Globalization, Tax Reform Ideals and Social Policy Financing

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ABSTRACT This article compares national income tax reforms during the last 25 years. There were two competing models of income tax reform, 'comprehensive' and 'dual' income taxation, the latter of which was in many ways more successful. The reason lies in the structural constraints policy makers face. While taxation of capital income is very costly, creating incentives to lower marginal tax rates, the high overall tax burden on labour makes it difficult to reduce tax rates on labour incomes. These conflicting pressures point towards separate tax rate schedules for capital and labour, as is characteristic of dual income taxes. The analysis has implications for the role of income taxation in achieving social policy outcomes. Most importantly, while progressive taxation of capital income is constrained by high costs, policy makers willing to separate capital and labour income taxation can use the income tax to reduce the tax burden on low wages.

KEYWORDS *ideas*, *income taxation*, *tax competition*, *tax mix*, *tax reform*

Introduction

This article deals with the income tax and its reform. Analysing patterns of income tax reform during the last 25 years – with a focus on Organisation for Economic Co-operation and Development (OECD) countries – provides useful lessons on the potential contribution of the income tax to achieving social policy outcomes and on the role of ideas in policy reform. Income tax policy affects substantive social policy outcomes in two major ways. First, the distribution of the income tax burden adds to the overall redistributive profile of societies. Second, the size of income tax relative to other types of taxes (i.e. the tax mix) may influence policy makers' ability to maintain high social policy expenditures (Kato, 2003; Wilensky, 2002: 430–85). As to the

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role of ideas, the worldwide income tax reform movement is often considered a textbook case of how powerful ideas, supported by particular countries and international organizations, spread around the world (Swank, 1998, 2003; Swank and Steinmo, 2002).

My goal in this article is to throw light on these issues. Within a simple but coherent perspective, I develop the following three claims:

1. *Reform Models*. The quasi-official, though often implicit, ideal type of the income tax reform wave in OECD countries was that of Comprehensive Income Taxation (CIT), according to which all types of income should be taxed jointly under a common rate schedule. In fact, however, most countries have not approximated this ideal. Instead, a second model emerged in the Nordic countries, Dual Income Taxation (DIT), according to which all types of capital income are taxed at a uniform low and proportional tax rate while labour incomes are subjected to a progressive tax rate schedule. The DIT model has influenced reform debates in many countries and has been embraced as a useful and consistent model of tax reform by international organizations such as the OECD.
2. *Structural Constraints*. The success of the DIT model is rooted in the structural constraints that characterize income taxation. Since some types of capital are too sensitive (i.e. costly-to-tax) to be taxed at high marginal and effective tax rates, the CIT approach would lead to income taxation at the lowest common denominator. Taken to the extreme, it would lead to a low proportional rate on all income ('Flat Tax'), thus constraining the progressiveness and revenue-raising potential of the income tax.
3. *Tax Mixes*. High-tax OECD countries have for a long time taken account of these structural constraints by granting large tax privileges to important types of capital income (business profits, capital gains, pension savings, owner-occupied housing), so that high income taxes have not necessarily implied high capital income taxes. Therefore, as exemplified by a country like Denmark, heavy reliance on income taxation has not prevented the building of a large welfare state.

I develop each of these claims in turn. The final section discusses implications for transition and developing countries.

Reform Models: CIT versus DIT

In the last two decades corporate and personal income tax systems have been restructured both in developed and developing countries (e.g. Boskin and McLure, 1990; Faria, 1995; Ganghof, 2000; Messere, 1993; Messere et al., 2003; Pechman, 1988; Shome, 1999). Basically, marginal tax rates have been cut and tax bases broadened. The recent literature on the political economy

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RÉSUMÉ

La Mondialisation, les Idéals de la Réforme Fiscale et le Financement de la Politique Sociale

Cet article analyse des types de réforme des impôts sur le revenu pendant les derniers 25 ans, et se concentre principalement – mais pas exclusivement – sur les pays qui appartiennent à l'Organisation de Coopération et de Développement économiques (l'OCDE). L'analyse fournit des leçons utiles sur le rôle des idées dans la réforme de la politique générale et le rôle des impôts sur le revenu dans l'accomplissement de résultats de politique sociale. L'article montre qu'il y avait deux modèles concurrents de réforme des impôts sur le revenu – la taxation 'compréhensive' et l'imposition 'double' sur le revenu – et que cette dernière avait plus de succès. La raison provient des contraintes structurales devant lesquelles les décideurs se trouvent. La taxation de beaucoup de sortes de revenus du capital coûte cher, et cela donne une forte motivation à baisser les taux d'imposition. Au même temps, la grande charge fiscale sur le travail donne une forte motivation à maintenir les taux marginaux d'imposition supérieurs sur les revenus du travail à un niveau élevé. Ces contraintes incompatibles indiquent des programmes distinctifs de taux d'imposition pour les revenus du capital et les revenus du travail – un trait distinctif de l'imposition double sur le revenu. L'analyse a des implications simples pour le rôle des impôts sur le revenu à atteindre des résultats de politique sociale. Premièrement, la taxation progressive sur le revenu du capital est gravement contrainte par des coûts élevés, mais si les décideurs sont prêts à séparer les impôts sur le revenu du capital des impôts sur le revenu du travail, ils peuvent utiliser les impôts sur le revenu afin de réduire la charge fiscale sur les salaires bas. Deuxièmement, les impôts dégressifs (les impôts indirects et les contributions à l'aide sociale) ne mènent pas forcément plus aux dépenses sociales élevées que les impôts sur le revenu – surtout parce qu'un taux élevé d'imposition sur le revenu ne suppose pas automatiquement une imposition élevée sur le revenu du capital.

RESUMEN

La Globalización, los Ideales de la Reforma Fiscal y la Financiación de la Política Social

Este artículo examina las pautas de la reforma del impuesto sobre la renta durante los últimos 25 años, enfocándose principalmente – pero no exclusivamente – en los países de la Organización para la Cooperación y el Desarrollo Económicos (la OCDE). El análisis ofrece lecciones útiles sobre el papel de las ideas en la reforma de las políticas, y el papel del impuesto sobre la renta para lograr resultados de política social. El artículo muestra que había dos modelos competidores de reforma del impuesto sobre la renta – los impuestos «integrales» y los impuestos «dobles» – y que el último tuvo más éxito. La razón se encuentra en las limitaciones estructurales que las personas que formulan las políticas enfrentan. Los impuestos sobre muchos tipos de rentas derivadas de capitales cuestan mucho, y a consecuencia de esto hay fuertes incentivos para bajar las tasas impositivas. Al mismo tiempo, la gran carga fiscal sobre el trabajo da fuertes incentivos para mantener las tasas impositivas marginales superiores sobre la renta del trabajo a nivel alto. Estas presiones opuestas indican programas diferentes de tasas impositivas para la renta de capitales y la renta del trabajo – como es característico de los impuestos dobles sobre la renta. El análisis tiene consecuencias sencillas para el papel de los impuestos sobre la renta en la consecución de resultados de política social. En primer lugar, los impuestos progresivos sobre la renta de capitales se encuentran muy constreñidos por los gastos altos. Sin embargo, si las personas que formulan las políticas están dispuestas a separar los impuestos sobre la renta de capitales de los impuestos sobre la renta del trabajo, pueden utilizar los impuestos sobre la renta para rebajar la carga fiscal sobre los sueldos bajos. En segundo lugar, los impuestos 'regresivos' (los impuestos indirectos y las cotizaciones) no son forzosamente más propicios para los altos gastos sociales que los impuestos sobre la renta, precisamente porque un nivel alto de impuestos sobre la renta no implica automáticamente un nivel alto de impuestos sobre la renta de capitales.

BIOGRAPHICAL NOTE

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