2017-11-20

"Policy designs and structural reforms for inclusive growth – the role of taxation"

Prof. Dr. Andreas Peichl

DG ECFIN Annual Research Conference 2017: Fostering inclusive growth
Brussels, 2017-11-20
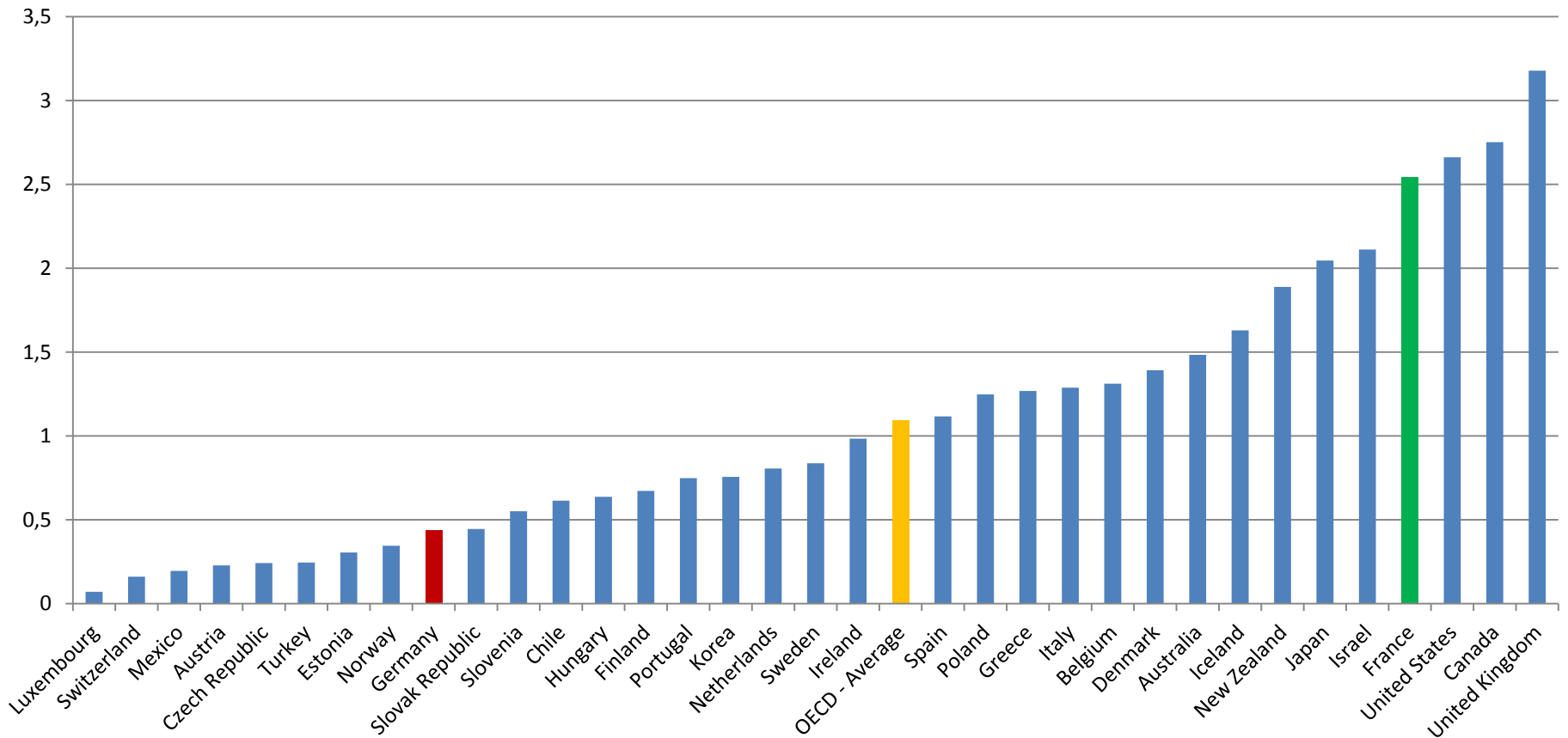
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Discussion

Discussion of previous talks:

- Etienne: „tax land!" (based on FR + UK, US, DE, CA)

- Juan: „Dual LM & EPL!" (based mainly on Spain)

- I agree (with almost everything in the slides / papers)

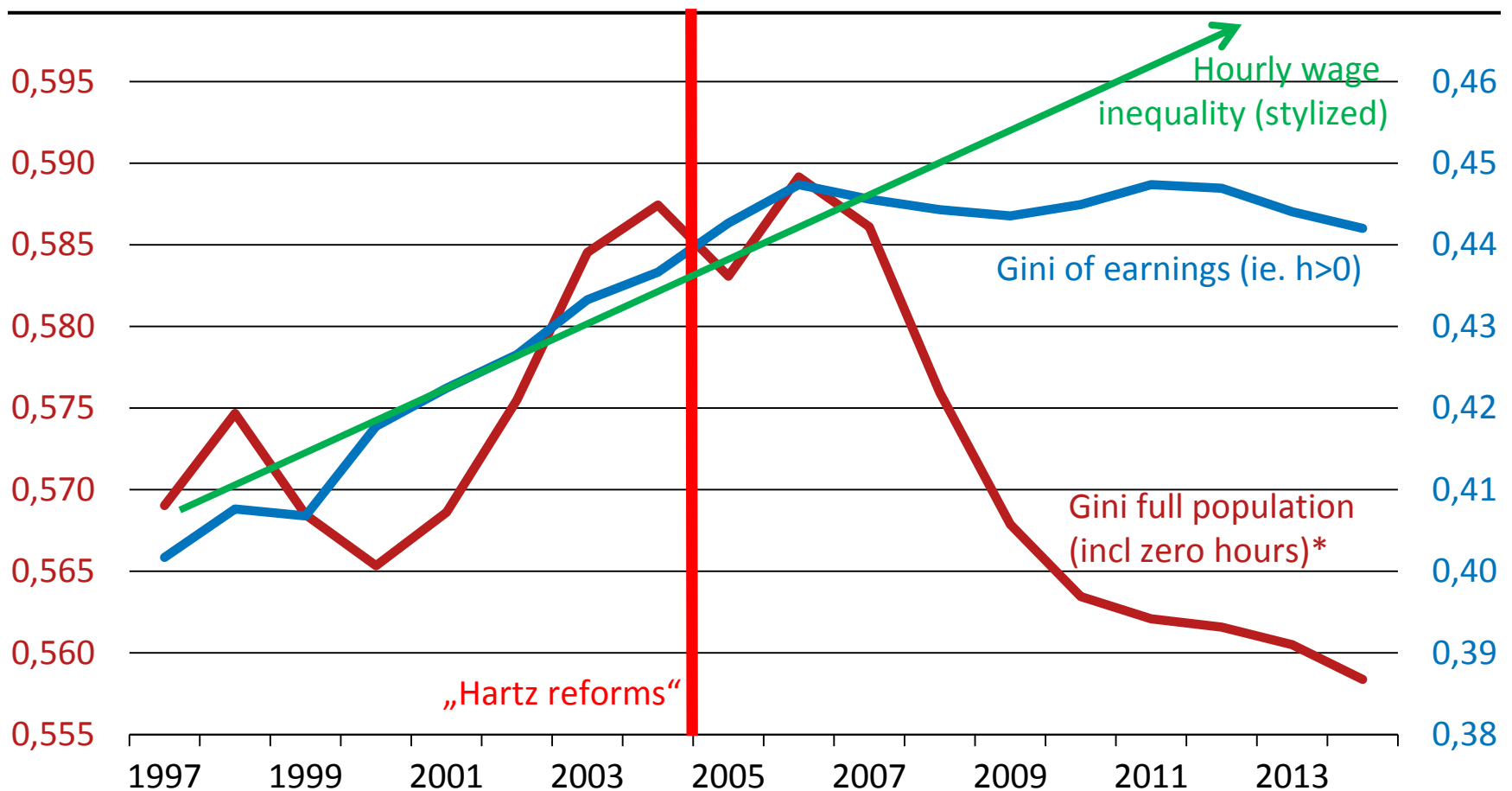- My task: role of tax-benefit system

Taxing land?

Revenue from property taxes
(% of GDP)

Data: OECD

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Role of labor market reforms (here: Germany)

Hourly wage inequality (stylized)

Gini of earnings (ie. h>0)

Gini full population (incl zero hours)*

„Hartz reforms"

* Die Arbeitsentgelte von Personen ohne Arbeitseinkommen sind gleich null gesetzt.
Grundlage sind Personen im Alter von 16-65. Inflationsbereinigte Größen.
Quelle: Felbermayr et al. (2016).

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Which policies to combat inequality?

International Panel on Social Progress: www.ipsp.org

**Ch. 3 on inequality, key policy message(s): „it depends",
as policies can affect inequality in different ways:**

- **pre-market** (e.g. education, land,…),
- **in-market** (e.g. anti-trust laws, financial (de-)regulation, labor market),
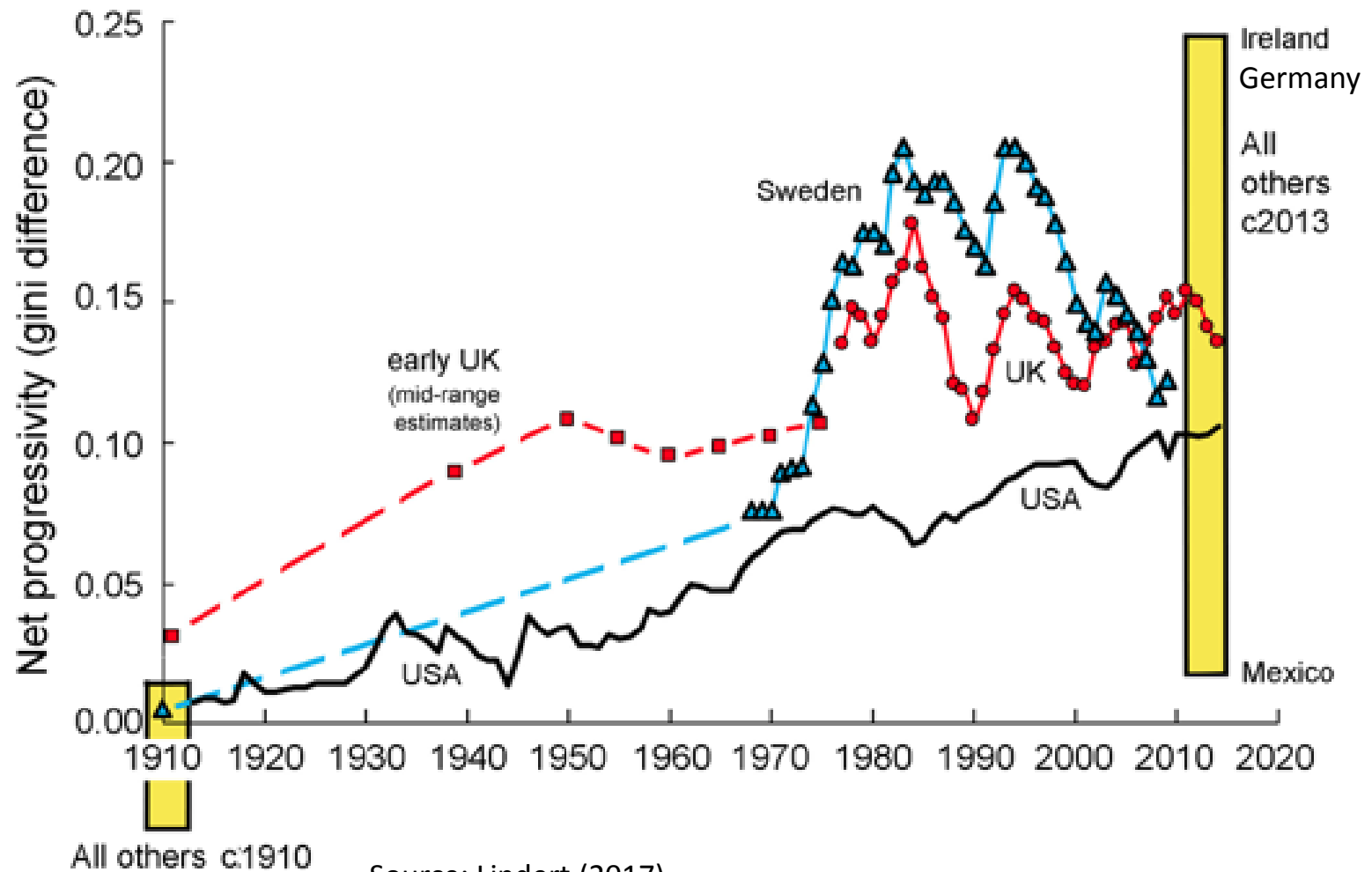- **post-market** (e.g. redistribution)

Common objectives, but priorities have to be **country-specific**

Discussion

Discussion of previous talks:

- Etienne: „tax land!" (pre-market)

- Juan: „Dual LM & EPL!" (in-market)

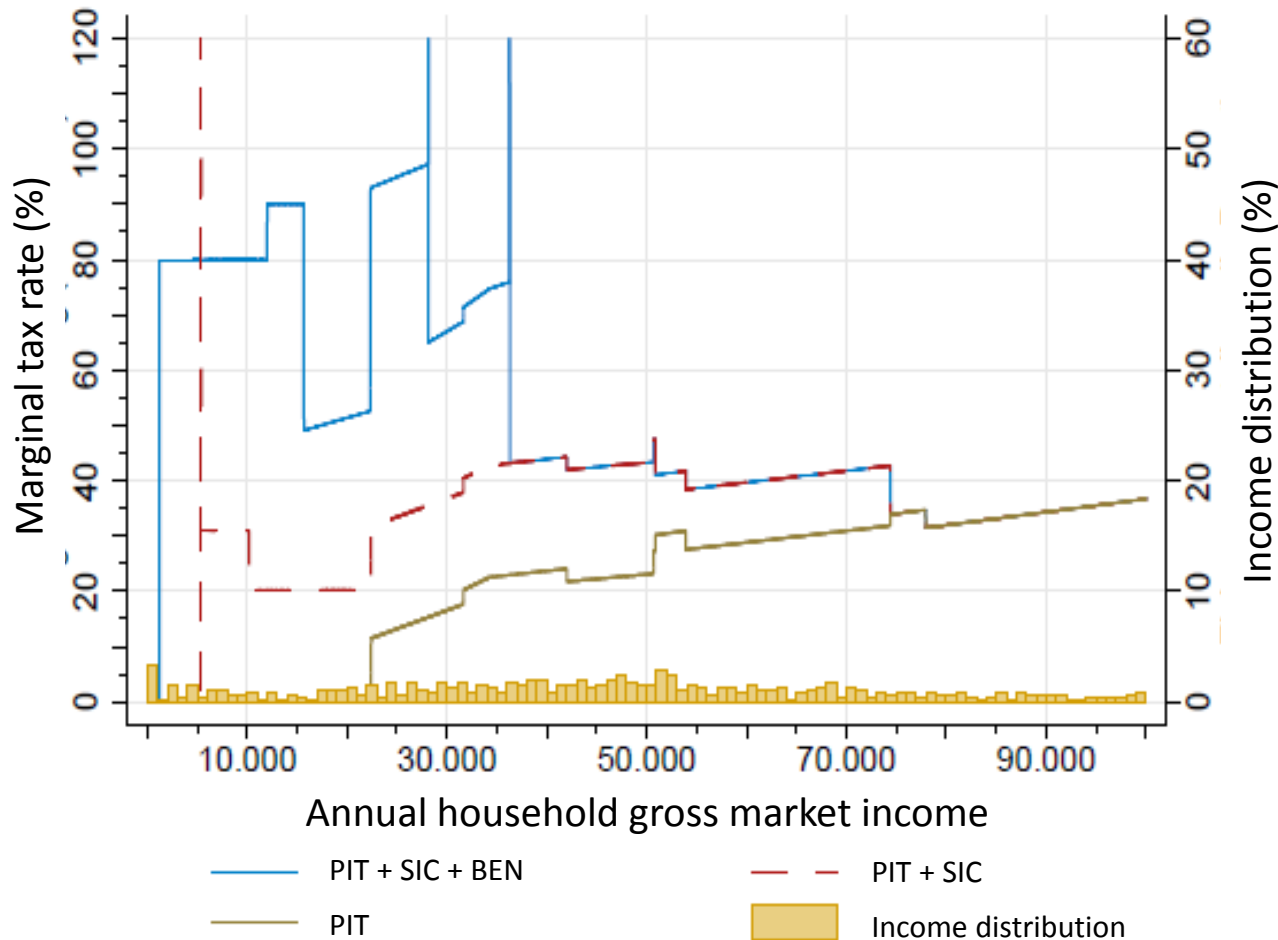- My focus: tax-benefit system (post-market)

History of redistribution

Source: Lindert (2017)

Are existing tax benefit systems fair?

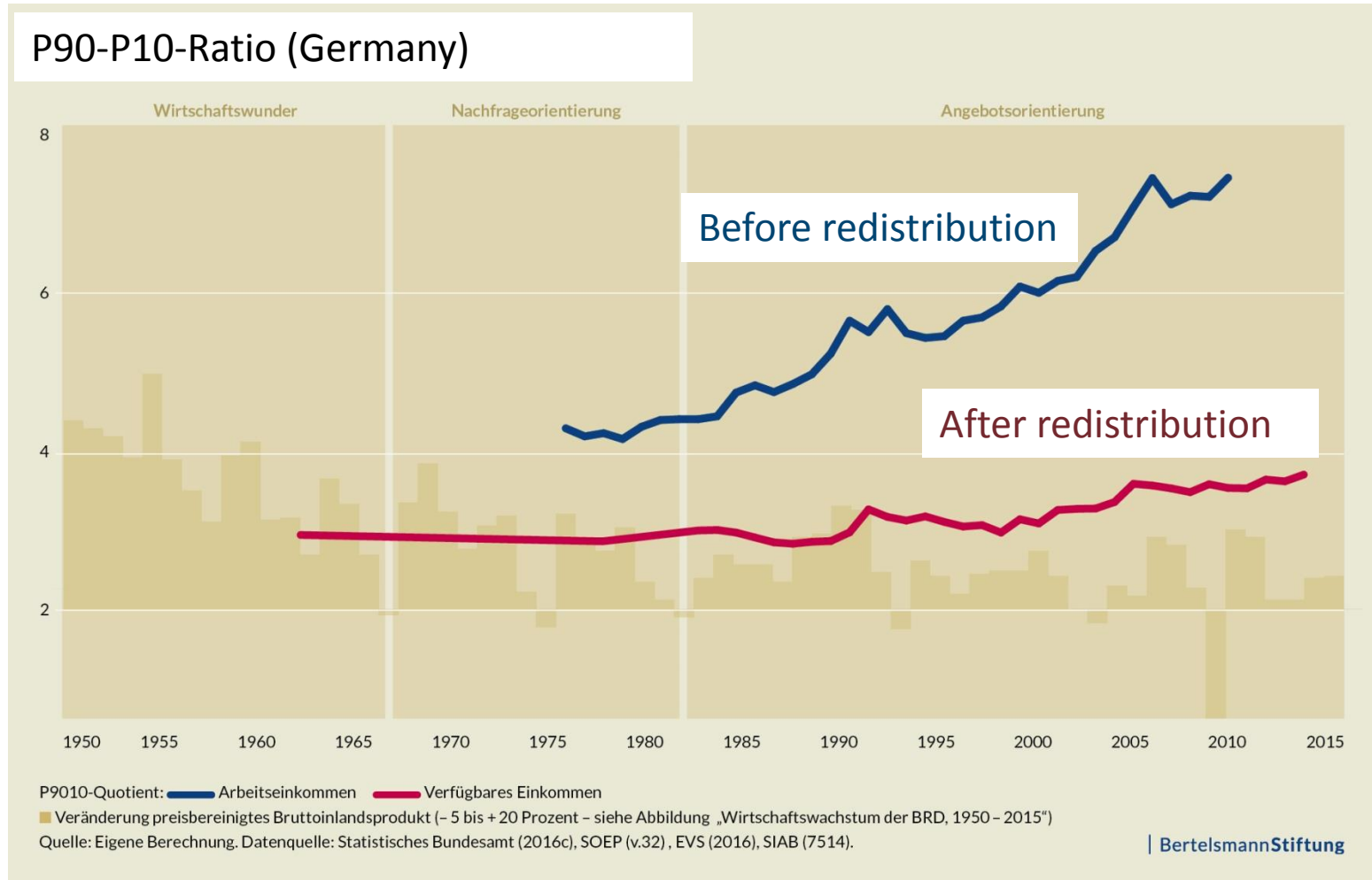Marginal tax rate, single-earner couple, 2 kids

Scope for reform?
Simulating (rev.-neutral) reduction in MTR (claw-back rate) at bottom:
- Increase in LS
- Decrease in Ineq
(Buhlmann et al. 2017)

No equity-efficiency trade-off!

What are the 'consequences'?

P90-P10-Ratio (Germany)

Before redistribution

After redistribution

Wirtschaftswunder   Nachfrageorientierung   Angebotsorientierung

P9010-Quotient: ■■■ Arbeitseinkommen   ■■■ Verfügbares Einkommen
■ Veränderung preisbereinigtes Bruttoinlandsprodukt (– 5 bis + 20 Prozent – siehe Abbildung „Wirtschaftswachstum der BRD, 1950 – 2015")
Quelle: Eigene Berechnung. Datenquelle: Statistisches Bundesamt (2016c), SOEP (v.32) , EVS (2016), SIAB (7514).

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Account for dynamic effects and feedback

Redistribution (especially high marginal tax rates) leads to behavioral feedback effects on pre-distribution:

- High marginal tax rates:
  → lower labor supply (esp. at the bottom and for secondary earners)
  → more tax avoidance / evasion (esp. at the top)

- Lower marginal tax rates:
  → more labor supply (esp. at the bottom; not so much at top)
  → more rent-seeking (especially at the top)

Further issues

- Changing household structures and assortative mating increases inequality (Peichl et al. 2010, Pestel 2016)

- Local public goods and regional price differences matter (Aaberge et al. 2012)

- Deduction possibilities are concentrated even more than market income (Dörrenberg / Peichl / Siegloch 2016)

- Incidence of taxes:
  - Corporate taxes are pass-through to (low-skilled) workers (Fuest / Peichl / Siegloch 2017)
  - Property taxes: Incidence on renters? (Löffler / Siegloch 2016)

Policy agenda

Increase Equality of Opportunity

- Pre-market: More investment into (early-childhood) education
- Training and qualification of low-wage earners and (long-term) unemployed
- In-market: level the playing field (combat rent extraction, structural reforms: LM, financial system,…)

Reform of tax benefit systems

- Integrated system of taxes, benefits and social insurance
- Reduce deduction possibilities and loopholes
- Higher wealth taxation?
  - Property taxation!
  - Inheritance taxation?
- But: tax competition especially over firms and high-skilled is increasing → important to *fight tax avoidance / evasion*
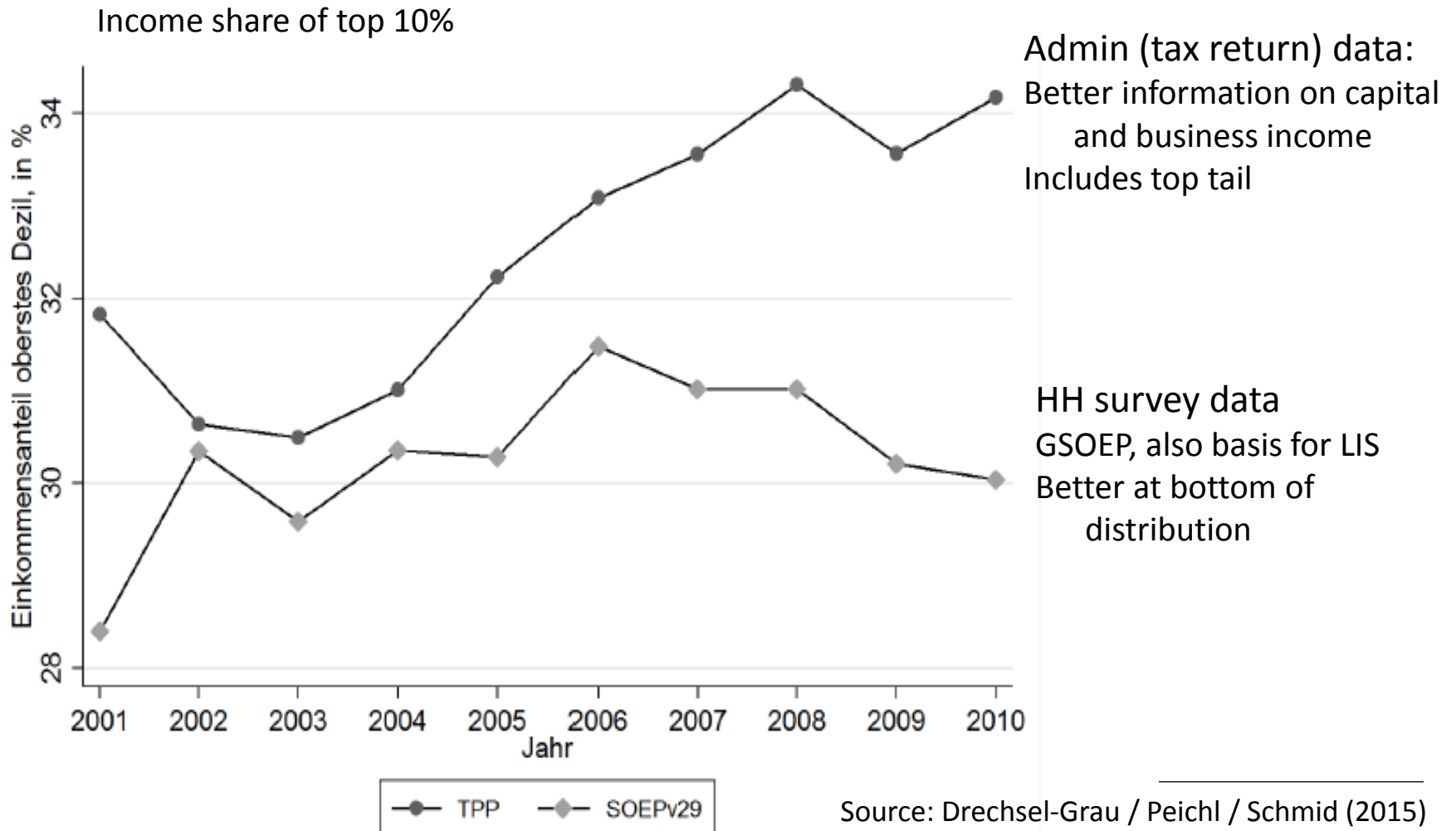
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Inequality trends in DE: DATA matters!

Income share of top 10%

Admin (tax return) data:
Better information on capital
    and business income
Includes top tail

HH survey data
GSOEP, also basis for LIS
Better at bottom of
    distribution

Source: Drechsel-Grau / Peichl / Schmid (2015)

The effect of policy (reforms) on Inequality

Inequality big (policy) issue

Role of (structural) policy reforms?

Problem: measuring causal relationships empirically!

- Data matters → need for better (more admin) data

- Identification crucial – but problematic in policy relevant (macro) context (see also debate on inequality and growth)

- Do NOT rely on cross-country data estimates (for policy advice)! Alternatives:

  - Using simulation models (MSM-DSGE): generate exogenous variation by construction

  - Synthetic control methods

Which policies to reduce inequality?

Identification crucial – but problematic in policy relevant (macro) context (see also debate on inequality and growth)

My reading of literature: government expenditures reduce inequality, while effects of tax progressivity are smaller (and often insignificant) implying that indirect behavioral effects play a (bigger) role with tax progressivity.

Findings might help explaining differences in inequality btw EU and US:

- While the US has a very progressive income tax schedule, very little redistribution occurs through social benefits (lower level of taxation).

- In contrast, European welfare states rely (on average) much more on benefits and government expenditure to fight inequality (Fuest et al. 2010).

- Introduction of the EITC in the US has effectively reduced inequality without large disincentive effects (Chetty et al., 2013).

Expanding the EITC and other benefits might be a fruitful way forward in order to combat rising inequality.

„Great Gatsby Curve" (Corak, 2012)

Source: Corak (2012)
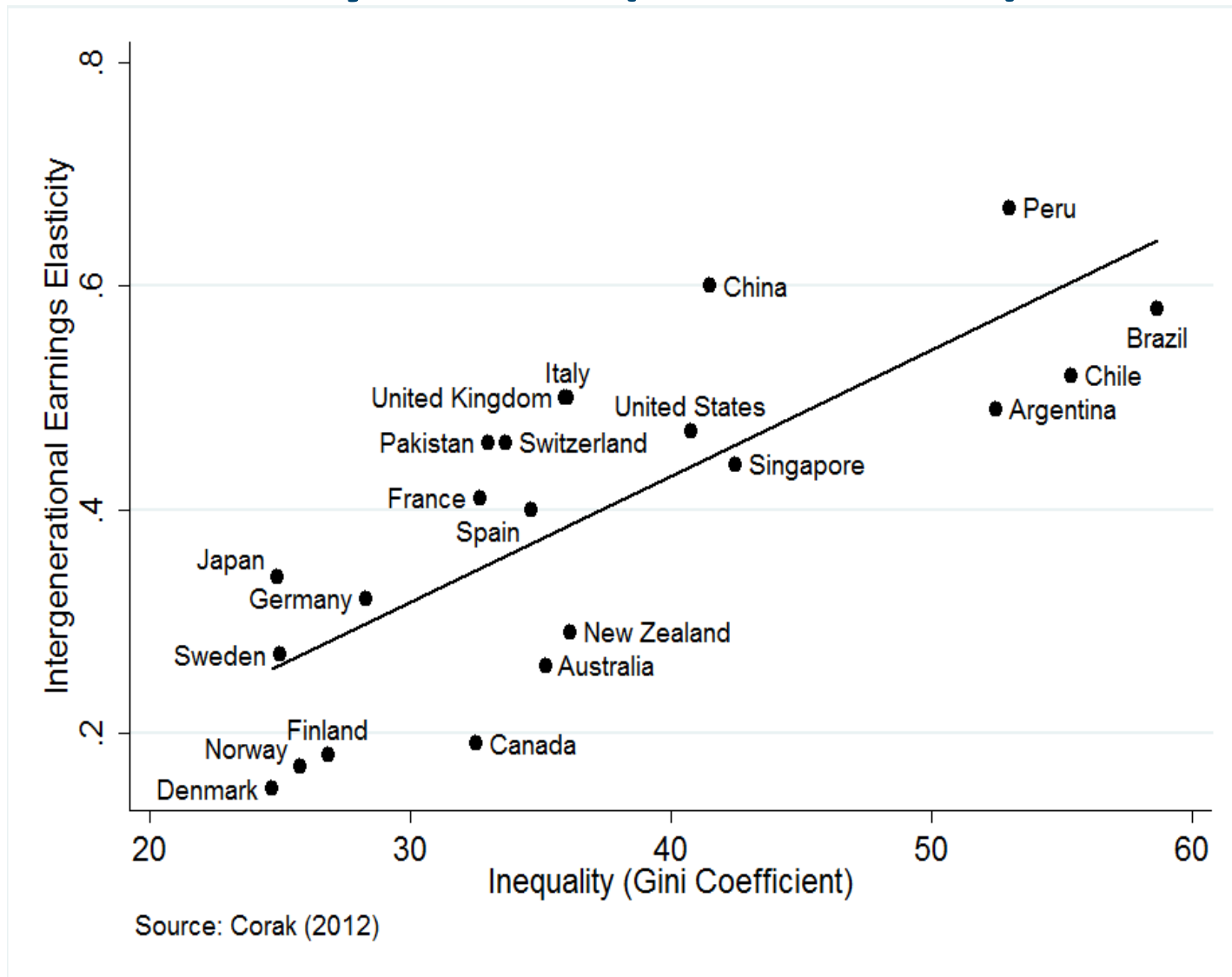
What results arise from optimal tax theory?

- Usually very complex formulas

- But: typically consist of 3 components:

  1. Income distribution   → **observable**

  2. "Welfare weights", i.e. social (fairness) preferences   → **political judgement**

  3. Efficiency constraints (measuring behavioral responses)   → **can be estimated**

- Example
(from Jacobs, 2012):

Table 1: Revenue-maximizing top rates for a selection of countries

Country	Pareto parameter[a]	Effective top rate[b]	Optimal top rate $\varepsilon = 0.3$	Optimal top rate $\varepsilon = 0.15$	Optimal top rate $\varepsilon = 0.45$
Australia	1.89	0.45	0.64	0.78	0.54
France	2.54	0.62	0.57	0.72	0.47
Germany	1.61	0.47	0.67	0.81	0.58
Netherlands	3.35	0.54	0.50	0.67	0.40
Spain	2.04	0.40	0.62	0.77	0.52
United Kingdom	1.77	0.52	0.65	0.79	0.56
United States	1.58	0.43	0.68	0.81	0.58

IPSP Chapter 3 on Inequality

International Panel on Social Progress: www.ipsp.org

Key policy message(s): „it depends":

- Policies can affect inequality **pre-market** (e.g. education, land), **in-markets** (e.g. anti-trust laws), or **post-market** (e.g. redistribution)

- Common objectives, but priorities have to be **country-specific**

New model of the welfare state necessary?

- Political economy matters (e.g. size and strength of middle class, democracy, political coalitions, collective actions)

- Limited scope for international policies (e.g. tax avoidance, evasion; financial sector regulation; carbon pricing)

Consequences of high MTR at bottom: lower LS

Monatliches Bruttoerwerbseinkommen (in Euro)