but little done by governments in base broadening.

Many in mainstream academia appear to offer intellectual support for inequality on the grounds that their neo-classical models favour low taxation as less distorting for the operation of free markets. For example, Dolenc and Laporsek (2010: 344) assert that ‘the empirical estimates suggest that the EU-27 should continue with the trend of reducing the tax wedge, as this would increase employment growth and employment rate and decrease unemployment, especially in Member States with high tax wedge’. Indeed they, like many economists, reduce ‘competitiveness’ to simply labour costs, failing to understand the complexity of this term which has become one of the most discussed, if least understood economic benchmarks.9

They assert that ‘as the empirical estimates confirm the detrimental effect of tax wedge on employment growth’ and assert ‘the reduction in tax wedge is not sufficient measure to increase employment, as the high unemployment rate in many EU Member States is also the consequence of high unemployment benefits, wage bargaining system and powerful labour unions, employment protection legislation, differences in distribution of wages within EU, etc’ (p. 356). This is a very conservative political perspective.

Johansson et al. (2008: 8) admit a potential trade-off between what they call 'growth-enhancing tax policies and distributional concerns.' They suggest subsidies to employers through ‘for example, “in-work benefits” [to] increase the income of low-income households, thus reducing inequality.’ They advocate to ‘reduce the top marginal statutory rate on personal income since it has an impact on productivity via entrepreneurship by affecting risk taking by individuals’ while at the same time admitting that ‘the empirical research

8. Not deliberately, but as a consequence of their model’s output.
9. They say ‘Alesina and Perotti (1997) on the sample of 14 OECD countries empirically confirmed the theoretical model which showed that an increase in redistribution financed by an increase in labour taxes leads to an increase in the unit labour cost and therefore induces a loss of competitiveness. In turn, the loss of competitiveness causes a reduction in the demand for exports and a fall in employment in all sectors of the domestic economy.’ (Ibidem: 346).
points to conflicting ways in which entrepreneurship could be affected'. They then claim that their study finds that 'a reduction in the top marginal tax rate may raise productivity in industries with potentially high rates of enterprise creation,’ a point challenged later.

A country’s competitiveness is complex and covers far more than the crude measure of short-term movements in labour costs or even in unit labour costs. The World Economic Forum (WEF) lists 12 pillars which include efficient institutions, legal and educational systems, corruption, infrastructure, financial systems, R & D etc. (see for example the Global Competitiveness Report of the World Economic Forum or Scorecard of the National Competitiveness Council of Ireland). Every year, the top performers in the WEF are dominated by countries with high personal taxes and high labour costs because unit labour costs are but one small aspect of the issue of competitiveness. ‘Labour market efficiency’ is but one of the 12 pillars and merits just 17% in the WEF report’s ratings and total labour costs are but a small part of this. The WEF report is constructed by top corporate executives who clearly do not attribute great importance to labour costs. Thus personal taxes which make up a significant part of the costs of employing labour, would not merit the importance given to it by some economists.

There may be partial recognition that the OECD’s Johansson’s ‘hierarchy of taxes’ argument is ideological as another OECD paper by Cournède et al. (2014) has tried to address this in a paper called Reconciling fiscal consolidation. While it does attempt to rank policy instruments by impact on equality, the same certainty that personal income taxes are ‘harmful’ does regrettably influence its analysis. In its disapproval of higher taxes on high incomes, the study urges the usual conservative line of broadening the tax base rather than raising rates : ‘On the tax side, the adverse growth impact of hikes can be reduced through the closing of loopholes and base broadening (including by curbing fraud and evasion) rather than via rate increases’ (p. 45).

Nevertheless, conservative economists are correct in making the case for far less exemptions, loopholes and tax subsidies, most of which go to those on high income, the wealthy and corporations. These exemptions also do distort economic activity in many instances. The removal of the vast array of tax loopholes in member states can either fund cuts in the higher rates for high income people, or in increased revenue to provide better public services for all. There is an examination of tax expenditures in Appendix 2.

Johansson et al. (2008: 9) say ‘lower corporate and labour taxes may also encourage inbound foreign direct investment’ (FDI). The first assertion is, of course, correct and the second only seems to apply to very high income ‘earners’. It is well known that countries which are leading the race to the bottom in cutting their rates of corporation tax (CT) have been successful in

10. Consolidation’ means ‘austerity’ in the Orwellian language of neo-classical economists, EU bodies and other advocates.
attracting MNC investment. Ireland has led the race towards the bottom in the EU with its low nominal rate of 12.5% and has attracted large numbers of US MNCs in particular. However, many have located there for other reasons such as access to the EU though an English-speaking pro-European country with highly skilled, flexible, well-educated workers and there are also attractions in agglomeration in clusters of firms such as in pharma and ICT (Sweeney 2007).

The second assertion that low taxes on incomes attract FDI appears to run counter to the evidence – most FDI flows to high income economies which usually have high personal taxes.

The reduction in CT rates by so many states in recent years in the race towards the bottom means that this policy is becoming redundant, as rates keep falling. Further, MNCs seem to be able to place their CT base in tax havens and so do not need to pay any tax in developed countries, whatever their rates, in the absence of international action.

The European Commission in its Country Specific Recommendations (2014: 18-58) under the European Semester Cycle for 2011 to 2014 pursues a relentless agenda against progressive taxes in most member states. It demands the reduction of what it calls the ‘effective tax and social security burden on labour’; ‘reduce the high tax wedge on labour’; ‘shift taxes from labour to less growth distorting taxes’; ‘reduce the high taxes on labour’; ‘shift taxation to less areas detrimental to growth’; ‘reduce the tax wedge’; ‘reduce high taxes and social security contributions’.

This is an extraordinary litany of anti-personal tax, anti progressive tax demands in a document written by some publicly funded agencies.

In contrast, the IMF, a body which implemented the Washington Consensus in many countries in the past, now dissents from this dominant view of tax hierarchies, at least in its study of fiscal stimulus after the Recession which began in 2008: ‘the output effects of temporary cuts in labour income tax rates are not very large, and in fact are smaller than for general transfers under monetary accommodation. This is because they increase potential output, which reduces the inflationary effects of the stimulus and therefore the effectiveness of monetary accommodation. Similar comments apply to cuts in corporate income taxes. In contrast, the simulations suggest that the incentives for increased household spending from temporary cuts in consumption taxes are significantly larger.’ (IMF 2010: 18).

The IMF, ILO, other international bodies and numerous economic reports are now returning to focus on equity because it is clear from the evidence on inequality that the system of re-distribution is broken.

In their paper defending austerity, Cournède et al. (2014: 21) of the OECD quote Johansson favourably on the hierarchy of harmful taxes and assert that ‘evidence suggests that, in advanced economies, reducing the size of government increases output’ but then admit that there is ‘clearly no consensus
on what constitutes the optimal size of the public sector even from a strict efficiency point of view. It suggests cuts in subsidies, which is a reasonable suggestion in tough times, proposes cuts in pensions, but takes the usual supply side argument, suggesting cuts in welfare i.e. unemployment benefit and also assert that ‘cuts in disability payments can boost labour utilization.’

Interestingly, like the IMF, Cournède et al. (2014: 22) in their OECD paper concede that international experience largely suggests that fiscal multipliers ‘are highest for public investment and government consumption and substantial but smaller for transfers and taxes.’ They also concede that ‘many consolidation instruments work in the direction of aggravating income inequality’ and ‘a number of taxes fall more heavily on lower-income households’ (p. 23) and increasing them would raise disposable income inequality. They suggest that ‘hikes in inheritance and capital gains can reduce income or wealth inequality’ as does property tax (p. 24). They admit that raising income taxes and corporate taxes reduces inequality.

The importance of examining the tax system rather than one tax like that on personal incomes alone is underlined by a study of household taxes on incomes and consumption in Ireland by Collins (2014). Ireland has a relatively progressive income tax system by OECD or EU standards (on lower to middle incomes, though less so in higher incomes) yet he shows how regressive consumption taxes are, particularly for the bottom decile of households. The bottom decile pay 32 percent of household income in consumption taxes, compared to the average for the country of 10 percent and just 6 per cent for the top decile.

Figure 3 Direct, indirect and total household taxation as % gross income in Ireland (equivalised data, i.e. adjusted for household composition and size)

![Graph showing direct, indirect, and total household taxation as a percentage of gross income in Ireland](source: Collins 2014)
Across the income deciles the cumulative effect of household’s total taxation contributions displays a U-shape, as Figure 3 shows; contributions are highest at the bottom and top of the distribution and lowest for those in the middle deciles. This illustrates that further moves from personal income taxes to consumption taxes will heighten inequality because the high level of regressive taxation are on the lowest deciles.

The power of immensely endowed think-tanks funded by extreme right-wing billionaires like the Koch brothers\(^\text{11}\) has helped shape and now change the debate on key issues like taxation, welfare systems and size of government. Their reach is long and powerful, influencing politicians, economists and policy advisors.

Finally, the 2008 OECD Johansson paper, which is seen as the original source of the ‘harmful taxes’ argument, was much more nuanced than many who quote it with such certainty today. Johansson et al. admitted ‘that practical tax reform requires a balance between the aims of efficiency, equity, simplicity and revenue raising’ (Johansson et al. 2008: 2). Its focus is on efficiency and they concede: ‘Even more importantly, fully disentangling the revenue raising function of the tax system from its other objectives, e.g. equity, environmental or public health matters is difficult’ (p. 5).

Before the counterview is analysed in more detail, the design of a good taxation system is briefly examined.

\(^{11}\) Heritage Foundation, Cato Institute, Freedom Works and Americans for Prosperity. For more US think tanks see http://www.pfaw.org/right-wing-organizations.
4. The design of a good system of taxation

The notion that some taxes can be more harmful than others has some resonance, but to really assess taxes, the system of taxation must be examined as a whole. All factors must be taken into consideration, spelling out the trade-offs between objectives and within consistent principles. There has been a recent major UK study of the design of a tax system by Mirrlees et al. (2014) which may re-direct many taxation studies away from the dominant view of focusing only on what is perceived as efficiency.

It found that ‘the pre-tax distribution of earnings matters a great deal for the appropriate structure of the tax system’ (Mirrlees et al. 2014: 71) and that income and wealth distribution has become much more unequal in many countries over the past thirty years. It therefore argues that equity and fairness has to be a major consideration in the taxation system.

The 'hierarchy of taxes' argument focuses solely on efficiency and ignores the costs in equity, in neutrality etc. other than to note them. Further, on the other hand, many would argue that an equitable tax (and transfer) system generates a more efficient economy in the longer term.

Taxes do impact on behavior and high taxes on income can have disincentive effects but the key is to balance the gain in redistribution with the loss of output. If people earn (receive) excessive income, the objective of policy may be largely redistributional, particularly as taxation is a driver of this objective along with transfers.

A neutral tax system is one that treats similar activities in similar ways. It is a worthy objective to ensure that income is treated in the same way so that people and firms will not spend a disproportionate amount of time and resources in trying to avoid tax by shifting the way they do things, Mirrlees argues. However, neutrality is not always the objective and governments do try to tax undesirable things like smoking and environmental damage and other externalities. They also seek to give tax subsidies to favoured business sectors, through tax expenditures.

A simple tax system is likely to be relatively transparent and impose low administrative costs. But the world is complex and so no tax system is likely to be truly simple. Stability is another objective and tax systems that continually change do impose greater compliance costs on those who are taxed. Transparency is another objective but the more complicated the system, the less transparent it is. Most tax systems have a myriad of exemptions,
allowances and loopholes which have grown up under lobbying pressure of decades and are far from transparent. That is why it is worthwhile executing a root to branch assessment by a Tax Commission periodically. It may lead to some progressive changes. Tax and transfer systems can have unintended impacts and thus need to be re-appraised regularly to ensure the desired outcomes are achieved.

Mirrlees (2014: 25) makes the point that it is important to look at more than one year as people’s incomes and circumstances change over time. It says ‘These lifetime variations help to explain why the treatment of savings is so important when deciding how to tax. People accumulate and run down savings and debts to smooth their spending over time.’

Mirrlees points out that in assessing progressivity, we should also look at the impact of the taxation system as a whole rather than at, say, just income tax, as many are inclined to do, neglecting wealth taxes (or their absence), inheritance and importantly, the impact of consumption taxes. The assessment should also include the welfare system and tax credits. Earnings usually start low when people are young, rise for a period, and then decline later approaching or after retirement. These patterns can vary greatly depending on occupations and skills.

It points out that income tax is progressive as the average tax rate generally rises with income. As the marginal tax rate is usually higher than the average tax rate, then higher marginal tax rates pulls average rates upwards. The way to achieve progressivity in income tax is to have a basic tax-free credit or allowance before tax starts being payable.

Mirrlees et al. make another important point on fairness pointing out it is not merely achieved by redistribution. They point out that ‘fairness of procedure, fairness with respect to legitimate expectations, and fairness in treating similar people similarly also matter.’

The IMF (2013: 46) warns that ‘the empirical literature from which the hierarchy of “growth friendliness” is drawn presumes that the only thing that matters for growth is how much revenue is raised by a given tax, not the details of its design.’ It is a time for a different approach to the harmful taxes view. It argues that its research ‘provides a strong caution that looking only at broad categories of tax instruments is unlikely to be enough in thinking about taxation and growth: details matter.’
5. **A counterview on ‘harmful’ tax hierarchies**

Contrary to the ‘harmful taxes’ viewpoint, there is a strong counter case for higher income taxes on profits and on high incomes which will raise revenue and also boost economic efficiency. Atkinson *et al.* (2009) argue that progressive income taxation policies should be used to reduce inequality which is partly due to an unprecedented rise in top incomes. The rapid rise in top incomes in the past 30 years is partly due to the decline in tax progressivity.

A counter-view to those favouring progressive tax policies is that government intervention of any kind, including taxation, distorts markets and introduces market imperfections. Allowing markets to operate without state intervention, the argument goes, is always better because the best operators will succeed most. The best firms – in all senses including efficiency, quality, productivity – will obtain the highest profits, the best workers will get the highest wages, and so on. Progressive taxes reduce these market effects. By taking more from the highest earning economic actors, who are, if this is correct, the best, the government ensures that the net return that the high paid receive is less than the market (or ‘equilibrium’) return. Taking less from the lowest paid, and even transferring payments to them, ensures that they receive more than what the market would dictate. These effects change people’s behaviour, in the end reducing the productivity of the economy.

One answer to this argument against progressive taxation is Lipsey’s *General theory of the second best* (Lipsey and Lancaster 1956) which states is that if there are any market failures in one sector of the economy, actions to remove imperfections in other sectors may actually reduce the efficiency of the economy generally. Given the numerous departures from perfect market conditions in industrial and labour markets, removing progressivity of the tax system in order to reduce market imperfections may actually increase the distortions in the economy as a whole.

Although this theory is known to all economists, there tends to be a commitment among many within the ‘Washington consensus’ to reducing government intervention, including taxation. The simplistic justification for this, of increasing efficiency because it reduces market imperfection, is, on the basis of the theory, unlikely to be correct.

As Dani Rodik (2014) points out, errors regularly made by economists are those of commission. These are ‘cases in which economists’ fixation on one particular model of the world makes them complicit in the administration of policies whose failure could have been predicted ahead of time.’ Removing progressivity
in taxation because of an apparent obsession with minimizing the impact of government on markets is an example of this. More broadly, as Rodik explains, ‘Economists’ advocacy of neoliberal “Washington Consensus” policies and of financial globalization... overlooked serious second-best complications, such as learning externalities and weak institutions, which blunted the reforms and, in some cases, caused them to backfire.’

In the context of arguments for and against progressivity of taxation, it is of interest to note a contrast between underlying assumptions about the behaviours of the higher and lower paid. Better-off people in society, especially entrepreneurs, are assumed to be motivated to work harder the higher their returns. Reducing these returns, by implication, would reduce their entrepreneurial efforts. On the other hand, the low paid are often assumed to reduce their efforts if their pay is increased.

The reasons why entrepreneurs, for example, work very hard and innovatively, include a variety of motivations, including autonomy, achievement, a desire for job satisfaction and other non-economic rewards, as well as the potential for financial returns (Cromie 1987). More recently it has been shown that serial ‘entrepreneurs are driven by goals and motives, which may indeed be economic, but not necessarily to maximize economic gains’ (Carsrud and Brännback 2011: 26). Do workers put in less effort if they are paid more? Again recent research contradicts this, with a careful empirical study by Halaby (2014) for example, showing the opposite, that greater effort is put into work the higher is the wage. In Halaby’s words, ‘higher pay elicits greater willingness to work harder’.

Levels of taxation are important and the rate and the effective rate, after exemptions and income bands, do influence behavior, but it is a very complex area which does not lend itself to simple analysis, particularly when one of the key principles of taxation, equity, is ignored. There are many other factors which influence behavior in regard to taxation levels.

Piketty and Saez (2012) examine many of the multitude of factors which impact on behavior focusing on elasticities of labour and taxation. The factors include international migration, the various taxes and transfers, minimum wages, labour supply elasticities at different levels of earnings, regular earnings, overtime, additional earnings, income shifting (eg to capital gains), opportunities for evasion and avoidance, the impact of tax breaks for families, couples and children, the impact and interaction of transfers and taxation, means testing, relative incomes (to others), fixed costs of working and actual tax rates. They are critical of ‘the classical trade-off between equity and efficiency which is at the core of the optimal labor income tax problem’ (Piketty and Saez 2012: 1).

Income tax elasticity is not fixed and can be altered by changing the tax base. Saez et al. (2009: 58) examine the important issue of the elasticity of taxable income (ETI) which they believe holds the promise of more accurately summarising the marginal efficiency cost of taxation than a narrower measure of taxpayer response such as the labor supply elasticity. They found that that ‘there is much evidence to suggest that the ETI is higher for high-income
individuals who have more access to avoidance opportunities, including deductible expenses.’

This finding highlights the importance of the fact that ‘the ETI is not an immutable parameter, but can be influenced by government policies regarding, for example, the broadness and extent of enforcement of the tax base.’ Thus they find that it varies across countries and within countries over time when non-rate aspects of tax systems change. Thus simplistic models of tax hierarchies may not apply to every country and for all time, even if they were based on broader factors.

Tax does generate behavioral responses which reflect inefficiency, and ‘this is especially true of high-income, financially savvy taxpayers’ (Saez et al. 2009: 59) and it generates responses in timing, shifting, and avoidance ‘but only at the top end of the income distribution.’ And Saez et al. conclude that as estimates of the long-run elasticity of taxable income are ‘plagued by extremely difficult issues of identification, so difficult that we believe that there are no convincing estimates of the long-run elasticity of reported taxable income to changes in the marginal tax rate.’

There is disagreement on the impact of income tax rates on different categories of workers and various economic models take separate segments of the labour force with differing rates and credits etc. can find many outcomes. It is correct that the labour market is differentiated and there are diverse impacts of various tax levels on categories. Similarly the impact of income taxes on workers and on employers will differ and each must be separately examined.

There is some evidence that low paid, older workers and the internationally mobile professionals and top executives may react more to increased taxation than the vast majority of employees. Within the labourforce other groups can be studied and differing outcomes will be found. It is argued that tax on low pay is a disincentive to work for the low paid but it can be similarly argued that increased taxes on them may have little impact on their incentive to work as they have to earn enough to survive and so will work longer hours or two jobs.

It is argued that a country with high income tax rates on high incomes will have difficulty attracting or retaining mobile executives, professionals or stars. A study (Kleven et al. 2010) of 14 European nations did find that football players tend to locate in countries that have comparatively low income tax rates. This response to tax rates is especially pronounced for the most able and well-paid athletes, but it is actually negative for the least able and lowest paid among the professionals.12

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12. In 2004 Spain introduced the ‘Beckham Law’ which allowed nonresidents to be taxed at a flat rate of 24 percent instead of the progressive rate for residents, whose top marginal rate by 2008 stood at 43 percent. After the law, Spain saw its share of foreign players increase while Italy, which had a similar top league, saw its share of foreign talent shrink. Similarly, Denmark (in 1992) and Belgium (2002) introduced tax breaks to foreign players. Other countries like Ireland have no tax on sports stars’ earnings for the period of playing.
So the very high paid do respond strongly, but not the bulk of players. The IMF says ‘the mobility of European soccer players – a mobile, highly paid group if ever there was one – suggests this [tax response] may not be as great as one might suppose’ (2013: 37).

Similarly, Ireland introduced the Special Assignee Relief Programme (SARP) under pressure from the lobby, American Chambers of Commerce in Ireland, to subsidise employers who send high paid executives in their companies from abroad to take up positions in the Irish based operations. There is an exemption from income tax on 30% of salary between a minimum of €75,000 and up to €500,000 over 5 years, with additional benefits. In spite of this subsidy, which contravenes the core tax principle of horizontal equity, the take-up was only seven executives in its first years of operation, indicating that higher income tax was not a deterrent to mobility for this group of MNC executives.\(^{13}\) In Budget 2014, the ceiling was abolished after lobbyists from MNCs argued that it needed to match those ‘SARP-like schemes currently in force in the Netherlands, France and Switzerland’\(^{14}\).

Perceptions and importantly, misperceptions of taxation, the obsession with marginal income tax rates, ignorance of effective income tax rates, where the perceived incidence of taxation falls and other external factors all do influence behavior in regard to taxation. Many people misunderstand taxation, particularly regarding marginal and effective income tax rates and the incidence of taxation. These misperceptions do appear to impact on behavior. There appears to be an undue focus on marginal income tax rates which may have little impact on many taxpayers and a lack of recognition of how much people pay in consumption taxes, a misperception which favours those who are hostile to direct progressive taxes.

The OECD and orthodox economists are correct in stating that rates and levels of taxes do have important impacts on the economy and its efficiency, and that some taxes have more effect than others, as but other factors such as equity are important.

There is a difference between what a worker takes home and the cost of employing them made up with income tax and social charges, which varies greatly between states. In some this is high and in others it is low. The extreme argument against ‘harmful taxes’ is that there should be no difference, and then employers facing a low cost of employment would hire many more workers. Yet as trade unionists have pointed out *ad nauseam*, in countries with very low wages, there is not full employment. Belgium has the highest charges and high unemployment, ‘proving’ the ‘harmful taxes’ argument. On the other hand, Germany and Austria have the lowest unemployment rates in Europe (mid 2014) but have the highest charges and Ireland has the lowest charges, but has had very high unemployment (exceeding 15 in 2011 but at just over 11 per cent in mid 2014).

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\(^{13}\) Dail Questions, 19th December 2013. https://www.kildarestreet.com

\(^{14}\) Department of Finance 2014.
If countries have a high ‘tax wedge’ consistently over decades, as the conservatives call this difference, its impact on employment is muted, just as it is in those with lower differences in employment costs. If the high countries were to suddenly reduce it, it is likely to have an immediately but temporarily impact on lower skill jobs and second earners. The cost of reducing it, if substantial, would be paid in lower social wages ie crèches, and other public services. Whatever the argument, there is usually a counter argument but consistency in policy is important.

It has been seen that generally most redistribution in developed economies is through transfers and only about one-quarter is through taxation. Conservatives therefore argue that progressivity in taxation is not as important as welfare transfers, but this neglects the fact that most revenue for the transfers comes from taxation. Both are important and neglecting the progressivity of the whole tax system, even if it is progressive at the lower income end, can mean that most of the heavy lifting can come from middle incomes and little from the wealth and high incomes. However, transfers matter little to those at the top of the income scale. For them, it is the top income tax rates combined with allowances and exemptions which matter. It is the cuts in the top rates that have benefited them most.

Huang and Frentz (2014) are critical of the argument that corporate taxes harm economic growth and they reject the view that taxes harm economic growth, citing many studies and are of the view that the issue is complex.

The IMF (2013: 31) largely appears to agree with the conventional economic literature on the supposed hierarchy of taxes which it says ‘suggests that corporate income taxes have the most negative effect, followed by labor income taxes, then consumption taxes, and finally property taxes’ but it differs with the OECD’s tax hierarchy in an important respect. IMF does not find corporate income tax to be more harmful for growth than personal income tax. It also admits that ‘this literature remains contentious: the ranking of instruments is not robust to different specifications. It says ‘personal income tax is associated with larger multipliers than the corporate income tax and that increases in the VAT are associated with sizable short-term output losses. Such differences imply a new set of trade-offs in designing consolidation instruments.’

However, IMF concludes saying ‘the short-term hierarchy of taxes is even less firmly established than that for the long term’ and it warns that ‘much more is still to be learned before policy can reliably be shaped by the results of these studies’ (2013: 31).

Thus the conclusion strongly suggests that OECD, some economists and governments should not act on such one-dimensional studies, which have profound outcomes on so many people, especially those on low incomes and which seem to be aimed at benefitting the rich and high income earners.
5.1 Taxes are payments not ‘burdens’

It was seen that the word ‘tax’ is described as a ‘burden’ by many international bodies – OECD, IMF, Eurostat, the European Commission and others. It seems to be policy to append the word burden to the word taxation. It is a deliberatively pejorative use of the word. The correct term is payment or charge. Why is the payment to a doctor by a private patient a payment whilst the same payment to taxes becomes ‘a burden’? The answer is simple. It is ideological and seeks to undermine the public sphere and taxation. There is therefore evidence of a level of capture of sections of major international bodies by far-Right US think tanks in their constant use of this pejorative word ‘burden’ around taxation.

5.2 The case for increased tax rates on high incomes

Income taxes raise over half of the taxation in most developed countries and are among the most progressive of taxes, in spite of the major reductions in top rates on high incomes. Inequality in earnings has risen substantially especially in the US and UK and this is in no small way due to the cuts in income tax at the top. The success of conservatives and those accountants, lawyers and economists who have lobbied for the rich in seeking to preserve the privileges of wealth and low taxed, high income ‘earners’ is remarkable. The regrettable bye-product of their success, as they would see it, is in achieving the current levels of inequality. They now must be taken aback at
international anger against inequality, against tax avoidance by profitable firms and by the popularity of Piketty’s book, *Capital in the 21st Century* which advocates ‘confiscatory taxes.’

In his magisterial best selling book, *Capital in the 21st Century*, Thomas Piketty (2014) shows in the above Figure 4 how much top income tax rates have been reduced in four major economies in the past decades.

The top marginal rate in the US was around 90% on very high incomes for two decades from 1943 to the mid 1960s as can be seen in Figure 4. The high rates in the post war period did not prevent the take-off of the US economy in the Post War golden era. In fact the high income tax rates may have assisted growth. This is clear evidence that very high taxes on incomes are not detrimental to economic growth.

Hungerford (2012: 16) succinctly sets out what has happened in the US in his report to Congress, ‘Throughout the late-1940s and 1950s, the top marginal tax rate was typically above 90%; today it is 35%. Additionally, the top capital gains tax rate was 25% in the 1950s and 1960s, 35% in the 1970s; today it is 15%. The real GDP growth rate averaged 4.2% and real per capita GDP increased annually by 2.4% in the 1950s. In the 2000s, the average real GDP growth rate was 1.7% and real per capita GDP increased annually by less than 1%.’

He continues ‘there is not conclusive evidence, however, to substantiate a clear relationship between the 65-year steady reduction in the top tax rates and economic growth. Analysis of such data suggests the reduction in the top tax

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**Figure 5**  
Top inheritance tax rates, 1900 to 2013

rates have had little association with saving, investment, or productivity growth. However, the top tax rate reductions appear to be associated with the increasing concentration of income at the top of the income distribution.’

The high taxes on wealth are important too especially in a meritocracy, which most European countries aspire to be. Piketty’s historical research on taxation also shows how much higher taxes had been in the past on inheritances in the same four countries in Figure 5.

It shows that there were very high rates in the US and UK for decades from the 1940s. He points out that the marginal rate of inheritance tax in the US was cut from 80 percent in 1980 to just 35 percent in 2013, as can be seen in Figure 5.

The rapid rise in top incomes since the 1990s has driven inequality. Salaries have risen much more strongly at the top than at the bottom. Changes are very large by historical standards and it is worse when the top 1 to 10 per cent are examined in contrast to those at the bottom of the income scale. Workers on low wages have fallen further behind and are more likely to fall below any relative poverty line as incomes for the lowest paid decile fall behind in developed countries. Information technology in globalisation is hitting middle incomes too. This means tax systems are becoming more important.

In one study of the tax treatment of top incomes, Piketty and Saez (2012: 40) show ‘a very clear and strong correlation between the cut in top tax rates and the increase in the top 1% income share with interesting heterogeneity.’ Thus the cuts in income taxes do benefit the rich. It found that countries ‘such as France, Germany, Spain, Denmark or Switzerland which did not experience any significant top rate tax cut did not experience large changes in top 1% income shares. Among the countries which experienced significant top rate cuts, some experience a large increase in top income shares (all five English speaking countries but also Norway and Finland) while others experience only modest increases in top income shares (Japan, Italy, Sweden, Portugal, and the Netherlands).’ They comment ‘interestingly, no country experiences a significant increase in top income shares without implementing significant top rate tax cuts’ (Piketty and Saez 2012: 40).

The examination of income tax should be undertaken in the context of the ‘Social Wage’. The Social Wage is the benefits accruing to workers and citizens within a society from the taxes which they pay and ‘denotes social benefits available to all individuals, funded wholly or partly by the state through taxation and received free or at subsidised cost. The social wage includes free education, National Health Service treatment, etc.’ This view goes further than Mirrlees which argue for the whole tax system to be examined, because this view includes welfare, free education, the social wage such as education, child care etc.

Godar et al. (2014: 2) of ILO, quoting Musgrave and Musgrave, points out that ‘since the 1980s, the distributive goal of fiscal policy was increasingly interpreted as an obstacle to efficient tax design rather than a goal by itself. ‘Attention appears to be shifting from the traditional concern with relative income positions, with the overall state of equality, and with excessive income at the top scale, to adequacy of income at the lower end. Thus the current discussion emphasizes prevention of poverty, setting what is considered a tolerable cut-off line of floor at the lower end rather than putting a ceiling at the top, as was once a major concern.’

This is an extremely important point in the radical change in the thinking which has informed policy actions. The dramatic cuts in income tax rates do not appear to have led to improvements in economic performance and efficiency than would otherwise have occurred in the past 30 years, but it has certainly led to far greater inequalities in incomes and wealth and contributed to the secular decline in labour’s share of national income as Piketty, Atkinson, Sweeney and many others have demonstrated.

The top marginal income tax rate and the corporate income tax rate have fallen substantially in recent years. There also has been an increasing trend of dualisation of the income tax, that is, increasing privileges for capital income in tax reductions by governments. Many European countries also deliberately broke with the comprehensive income approach by making capital income of individuals subject to a separate tax schedule with one low single tax rate, while labour income continues to be taxed. Thus as Godar et al. (2014: 3) say this ‘demonstrate that the traditional standards of tax justice have come under severe pressure in recent decades’.

Atkinson et al. (2011: 3) argue that ‘over the last 30 years, top income shares have increased substantially in English speaking countries and in India and China but not in continental European countries or Japan. This increase is due in part to an unprecedented surge in top wage incomes. As a result, wage income comprises a larger fraction of top incomes than in the past’ and they argue for progressive income and wealth taxes. They point out that other measure of inequality tend to miss high incomes and indeed one can argue that taxation data is similarly deficient in that the top income earners are major tax avoiders (and evaders) through complex trusts, avoidance schemes and offshore havens.

Since then Piketty’s Capital in the 21st Century has become the top selling economic book, outselling all works of fiction in the US on Amazon for a period. The popularity of this book arguing for confiscatory taxes on high incomes and wealth is the most direct challenge to the dominant view promulgated by the OECD economics department in its hierarchy of harmful taxes line.

IMF (2014: 34) states that ‘Tax systems around the world have become steadily less progressive since the early 1980s. They now rely more on indirect taxes, which are generally less progressive than direct taxes, and within the latter, the progressivity of the personal income tax has declined, reflecting most
notably steep cuts in top marginal tax rates.’ It finds that the bulk of rich countries cut their top rate of income tax by between 30 and 55 per cent between 1980 and 2012 as Figure 6 shows. This is a very substantial cut and impacts deeply on equity.

Figure 6  **Emblems of falling tax progressivity**

6.1 Fall in ratio of direct to indirect taxes

6.2 Top marginal personal income tax rate, 1980 and 2012, in per cent


5.3 Conclusion on increasing personal income taxes

Even the IMF (2014: viii) has admitted that ‘recognition that the international tax framework is broken is long overdue.’ It is no longer acceptable to workers and citizens that the focus of so-called ‘reforms’ is only from a supply-side, neoclassical perspective.

The IMF says significant revenue can also be gained from reforming the system. When the IMF states that there is ‘scope in many advanced economies to raise more revenue from the top of the income distribution (and in some cases meet a nontrivial share of adjustment needs), if so desired’ then it is time to address fundamental tax reform with equity in the calculation. The IMF also argues that there is a strong case in most countries, advanced or developing, for raising substantially more from property taxes.

Piketty and Saez argue that “The job of economists should be to make a top rate tax level of 80% at least “thinkable” again.”

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5.4 Tax policy is deeply contested and not simply technical

There is no simple view of taxation. It is deeply contested. While the dominant view on ‘harmful taxes’ is hostile to taxes on incomes and companies as detrimental to efficient economies, it was seen that the IMF (2010, p17) is more nuanced and dissents in parts. It found that ‘the multipliers from government investment and consumption, which are roughly similar in size, are clearly larger than the multipliers from transfers, labor income taxes, consumption taxes and corporate income taxes.’ It also found that ‘multipliers are small for general transfers, labor income taxes and corporate income taxes, and somewhat larger (but still small relative to government spending) for consumption taxes.’ Both points contradict the anti-progressive tax view.

Similarly, Godar et al. of the ILO (2014: iii) is critical of ‘the dominant view [that] higher taxes on top personal incomes, corporate income and wealth are detrimental to growth and employment.’ Godar in the ILO paper argues ‘that even the dominating theoretical framework leaves substantial leeway for redistributive taxation. From a Keynesian macroeconomic perspective, redistribution may even be systematically conducive to growth and employment.’ It says ‘international and national tax policies should actively promote ‘progressive taxation to correct the disparities in the income distribution.’

Also Thomas Piketty, recognising that it is not easy to find the optimal income tax rates, has taken a contrary viewpoint to the dominant one. ‘The main message coming from my book is not that there should always be a deterministic trend toward ever rising inequality (I do not believe in this); the main message is that we need more democratic transparency about wealth dynamics, so that we are able to adjust our institutions and policies to whatever we observe’ (Piketty 2014b: 2).

5.5 Higher taxes could raise more revenue

After thirty years of downward shift in taxes on top incomes, there have been some progressive changes in current taxation trends and policy proposals since the Recession began in 2008. However, there are no signs of a comprehensive reversal in the trend. This is probably because of the allegedly strong efficiency/equity trade-off that still retains the minds of too many policymakers.

Figure 7 shows if the top rate of income tax was restored to the rate it was in the 1980s, and only focusing on the top 1 per cent of income earners in each country, the reversion to the higher rate would bring in a great deal of tax revenue. And from those best able to pay it.

IMF (2013: 36) says ‘in many countries it might indeed be possible to raise more from those with the highest incomes.’ How much more? ‘The implied revenue gain if top rates on only the top 1% were returned to their levels in the 1980s averages about 0.25% of GDP but the gain could, in some cases, such as
that of the United States, be more significant.’ It would in fact be spectacular. It would bring in 1.25 per cent of GDP which is around $200bn a year (IMF 2013). Applying the IMF’s formula to Britain would mean that the exchequer would raise an additional £4bn from taxing top earners.

There has been a marked increase in income inequality in many countries over the last few decades and a spectacular increase in the income share of the top 1 percent in particular, especially in the Anglo-Saxon world according to the IMF (2013: 34), which quotes Piketty and Saez (2006); Atkinson, Piketty, and Saez (2011). It says that ‘Whether the changes in tax rates have helped drive increases in underlying inequality remains unclear’ but then it says ‘though it is notable that those countries with the largest reductions in the top marginal income rate have experienced the greatest increase in inequality’ (Table 2 below).

It can be seen that many of those countries with the largest cuts in the top tax rates had the biggest reduction in taxes paid by the top 10 per cent. The IMF paper also showed a strong correlation between tax cuts on the top marginal tax rates in disposable income inequality since the mid 1980s and late 2000s.

So unequal are some countries that IMF (2013: 34) found that ‘for a range of advanced economies, that the richest 10 percent account for a strikingly large proportion, 30–50 percent, of all revenue from the personal income tax and social contributions, with the top 1 percent alone accounting, on average, for about 8 percent.’

International bodies like IMF and OECD agree that the level of taxation and thus public spending, and thus, the size of government, is a political decision. However, there are two ways to see if a country has scope to increase taxation. First is to compare tax receipts of a country to those of its peers, controlling
An examination of tax shifting and ‘harmful taxes’

for factors like income per capita etc. A second way is benchmarking revenue performance – ‘stochastic frontier analysis’ to compare a country’s tax ratio not with the average, but with the maximum that others with similar characteristics have achieved. A country’s revenue as a percentage of this maximum (in percentage terms) gives an indication of what the IMF calls its ‘tax effort.’

Advocates of the hierarchy of taxes favour increasing VAT as they cut income tax rates and taxes on profits of corporations. Most admit it is regressive and cover this by saying government can increase welfare to compensate. There is a wide range of exemptions and multiple rates of VAT and it is an area of taxation which is open for reform. But it is difficult to do. For example, food is exempt in some countries. The additional costs could be substantial and would fall mostly heavily on low income families.

Figure 8 shows how much more tax could be raised in advanced countries according to the IMF’s estimates by comparison to peers and the possible source of taxes. This is interesting work and while it shows the high tax countries have little scope to raise more (per this study), some like the US, could increase taxes by 7.4% of GDP or $1,184 billion in 2014 per this exercise. This appears unlikely to occur unless there is a war.

The IMF (2013: 30) finds that in European economies, what it terms ’policy imperfections are generally much more marked than compliance problems, reflecting extensive exemptions and frequent use of multiple rates. Halving the

<table>
<thead>
<tr>
<th>Country</th>
<th>Change in top marginal tax rate</th>
<th>Change in share of taxes paid by those with incomes in the top 10 percent</th>
</tr>
</thead>
<tbody>
<tr>
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<td>-13.00</td>
<td>0.05</td>
</tr>
<tr>
<td>Canada</td>
<td>-14.00</td>
<td>0.07</td>
</tr>
<tr>
<td>Czech Republic</td>
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</tr>
<tr>
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</tr>
<tr>
<td>Finland</td>
<td>-17.00</td>
<td>0.03</td>
</tr>
<tr>
<td>France</td>
<td>-16.91</td>
<td>-0.07</td>
</tr>
<tr>
<td>Germany</td>
<td>-11.00</td>
<td>0.05</td>
</tr>
<tr>
<td>Ireland</td>
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</tr>
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<td>0.03</td>
</tr>
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<td>Poland</td>
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<td>0.07</td>
</tr>
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</tr>
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<tr>
<td>United States</td>
<td>-15.00</td>
<td>0.06</td>
</tr>
</tbody>
</table>

Source: IMF 2013.
policy gap, all else equal, would on average raise a very substantial 2.3 percent of GDP in taxation. However, to address the adverse impact that its particular (regressive) tax measures would have on poorer households, it suggests that fully half of this additional revenue gain would have to be used to fund transfer (welfare) programmes which would have to be implemented to compensate. So what they are saying is that some taxes would be increased under their efficiency criteria, and would hit the poor, including the working poor. However, the composition of many governments is such that they might not increase public spending to make up for the impositions of such regressive tax increases.

5.6 Other taxes in the hierarchy

It has been argued that the whole of the taxation system has to be examined rather than a focus on one particular tax – usually income tax. Therefore, other taxes including property tax, inheritances and wealth tax and financial taxes are examined too. Important tax issues including tax expenditures, the black economy and international taxes are examined briefly in Appendix 2. It can be argued that these issues are equally or more important to efficiency than tax shifting, but some are vital to addressing other principles of taxation like neutrality, certainty and equity.

5.7 The decline in labour’s share of national income

In addition to the decline in top tax rates on income and inheritances another driver of equality, perhaps greater than taxes, has been the decline in labour’s
share of national income. Sweeney (2013: 124) found that labour’s share of national income in most countries over the past 30 years has declined, while capital’s share has risen. ‘The main impact of the falling labour share is growing inequality, between those at the top and those at the bottom. Within the labour share, the relative incomes of those with education and position rose. The main impact of the decline in the labour share on the economy is reduced demand.’ He says ‘there are many reasons for the decline in the labour share of national income internationally and some overlap. While many economists attribute the bulk of the change as endogenous - as largely due to technology, most of the other drivers are due to policy changes’ (Sweeney 2013: 120).

He lists eleven main factors, some of which overlap and interact, many of which were policy driven. These are technological change; globalisation; increased domestic and international competition; the impact of financialisation; the reduction of labour’s bargaining power through the de-regulation of labour, of collective bargaining rights etc.; offshore outsourcing; the sectoral shift in employment from manufacturing to services etc.; changes in education and skills; other forms of de-regulation especially in the decline in corporate governance standards in private business; the shift in power from sovereigns to corporations and finally privatisation.

Sweeney points out that most international bodies are fully aware of the decline in the share of income accruing to labour, and have undertaken excellent analysis of the trend, including the reasons. Many economists and the international agencies all argue that inequality must be addressed, though all have different views on how this should be done. For example, OECD (2011) argues that rising inequality creates economic and social and political challenges, stifling upward mobility and finds intergenerational earnings mobility is low in Italy, UK, US but much higher in the Nordics. The most powerful instrument is to reform the tax and benefits systems and it admits that reductions in the top taxes on high incomes have played a significant part having been reduced from 60 / 70 percent in major OECD countries to 40 percent in the late 2000s.

Sweeney (2013: 126) is critical of some international bodies – ‘the attitudes of the IMF and OECD have been examined. Concern at the decline is expressed within these bodies, but in spite of the words, it is back to business as usual according to the Washington Consensus.’

The fall in labour’s share of national income over 30 years in most countries is of immense concern. It is tied in with the growth in inequality and must be effectively addressed.

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17. There are a multitude of authors on this subject, all in agreement on the key fact, the decline in the labour share in most countries over the past 30 plus years. They may disagree on solutions. See for example papers by Bassanini and Manfredi 2012, ILO 2012 /13, ILO 2007, IMF 2007 etc.
5.8 Tax, transfers and redistribution

Tax and transfers are the key methods of direct redistribution which improve equity, which in turn boost efficiency. There is a wide literature which emphasises the importance of equity in economic efficiency and a rapidly growing interest in equality, a point which will be returned to later.

It was seen that Johansson et al. explicitly set out caveats on how the moves to their own hierarchy of so called ‘harmful taxes’ would have regressive impacts through the increase in other taxes, such as on consumption. What is surprising has been how influential the paper has become with policymakers, the OECD etc. It has gained immense traction, perhaps reflecting the political direction of policymakers, in spite of the causes of the Recession which began in 2008.

Bodies like the OECD admit that ‘before taxes and transfers, income dispersion mainly reflects labour market outcomes.’ (OECD 2012c: 3) and say that ‘the personal income tax tends to be progressive, while consumption taxes and real estate taxes often absorb a larger share of the current income of the less well-off.’ However they argue that most of the correction of market outcomes is through transfers with only about one quarter coming through direct taxation. This may be one reason why such bodies are against progressive taxation, believing that it is not as important in reducing income inequality as are transfers.

However, this is precisely the point – taxes could and should play a much bigger role in the reduction of income inequality than they do at present. It is the shift away from progressive taxes is reducing the impact of taxation in such redress, leaving those who are left behind by markets at the whims of welfare systems, rather than receiving partial redress through active taxation policy.

Some reforms of tax and transfer systems entail a double dividend in terms of reducing inequality and raising GDP per capita. In particular, the OECD (2012c: 3) finds that ‘reducing tax expenditures, which mostly benefit the well-off, contributes to equity objectives’ but it then argues that the gains should fund cuts in progressive taxes on incomes.

5.9 An empirical case of tax shifting

One country which implemented tax shifting, from direct to indirect taxes in a short period, was Ireland. There is general retrospective agreement that the shift in taxes from direct to indirect taxes, which were largely generated from the booming property market was one of major causes of its economic collapse.

The government made major reductions in direct taxes – on personal and corporate incomes and capital gains – in the late 1990s into the 2000s. Nominal corporation tax was progressively reduced from 36% in 1997 to 12.5% in 2003. Major beneficiaries of this action were the banks which had substantial additional post tax profits to lend, which they did without care.
Personal income taxes were cut substantially for industrial workers with the effective rate of 21% in 1997 reduced to just 11% in 2001 (ICTU 2004). Tax revenue continued to exceed public expenditure because taxes were flowing in from consumption taxes (and simultaneously, even with the effective income taxes rates halved in a just few years, growing employment increased this source of revenue). Much of the consumption taxes were on property. So when the Crash came in 2008, the revenue form indirect taxes dried up. This lead to the need for the Troika bailout because suddenly there was insufficient revenue to run the state from this volatile property sector.
6. **A more equal society is a more efficient economy**

Many bodies, including those which describe taxation as a ‘burden’ instead of a transfer within an economy and want smaller governments, less taxation and less public spending, now appear to be disturbed by the clear evidence of growing inequality. Many liberals advocate widening the tax base, more focused transfers, and more education and training especially for those on lower incomes.

These low-interventionist recipes have not worked and are no longer acceptable. Some international bodies are actually changing their policies. The striking evidence-based research on inequality and taxation by Thomas Piketty and its huge popularity with the learned public, worldwide, means that change must come in taxation. It is quite evident that taxation plays a major role in reducing inequality. While transfers do make up three-quarters of redistribution, the transfers are from taxation and the way in which it is raised is vital in the whole ambit. Transfers have no impact on high income earners. Yet the taxation of such incomes, in highly unequal economies do have a disproportionate impact simply because they have so much income and wealth.

There is a wide literature setting out how more equal societies are more efficient as well as being far better to live in. Wilkinson and Pickett’s book the *Spirit Level* has had a large impact on citizens who are increasingly disturbed by growing inequality. As they say in their opening ‘it is a remarkable paradox that at the pinnacle of human material and technical achievement, we find ourselves anxiety ridden, prone to depression, worried about how others see us, unsure of our friendships, driven to consume with little or no community life’ (Wilkinson and Pickett 2009: 3). The OECD (2014) report on inequality found that when income inequality rises, economic growth falls and concluded that redistribution (through taxes and benefits) has not led to bad growth outcomes.

Ostry *et al.* (2014: 10) found that ‘there is surprisingly little evidence for the growth-destroying effects of fiscal redistribution at a macroeconomic level.’

They found (p. 4); ‘First, more unequal societies tend to redistribute more.’ It is thus important in understanding the growth-inequality relationship to distinguish between market and net inequality. Second, ‘lower net inequality is robustly correlated with faster and more durable growth, for a given level of redistribution.’ These results are highly supportive of our earlier work. And third, ‘redistribution appears generally benign in terms of its impact on growth; only in extreme cases is there some evidence that it may have direct negative effects on growth.’
There is a growing acknowledgement of the value of a more equitable economy for generating more opportunity for greater numbers and thus for a more efficient economy and so for a more contented and safer society. Taxation, seen by the Victorians as important in this area, has to begin to again play its role in making societies more equal and economies more efficient.
The level of public spending in a country is determined over a long time by many contested, but democratic political decisions. The size of the average advanced economy has hovered around 40 to 48 per cent of GDP since the early 1980s, having risen from 12 per cent in 1913. The size of the modern state will probably remain around this band for the foreseeable future, but how it is funded (and spent) is deeply contested.

Public spending is funded by taxation. Conservatives generally argue for low taxes and low public spending, while progressives generally argue in the opposite direction. There are differences over which taxes should be used to generate more or less revenue. In generally, conservatives and most economists favour lower taxes on (high) incomes, lower taxes on profits from corporations and shifting to higher taxes on consumption. They have argued from their models which focus on what they term as efficiency and on elasticities in labour markets.

The OECD, EU Commission and other bodies are now promoting a ‘hierarchy of harmful taxes’ where they argue that first, taxes on profits and secondly, taxes on personal incomes are the most harmful taxes for employment and growth. They want to shift from these taxes to consumption taxes (which they say are also harmful, but lower on their hierarchy). Taxes on inheritances and wealth are less harmful, they admit but are not discussed much by them, though they do favour recurrent taxes on property as being less ‘harmful.’ Interestingly, the IMF does not find corporate income tax to be more harmful for growth than personal income tax and admits that ‘this literature remains contentious: the ranking of instruments is not robust to different specifications.’

This hierarchy of harmful taxes line has become an ‘economic law’, which is being pursued by many policymakers as a ‘truth.’ For example, it was seen that the European Commission in its *Annual Growth Survey: Country Specific Recommendations* (2014: 24-30) under the European Semester Cycle is very much against progressive taxes in member states, demanding the reduction of what it calls the ‘effective tax and social security burden on labour’ and to ‘shift taxes from labour to less growth distorting taxes,’ *ad nauseam*. These recommendations are not just very ideological and one-sided, but are flawed, being based on one narrow principle of taxation and ignoring the others. If implemented, they will lead to much greater inequality, which is detrimental for growth and development in the long term.
When all principles of taxation and the whole system of taxation, over lifetimes, along with more complex elasticities of factors are included in the design of the tax system, the outcomes are different than what conservatives argue. The assertion that income tax and tax on profits are ‘harmful taxes’ does not stand up to scrutiny. It ignores key principles of taxation. The design of a good tax system should seek to address efficiency, but also equity, certainty, neutrality, transparency and revenue raising, some of which conflict. It was seen that when the whole of taxes approach is taken, outcomes can be different than just examining the outcome of one tax. When consumption and income taxes on households are examined together, consumption taxes can hit low income households very hard, while barely affecting those at the top, with the converse being true.

It was seen that it is not only taxation which motivates high earning entrepreneurs and that there are a multitude of factors which influence behaviors. Tax does generate behavioral responses especially for high-income taxpayers and it generates responses in timing, shifting, and avoidance ‘but only at the top end of the income distribution.’ It was seen that Saez et al. (2009: 59) conclude that because estimates of the long-run elasticity of taxable income are ‘plagued by extremely difficult issues of identification, so difficult that we believe that there are no convincing estimates of the long-run elasticity of reported taxable income to changes in the marginal tax rate’ and it was seen that high income earners are less impacted by high rates as they have greater opportunities for avoidance.

The dominant economic view today is arguing for even lower taxes on high income earners and on companies. This has major implications for individuals and households and society. This anti direct tax view is being driven by the official OECD depiction of some of the most progressive taxes as ‘harmful taxes’ and by the pejorative, Tea-Party description of tax as a ‘burden.’ This is such a powerful anti-tax, anti ‘big government’ political campaign that it has been internalised by many. This paper is calling for a halt to this march against civilisation. For it it’s taxes which fund civilisation, the police, the arts, education and health care.

The description of tax as a ‘burden’ is a pejorative description of a vital policy instrument which is intensely ideological. Taxation is a payment or a charge. It is not a ‘burden.’

Piketty’s book *Capital in the 21st Century* has captured the public imagination. Its stark message is for increased taxation of incomes and inheritances and it flies in the face of this policy as it has developed over the past 30 years. He also directly challenges the ideology of the ‘hierarchy of taxes’ paradigm. It was seen that the IMF (2013: 34) pointed out that tax systems have become steadily less progressive since the early 1980s, relying more on indirect taxes, ‘which are generally less progressive than direct taxes, and within the latter, the progressivity of the personal income tax has declined, reflecting most notably steep cuts in top marginal tax rates.’ It finds that the bulk of rich countries cut their top rate of income tax by between 30 and 55 per cent between 1980 and 2012, a very large reduction.
In general, most redistribution in developed economies is through transfers and only about one-quarter is through taxation. Conservatives have therefore argued that progressivity in taxation is not as important as welfare transfers, but this neglects the fact that most revenue for transfers comes from taxation. Both are important and the progressivity of the whole tax system is important and further, transfers matter little to those at the top of the income scale.

Globalisation and de-regulation including of capital controls have provided great opportunities for the very rich and for MNCs to evade and to avoid taxation. Democratic countries have been vying with each other in efforts to attract FDI and rich tax exiles by reducing progressive taxes. Politicians of all persuasions have come under immense pressure from their lobbyists. They have acquiesced by reducing high taxes on incomes, on wealth on inheritances, on gains and on profits and abolishing some key taxes on rich people.

Yet in spite of large reductions in top income tax rates and in corporation tax rates, tax revenue from personal incomes and corporations has not declined over time. This is because the majority of taxpayers have made up the revenue lost from high personal taxes previously paid by high earners and by the greatly increased share of national income going to corporations which boosted profits and thus overall corporate tax revenue, despite many cuts in rates, aided by some base broadening.

However, both wealthy individuals and profitable corporations no longer have to pay any tax, anywhere, if they so chose, thanks to globalisation, through the use of tax havens and the acquiescence of democratic governments in facilitating tax competition.

However, steps are finally being taken, in response to public anger, by G20 and OECD to curb profit-shifting and erosion of the tax base by MNCs. The moves to force the transfer of financial information from tax havens on individuals and corporations are positive. But it is only a start. The pendulum against progressive taxation has swung much too far in favour of the rich, under the guise of efficiency. Much more needs to be done. The key bodies and governments which appear to favour both low taxes and reductions in growing inequality, must address their internal differences and question the policy path they have been taking and become consistent.

Growing inequality demands a deep response by governments and by Europe. The public is deeply disturbed by thirty years of increased inequality and by the secular decline in labour’s share of national income. It is time that equity was factored into all policy making as a key principle and not a residual. The assertion that progressive taxes are ‘harmful’ to growth was seen to be highly questionable. Quite the contrary, there are very strong reasons in equity to move back again towards higher direct taxes on profits of corporations and higher taxes on high incomes with tax rates reverting to those which stood in the past when growth was actually higher and to also reduce exemptions on companies because these actions should increase economic performance.
Indeed there should be a return to the higher taxes on high incomes and on wealth of the very rich that pertained during the golden era of the Post War recovery years in many states. A more equal society is a more efficient one as many more can participate more fully, adding to national income and wellbeing. It was seen that Diamond and Saez made three recommendations on the design of a good tax system. First, they recommend that very high income earners should be subject to high and rising rates, secondly, the earnings of low income earners should be subsidised and thirdly, capital should be taxed.

The call for a shift from what are called ‘harmful taxes’ is a sophisticated argument to shift from progressive to more regressive taxes. *Cui bono?* It is very high income ‘earners,’ the rich and profitable corporations. Equity is an important factor in both taxation and economics, which must be reintroduced into all debates on policy.

18. Who benefits?
Recommendations

General

1. The description of tax as a ‘burden’ is pejorative. Taxation is a vital policy instrument. Taxation is a payment or a charge. It is not a ‘burden’. The attachment of the word ‘burden’ to the word ‘taxation’ should cease immediately.

2. The assertion that taxes on profits or on personal incomes are ‘harmful taxes’ is incorrect and also ideological. It does not stand up to scrutiny. It ignores key principles of taxation.

3. ‘Equity’ or fairness is one of the principles of taxation, and should be included in all tax analysis along with ‘efficiency’. The downward trend to low taxes on high incomes and profits, and the widespread evasion, avoidance and use of tax shelters has contributed to great increases in inequality.

4. There are very strong reasons to move towards reverting back to the rates of direct taxes on profits of corporations and on high incomes which pertained in the recent past.

5. The attempt to reduce the design of taxes into a purely ‘technical’ one-dimensional analysis, is incorrect and particularly so when it is promoted as truth or an ‘economic law.’

Europe

6. The European Commission should immediately establish a once-off Commission on European Taxation, of widely representative ‘wise persons’, to chart the broad evolution of taxation in the Union.

7. There should be broad overall agreement on the general evolution of a European taxation system to facilitate an effective and social Single Market, while recognising that taxation is a national competency.

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19. Taxation is now routinely described as a ‘burden’ by the OECD, European Commission, some governments and other publicly funded bodies. There appears to be an unconscious level of ideological hostility to taxation.
8. **EuroTax** should be established as an international European-wide tax investigation centre, well funded, with wide powers of investigation into tax evasion and tax avoidance by wealthy individuals, companies and criminals.

9. The European Commission in its Country Specific Recommendations (2014) under the European Semester Cycle for 2011 to 2014 is extremely hostile to progressive taxes in most member states because it has succumbed to the 'harmful tax' line. From now on, the Commission should base its demands on ‘a whole of taxation analysis’ (as in 3) and not on only one principle of taxation to the exclusion of others, an analysis which, besides, is also highly questionable.

10. The introduction of wealth taxes, or at the very least, the undertaking of wealth or net asset assessments, in all member states would provide a key mechanism for countering evasion and avoidance. It would also provide firm data for economic policy and a proportion of revenue could be pooled which would provide a European Automatic Stabilisation Fund.

11. Taxation must be coordinated effectively so that tax competition is minimised, particularly within the Union.

12. The automatic sharing of bank information between states and banks will now give tax authorities more the information to calculate the net wealth or assets of every citizen, national projects which should to be undertaken, (as per recommendation 10).

13. The Commission should break-up the Big Four Accounting and legal firms which exert undue influence and almost determine taxation policy in many member states, through their dominance and control of ‘professional’ bodies, departments in universities and other fora, which promote regressive taxation. Their functions, such as auditing taxation and consulting which lead to conflicts of interest should also be broken up.

14. There must be much greater cooperation by states to counter avoidance of income tax and social security charges by MNCs by basing employees in low tax member states and by the use of (bogus) self-employment schemes and contractors and the European Commission,

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20. A European progressive tax, for one decade, on private wealth would help to reduce public debt towards 60 per cent of national income should be seriously considered to redress inequality. Set at around 0 percent on net fortunes below one million euros, 1 percent on fortunes between one and five million euros, and 2 percent above five million euros, annually, would raise around 2 percent of GDP as suggested by Thomas Piketty. It would put member states back on a sound financial footing; with a proportion going to a European fund to assist as an automatic stabilisation fund; supervised by EuroTax in conjunction with member state tax authorities; it would also be a key methodology in countering evasion because we would finally know who owns what, where.
with EuroTax, should make it extraordinarily difficult for any **Tax Exiles** of the 28 member states to even visit the European Union to oversee their businesses unless they are registered for tax in the Union. Citizenship rules must be tightened to ensure compliance by evaders and avoiders.

**Member states**

15. All member states should **agree, over time, to broad principles of taxation**, to attempt to tax income and wealth in line with these principles under main forms of taxation and to coordinate rather than harmonise the tax system.

16. The tax system in all member states should be simplified by **abolishing as many exemptions and allowances as is possible** and reducing tax expenditures (tax breaks) including interest payments for companies and individuals. Simplification of the overall system by such eliminations will allow higher revenue or lower rates and will help make income tax and social security systems far more effective and fairer.

17. The **downward trend in the taxation of high incomes must be reversed**, by increasing taxes on high personal incomes, i.e. above €100,000 (in 2014) in member states, over time.

18. **Enhance the investigative capacity of each member state** in taxation to ensure that the influence of the Big Four and other accounting firms is minimised. Implement strict rules before senior Revenue and other economic officials can be employed by accounting and legal firms.

19. **End tax dualism**: where income from some sources (eg capital) is taxed at lower rates than other sources. There have been increasing privileges for capital income in contrast to wage income, over recent decades.

20. **Tax evasion is theft and much tax avoidance is close to theft.** Europe must crack down in every way possible against these financial criminals, and on those who facilitate the billions lost in taxation annually. The day of tolerating evasion by high income earners, drug barons and other criminals, including evading businesses, should be ended. The European Union requires a sound fiscal base in the long term.

21. All governments should **crack-down hard on family and other Trusts** which facilitate avoidance and all large trusts (such as large companies) should have to **publish full accounts**, annually.

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21. In short, some states may have no tax on capital gains, zero tax on certain activities which other do tax and so on which encourages tax shopping, but only by the very rich and MNCs.
22. The welcome moves forcing **tax havens** like Switzerland, Monaco and others to disclose information on European citizens (and USA), the European Commission should move strongly against all tax havens within its geographical area to eliminate any loss of tax revenue from all 28 states.
## Appendix 1 — Implicit tax rates on labour

### Table 3  Implicit tax rates on labour

<table>
<thead>
<tr>
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Source: Eurostat 2014.

Note: The ITR on employed labour is defined as the sum of all direct and indirect taxes and employees’ and employers’ social contributions levied on employed labour income divided by the total compensation of employees working. The ITR on labour is calculated for employed labour only (so excludes social transfers). ITR on labour should be seen as a summary measure that approximates an average effective tax ‘burden’ (sic) or charge on labour income in the economy. It is not a good comparator for different incomes and a difficulty in assessing both ITR for labour and capital is that it includes income from many sources like capital, labour, welfare and self employment, pensions etc. (see Eurostat 2014: 282)
Appendix 2 — Other taxes in the hierarchy and other tax issues

Other taxes

Property taxes
Property taxes are low on the tax hierarchy. If properly structured, they can be progressive, equitable, raise revenue in a very stable way and help prevent property bubbles which undermine whole economies as the recent experience of Spain and Ireland demonstrated. They are generally progressive but need to be carefully constructed.

Recurrent taxes on immovable property are indeed one of the least distortionary type of property tax. However, these taxes are very unpopular in many countries. The use of up-to-date valuations and reliefs for people with low incomes and illiquid assets, along with an increase in the progressivity would make such a tax more acceptable.

The IMF study (2013) found ‘few countries have yet significantly raised property taxes as part of their consolidation efforts.’ It argued for increases ‘in property taxes, especially recurrent charges on residential properties while scaling back transaction taxes, arguing that ‘property taxes appear to be relatively growth-friendly and can serve equity and accountability aims; transaction taxes impede efficient trades.

Wealth taxes
The IMF (2013: viii) says ‘taxes on wealth also offer significant revenue potential at relatively low efficiency costs. Their past performance is far from encouraging, but this could change as increased public interest and stepped-up international cooperation build support and reduce evasion opportunities.’

Wealth and inheritance taxes play crucial roles in ensuring the effective taxation of incomes. As OECD says ‘They are also a very useful backup to personal income taxes since they provide tax authorities with information that enables them to identify inconsistencies between income flows and wealth held by taxpayers.’ (Johansson et al. 2008: 51)

Wealth taxes should be based on high net wealth. Wealth taxes are useful instruments for redistributing income from the wealthy when they are based on total net wealth and have an exemption level that is high enough to exclude the life-cycle savings of all but the wealthy, as defined by governments.

Figure 9 shows the share of net wealth held by half of the population on these rich countries and also the share held by the top 10 per cent.
The low share held by 50 per cent of the population and the high proportion held by the richest one tenth is not an indicator of a well functioning society. The chart makes a strong case for a wealth tax and for inheritance taxes at death.

Piketty points out that Europe is very rich, but wealth is very unequally distributed and many of its nations are relatively poor, with huge public debts. Piketty argues for a European progressive tax over a decade on private wealth to reduce public debt towards 60 per cent of national income, the figure espoused in EU treaties. He argues less for high income taxes than for this annual progressive tax on capital. This will encourage entrepreneurship, innovation, new accumulation and halt the unlimited growth of inequality of wealth.

One of Piketty's key demands is the automatic sharing of bank information between states and banks. The principle is simple, he writes: ‘National tax authorities should receive all the information they need to calculate the net wealth of every citizen.’ Piketty seeks a global tax which is ambitious, but he believes that it is possible to enforce a regional wealth tax in an area the size of Europe or the United States. An example of the sort of rate schedule that he has in mind is 0 percent on fortunes below one million euros, 1 percent on fortunes between one and five million euros, and 2 percent above five million euros. This is an annual tax, not a one-off levy. He estimates that such a tax applied in the European Union would generate revenue equal to about 2 percent of GDP, to be used or distributed according to some agreed formula. The administration of this tax would require a far greater degree of transparency and open reporting on the part of financial institutions, individuals and corporations.
International co-operation is required for such a tax – along much the same lines as the current OECD/G20 push for reform of corporate taxes across national boundaries – but the alternative is stagnation and the decline of democracy. He points out that we have little information on who owns what. There is no European balance sheet. Without this knowledge of ownership of capital, it is difficult to have an effective taxation system and, as we have seen from the financial crisis, to regulate capitalism itself.

Wealth is not taxed in many countries and in others it is taxed at lower rates than income from productive work. Thus there should be a comprehensive tax on net wealth and taxes on capital income should be aligned with income taxes.

**Inheritance taxes**

Inheritance taxes are not dissimilar to net wealth taxes, except that they are levied only at the end of the individual’s life. They avoid taxing most life-cycle savings which is fairer. Meritocracies should have strong inheritance taxes if they are give more equal opportunity by facilitating more efficient use of wealth.

Piketty and Saez (2012) are strongly critical of the orthodox view of the economist profession’s most popular theoretical models. They say ‘Taken literally, the policy implication of those theoretical results would be to eliminate all inheritance taxes, property taxes, corporate profits taxes, and individual taxes on capital income and recoup the resulting tax revenue loss with higher labor income or consumption or lump-sum taxes.’

In contrast to this line, Piketty and Saez promote the case for a rate of 60% on inheritances for the very wealthy and especially where there is concentration of wealth and ‘the optimal tax rate on capitalized inheritance would be as high as 50%-60%–or even higher for top wealth holders–if the social objective is meritocratic (i.e., the social planner puts higher welfare weights on those receiving little inheritance) and if capital is highly concentrated (as it is in the real world).’

Taxes on wealth transfers—on estates, inheritances, and gifts currently raise very little. The reasons are simple. The rates are far too low, there are too many exemptions and governments allow too many special arrangements which are designed to create multiple avoidance opportunities. It time for change if there is to be fairness in a meritocratic society which is to be efficient.

**Capital gains taxes**

Income from capital gains is generally taxed at a lower rate than income from work and in some member states gains are not taxed at all. There is a strong case for similar taxes in all member states to curtail tax holiday shopping by the rich. The best way to tax capital gains it to treat them as income. This can be problematic but it can be done. The case for higher capital gains taxes on share buybacks was made already.
Environmental taxes
Environmental taxes are crucial in addressing climate change and while they tend to be regressive, the impact must be reduced on low-income groups with additional benefits.

IMF (2014) advocates ‘effective carbon pricing by carbon taxation or by full auctioning under cap-and-trade schemes; eliminate fossil fuel subsidies and review environmental taxes’ more generally.

Financial taxes
The IMF says that ‘considerable progress has been made in developing bank taxes to reduce the debt bias toward debt finance’ that allows interest to be offset against corporate taxes. ‘The bias in allowing debt finance to be offset against tax affects all types of company but is especially troubling in regard to financial institutions, given the great damage that their excess leverage can cause.’

As expected IMF is not enthusiastic about the Financial Transactions Tax but it says ‘the financial activities tax (similar to a value-added tax, but limited to financial activities) has been well received technically but, beyond adoption of a variant in Iceland, has made little headway.’ A FTT is a worthwhile tax to reduce activity which is speculative and to raise revenue.

International taxation
IMF advocates that now is the time to reform the mess that is international taxation as the public is angry with the open evasion and avoidance by MNCs and the rich. It says ‘Reforming international taxation will be harder (than increasing taxes on wealth), as it must go beyond the control of tax-minimizing tricks to address more fundamental aspects.’ It sets out some paths to take, but it is time for national states to cooperate on this important area instead of indulging in mercantilist tax competition, particularly in the European Union, where the only winners are profitable MNCs, accountants and the very rich.

Dual taxation; taxing capital less than work.
There is an argument put forward that aggressive tax avoidance and actions like corporate inversions are a response to high tax rates and the double taxation on corporate profits in some countries. Profits are taxed and then the ensuing dividends may be taxed as well. It is argued that the same income should not be taxed twice. Yet double taxation is common. People sometimes complain of ‘double taxation’ when they have to pay a further tax (say on property) from income which has already been taxed. A general principle of taxation is that it falls on virtually every transaction in the economy and this should include dividends. For the average worker, income tax and one or even two social charges are levied on the same income and then when s/he spends that same income, there is also VAT and perhaps excise, giving up to five taxes on the same wage. Double taxation is not harmful but is a fact of life and what goes around, comes around.
The argument that coupon clippers/shareholders should be more lightly taxed than those who work productively runs counter to those who support a meritocracy, but it is much in evidence, as income from capital is often taxed much lighter than productive labour or enterprise. The nominal rates of taxation are irrelevant as effective tax rates are far lower, approaching zero in some high tax countries though avoidance, including the write-off of legitimate expenses.

**Trusts and evasion and avoidance**

It is vital that Trusts are subject to full scrutiny to ensure a fairer tax system for all. The G8 and G20 have said they are going to tackle secrecy of the tax havens. Both made specific commitments to create registers of the beneficial ownership of companies, which is most welcome. Tax Justice Network says if a tax haven registered company reveals that the company is wholly owned by a Trust settled in Jersey, since Jersey doesn’t disclose any information about who settles or benefits from trusts settled in that jurisdiction.

It quotes Daniel Thelesklaf, director of Liechtenstein’s Financial Investigation Unit: ‘We must not be naive . . . a criminal would never declare to a registrar that he controls a company, and the company registries will never be in a position to verify the information given to them . . . The beneficial ownership registry concept will only be credible if it included also legal arrangements such as trusts. Limiting it to companies only is window dressing at best’ (Tax Justice Network 2014). Thus tax authorities must break open Trusts to full scrutiny.

**Conclusion on other taxes**

This rapid review of other taxes demonstrates that there is considerable scope to raise substantial revenue which could be raised in an equitable, more efficient way than the move away from what are termed as ‘harmful taxes’ on corporations and high income earners, to consumption and other taxes which fall mainly on households. Equity is a core principle of taxation and should not be ignored in any analysis. A more equitable taxation system will be more efficient in the long run than moving further to even greater inequality, because it facilitates greater opportunity for more people.

**Other tax issues**

**Tax expenditures and exempt income**

Surprisingly, there is much agreement among economists on the distortionary impact of many though not all, tax expenditures. Most have evolved in haphazard ways under pressure from lobbyists. Tax expenditures are very costly for countries due to lost taxes and are inefficient in the main. Elimination of tax expenditures and many exemptions would broaden the base, simplify the system, be more transparent and bring in more more revenue.

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22. Also called incentives, allowances, exemptions and subsidies.
The levels of exempt income distorts the income tax system, undermining the principle of horizontal equity. Tax breaks, tax ‘incentives’ and tax expenditures are very similar. These tax breaks/incentives are very similar to the government spending taxpayers’ euros. They are subsidies from the public purse in many, though not all, instances.

However, in some instances, there is no cost to the Exchequer because additional economic activity is generated and no tax revenue has been spent. Instead, money which might not have been made by the additional economic activity is generated and so creates additional revenue which is foregone by the state, as a tax incentive to business. Such subsidies are fine, provided they work effectively. However, where the activity would have taken place anyway, in the absence of tax incentives, then the tax incentive is a waste of precious taxpayers money. It is deadweight.

There are however, additional problems with tax expenditures:

— **Tax expenditures are difficult to quantify in advance.**
  In the past, some tax expenditures have run into vast sums, costing the taxpayer extraordinary unanticipated and uncalculated sums in lost revenue. Government finance ministries have had great difficulty in anticipating the cost of tax ‘incentives,’ both because they the take-up is not known in advance and because they do not have sufficient information on their possible impact.

— **They are subsidies and have anti-competitive effects.**
  Tax expenditures are subsidies and are anti-competitive. This policy of tax subsidisation of investment, which is supposed to assist in incentivising economic activity, is anti-competitive. The European Union has a strong policy in curtailing state aid to private (and some public or state owned) companies, but until recently it was weak in its active curtailment of state aid through tax breaks and exemptions.

— **They have unintended consequences.**
  A classic example of the unintended consequences of tax expenditures was Section 84 lending in Ireland in the 1980s which was intended to close a tax loophole. It ultimately led to the hugely profitable banks paying no corporation tax, when the nominal rate of tax was then 50 per cent. Instead of lending firms money to buy plant and machinery the banks owned and leased it back, with the taxpayer picking up the bill. The government, wary of the effect on foreign investment by the elimination of the loophole overnight on, phased it out over time.

  The other major un-intended consequence of these schemes has been the aggressive tax planning by a number of tax advisors/consultants which has led to rich people and those with very high incomes paying no income tax whatsoever, while many other high earners pay little income tax. A key loophole has been through private pensions tax breaks which have favoured high income earners.
— **Tax expenditures should have a limited time span. They are very difficult to terminate.**

The ‘diffusion effect’ where there is demand for the expansion of tax breaks/incentives to new areas, if area-based, or to broaden their scope into other areas. This expansion has the effect of reducing their effectiveness while simultaneously increasing their cost. The drive of lobbyists of wealthy and corporates for such expansion under spurious ‘job enhancing’ promises is relentless. A EuroTax body would be helpful in closing down such expenditures where governments find it difficult to resist lobbyists.

— **Tax expenditures can be very regressive.**

Tax expenditures can be very regressive because the largest beneficiaries are usually high income earners and profitable corporates.

Tax exemptions also include allowances for children, blind persons, age allowance, carers, pension contributions, incapacitated persons, tax breaks to sportspeople, capital allowances for nursing homes (including convalescent facilities and associated residential units), holiday homes, student accommodation, private hospitals, sports injury clinics, third level educational buildings, patents, etc. Some of these are clearly worthwhile, others are dubious and some are a serious loss of taxation. The size and cost of tax expenditures is vast in many states and while many may benefit regular citizens, they have evolved haphazardly and undermine the tax system. Many tax breaks also go to the better off and corporations. The US sets out the cost of these in great detail for several years.\(^{23}\)

**The Black Economy or undeclared work**

The Black Economy reduces the quality of work available to workers, undermines social protection schemes, generates unfair completion for businesses and reduces tax revenue.

In 2013 the size of the Black, Undeclared or Shadow Economy is estimated at around 18/19 per cent of GDP in Europe though with large regional differences. From as high as 32.3 per cent in Bulgaria and down to single digits in other states it is a lot of untaxed activity according to the ILO (2013). ILO has warned that ‘undeclared work if not properly confronted, threatens to undermine the EU’s ability to meet its employment targets for more and better jobs and stronger growth. It is a form of social dumping that introduces unfair competition between firms on the basis of low wages and the non-payment of social security benefits and leads to working situations that violate the rights and dignity of workers.’

The liberal, open market view might be that low taxes reduce the Black Economy as it reduces the incentive to evade direct taxes. This view is contrary to the notion of fair competition in markets as it implies that a certain level of

\(^{23}\) Congress of the US, joint Committee on Taxation.  
https://www.jct.gov/publications.html?func=startdown&id=4663
tax cheating and thus lower costs is tolerable with low taxes. In fact the undeclared economy is much larger in the newer member Eastern states and in southern Europe e.g. Greece, Portugal and Spain with lower direct taxes than in the older 15 member states with higher direct taxes, undermining this assertion. The unweighted average has fallen slightly from 22.3 per cent of GDP in 2003 to 18.4 per cent in 2013, according to Schneider (2013).

Renooy and Williams (2014) found that there is ‘no correlation between higher taxes and larger undeclared economies.’ On the contrary, their study found that states a) in which larger interventions in the form of labour market policies to protect vulnerable groups; b) in which higher levels of social protection occur; and c) in which it is easier for firms to resort to temporary employment and temporary work agencies to meet labour demands have smaller undeclared economies.’ While their report is published by an employment agency, which may gain from the third conclusion, the first two conclusions are clear.

According to a tax campaigner, Richard Murphy of Tax Research UK, the UK Treasury is losing more than £40bn of tax a year because of evasion and the hidden economy, nearly four times official estimates. Hundreds of thousands of ‘shadow’ companies do not file tax returns, which Murphy estimated resulted in a £12bn loss of tax revenue.

Murphy is highly critical of the UK Revenue for underestimating tax losses. The Report estimates that 10% of all sales in the UK may not be recorded for tax purposes by HMRC. If this is correct, then it is possible that official estimates of the Black Economy for other EU countries may be wide of the mark. It makes the point that this tax gap is so large that it could mean none of the cuts in public service were necessary after the Recession which began in 2008. The exposure of HSBC bank involvement in major tax evasion in February 2015 is another indicator of the wholesale level of evasion.

A budget for the European Union
A discussion of taxation in Europe might include at least mention of the tiny EU budget. In the longer run, Europe will have to move to some form of fiscal union for a more legitimate political base. Such a union would provide substantial automatic stabilisers and transfers at EU level from its own taxation resources. It could also be the basis for EU-wide capital programmes. The current EU budget is wholly inadequate at less than 1 per cent of tax revenue for a globalised European Single Market with its own currency. It is suggested that this budget be set at a modest level.
References


An examination of tax shifting and ‘harmful taxes’

http://www.nber.org/papers/w16545


All links were checked on 19 May 2015.