Progressive Taxation for Our Times

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As developing countries struggle to cope with the pandemic, they risk being set back further by restrictive fiscal policies. These were imposed by rich countries who no longer practise them—if they ever did. Instead, the global South urgently needs bold policies to ensure adequate relief, recovery and reform.

Bold Fiscal Responses Needed

Governments must mobilise and deploy resources sustainably and fairly, consistent with the Sustainable Development Goals (SDGs). With rich countries' refusal to help more, adequate government financing is crucial.

Taxation is typically a more sustainable, effective and accountable way of raising government fiscal resources. But the pandemic has imposed extraordinary demands that require massive urgent spending.

National authorities can generate fiscal resources in two main ways—by collecting revenue or borrowing. Government borrowing is needed as revenue has been hit by the slowdown.

Massive fiscal-resource mobilisation and appropriate spending are needed to contain the contagion and prevent temporary recessions, such as those caused by lockdowns, from becoming debilitating protracted depressions.

Fiscal policy involves both government resource-generation and spending. But developing countries have been far more conservative in spending compared to the richer ones. The latter have introduced much bolder relief and recovery packages.

In the short, medium and long term, government spending and taxation must be progressive. Much depends on how revenue is raised and spent. Hence, both taxation and expenditure need to be considered.

Taxes Less Progressive Now

Governments must quickly develop progressive ways to finance the massive spending that is needed to protect lives and livelihoods. Over the last four decades, many governments have reduced progressive direct taxation, instead embracing regressive indirect taxes.

Higher tax rates on the wealthy made direct taxation progressive. The regression was mainly due to lobbying by powerful elites, including foreign investors. The influential Washington-based Bretton Woods international financial institutions led such advocacy.

Incomes of the wealthy are mainly derived from assets, rather than wages, salaries or payments for goods or services. But tax rates on the highly paid, as well as property, inheritance and corporate incomes, have declined in most countries.

Wealth is often untaxed, or only lightly taxed at lower rates. New rules now allow assets to be moved and hidden abroad. Depending on how one estimates, between USD 8 trillion and 35 trillion is held offshore, obscuring wealth concentration and inequality.

Taxation can reduce existing inequalities, but rarely does so despite the widespread presumption that taxes are progressive overall. Worse, most state spending is regressive, little mitigated by highly publicised social spending.

Difficult to measure, pandemic impacts on various inequalities vary considerably. Nevertheless, the vicious cycle that connects economic disadvantage with vulnerability has worsened disparities.

Ensure Progressive Taxation

To be equitable, taxation must be progressive. More equitable tax systems should get more revenue from those who are most able to pay while reducing the burden on the needy. Wealth taxes are the most progressive way to raise revenue while also reducing inequalities.

Direct taxes on wealth and incomes are potentially progressive. Progressively higher rates and exemptions for the poor can ensure this. Low rates on investment income and assets, such as property, wealth and inheritance, can be increased. Besides reducing inequalities, these can finance progressive spending.

Taxing windfall and excess profits is not only publicly acceptable, but can also raise considerable funds.

Some corporations and individuals have benefited greatly during the pandemic—for example, US billionaires reportedly became over a trillion dollars richer in 2020 and 2021.

In the longer term, progressive taxation means less reliance on indirect taxes, such as sales or consumption taxes, including value-added, or goods and services, tax, which burden those with lower incomes much more.

Tax evasion by the wealthy must also be deterred. Companies that use tax havens to pay less can be penalised—for example, by disqualifying them from all government and state-owned enterprise contracts. Tax systems can thus be made more progressive by improving design and with strict, equitable enforcement.

Equitable Recovery?

Ensuring equitable recovery requires urgent systemic reforms. Although unlikely to yield much more revenue in the near term due to the economic slowdown, introducing such reforms now will be politically much easier.

Taxation can transfer fiscal resources from the wealthy to the needy. Those living precariously, including those now at risk due to the pandemic and its broad impacts, urgently need help. But financing relief and recovery provides liquidity, which can avert protracted economic contraction and stagnation.

Some pandemic relief-spending in many countries has been 'captured' by the politically well-connected, as political elites and their cronies seize the lucrative new opportunities. These compromise not only relief and recovery but also reform efforts.

When relief and recovery are treated as temporary 'one-off' measures, they are unlikely to address pre-pandemic problems, including inequities. Governments should instead use the crisis to advance SDG solutions for both the medium and long term.

Multilateral Cooperation Needed

International cooperation can help, but the rich countries' Organisation for Economic Cooperation and Development (OECD) has long focused on addressing offshore tax evasion to secure more revenue for themselves.

A decade ago, the OECD broadened its attention, but continued to insist on its own leadership at the expense of developing countries. It has thus effectively blocked multilateral tax cooperation for decades, ignoring the UN's strong mandate from various Financing for Development and other summits.

Equitable international tax reforms remain urgent. But these have been undermined by earlier reforms that encourage cross-border flows of funds, enabling illicit financial flows from developing countries.

Although unlikely to yield much revenue for some time, US Treasury Secretary Janet Yellen's global minimum corporate income tax proposal deserves strong qualified support.

Developing countries need to ensure that transnational companies are better taxed, instead of the current G7 proposal for a low rate. Revenue should be distributed according to where both production and consumption take place instead of just where sales occur.

Effectively checking tax abuses also requires access to financial information and common, equitable and transparent rules, not those imposed by the rich. But such outcomes can be achieved only through UN-led multilateralism, with developing-country governments participating as equals.

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