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# Discussion of John Hills' "Consolidation measures on the revenue side: Which tax bases to use to safeguard social equity?"

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# A challenge

- Most people argue that the current economic crisis needs fiscal consolidation / austerity measures to offset public deficits
  - Though it is a non-Keynesian view and « *continued focus on nominal deficit targets runs the risk of compelling excessive fiscal tightening if growth weakens"* (IMF, 2012).
  - Able to restore trust in EU member states capabilities
- But those who most suffer of austerity programs are the most dependent people / the poorest, not those who bear « responsibility » in the raise of the crisis, the bankers, the richest people

« Regarding the composition of austerity measures, cuts in social benefits tend to worsen inequality more than other spending reductions (as in Germany, 1992–99, and Norway, 1993–97); tax-based consolidations that rely more on indirect taxes or are mixed with expenditure cuts tend to worsen inequality (e.g., that in Iceland, 2004–06). »

(IMF, Fiscal Monitor, October 12, p. 56)

# There is room for a debate on social equity and fiscal consolidation

- Then how to manage austerity in such a way it is socially equitable = how to put the greatest burden of austerity on the largest shoulders?
- Knowing that two ways exist – which can be combined – for reducing deficits
  - Cuts in spending (the solution preferred by most governements)
  - Tax increases: tax bases broadening / tax rates increases / tax liabilities increases / novelties on the revenue side.

# What social equity really means?

- The author rightly distinguishes various concepts (or cases relevant for) of social equity
  - Equal contribution / lump sum tax or loss in benefit?

    => actually a regressive device
  - Proportional contribution
    - Related to ability-to-pay / income – but which one: labor? global? / multi-dimensional welfare?
    - Related to largest gains prior to the crisis?
    - Related to responsibility in the crisis?

      => distributionally neutral possibly across time (some were singing yesterday who are crying today)

# What a social equity target implies

- As author says, social equity implies fiscal consolidation at least distributionally neutral, if not progressive.
  - But across-the-board cuts in public spending – preferred option of governments (?) – very likely to be regressive.
  - By contrast, general tax increases are roughly proportional to income (in UK case).
  - Within taxes, progressivity of direct taxes could offset regressivity of indirect taxes.

# Conclusion of the author

We share the author conclusion that…

> "It is hard to avoid conclusion that use of <u>all</u> available tax bases – and tax rates – is necessary to protect social equity, rather than there being a choice between them, and that doing so is likely to be more equitable than most forms of spending cut."
>
> "But even the most attractive options for extending the tax base bring a series of issues that make them difficult, to say the least …"

# Discussion

- I would like to devote my discussion to go beyond the presentation
  - Trying to propose tax packages

    => deemed to imply distributional neutrality
  - Trying to be imaginative

    => tax novelties
  - Being aware of the risk related to mobility

    => tax bases mobility and

    => the optimal decision making level.

# Tax packages (1)

- A first tax package candidate for distributional neutrality is a combination of
  - A VAT increase

    = typically an indirect regressive tax
  - An income tax liabilities increase

    = typically a direct progressive element
    - E.g. a proportional increase of the progressive rate
    - With a removal of « tax niches » in favor of high income taxpayers
  - The two measures are convergent (revenue goes up)

# Tax packages (2)

- A second tax package candidate for distributional neutrality is a combination of
  - A CO2 Tax

    = typically a regressive tax
  - The distribution of energy coupons / vouchers to poor people

    = a new government spending
  - The two measures are <u>not</u> convergent

    => where to put the income threshold?

  Results for France suggest to distinguish between rural and urban municipalities

# Tax novelties (1)

- Assume that taxing those who benefited of rents in the past is socially equitable, especially if their rent seeking activities bear some responsibilities in the crisis

  => Taxing financial activities

  - « Too big to fail » Pigovian argument => tax on the size of the banks through their liabilities towards customers or their assets => kind of insurance premium against an adverse externality
  - No VAT paid => tax on labor compensation in the financial sector

# Tax novelties (2)

- In search of
  - relatively immobile and inelastic tax bases
  - on which a very small tax might generate large revenue,
  - with small distributive effect…

  => A two-sided tax on mobile telephone communications and/or textos?

# The issue of mobility (1)

- Taxing more heavily capital income?
  - Conflict between efficiency rule (tax conversely proportional to mobility) and Haig-Simons equity
  - Raise the issue of, in case of mobility,
    - Rates: EU or upper level coordination
    - Base: how to « immobilise » the base? Exchange of information at EU level / collaborative FATCA (joint statement US and some EU MS, last February) / G20
    - Base: EU coordination => including capital gains (accruing? or realized?) in the tax base in all EU MS?

# The issue of mobility (2)

- Taxing wealth?
  - On an annual basis vs inheritance/bequest/realization
  - Again conflict between efficiency rule (tax conversely proportional to mobility) and Haig-Simons equity
  - Raise issues
    - Expanding the scope of the savings directive
    - Adopting Dutch Box 3?
    - Rates: EU coordination
    - Base: exchange of information at least at EU level / collaborative FATCA
    - Base: EU coordination => including capital gains in the tax base in all EU MS?

# Conclusion

- Assuming that fiscal consolidation is desirable and revenue increase is at stake, we have to
  - Create combinations of tax increases which are distributionally neutral or at least neutral for lower deciles
  - Create combinations of tax increases and compensations s.t. neutral for lower deciles
  - Be imaginative
  - Be aware of mobility issues and of the optimal geographical level for tax design decision making …which then may be larger than for cuts in spending.