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## **Asset-Centred Redistributive Policies for Sustainable Development**

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# Asset-Centred Redistributive Policies for Sustainable Development

Pierre Kohler\*

April 2014

## Abstract

Analyses of redistributive policies generally focus on income flows while subordinating most concerns to the overarching objective of promoting economic growth. This paper follows an alternative approach with the objective of proposing an asset-centred analytical framework, which encompasses income flows, but is centred on the stock of income-generating assets in the private and public sectors. Such a stock-flow approach reveals an artificial blind spot common to many analyses of redistributive policies: wealth redistribution. The proposed framework further allows better outlining key linkages between redistributive policies and sustainable development, including issues arising from the private ownership and overexploitation of finite natural resources. Contrasting the potential scope of asset-centred redistributive policies with the more narrow set of policies that have been implemented in most countries/regions over the last 30 years, the paper makes several recommendations for redistributive policies in support of greater equity, economic democracy and sustainable development.

JEL Classification: D31, H2, H3, H4, H41, H71, H82, H87

Keywords: Income, wealth, inequality, public social spending, revenue mobilization, progressive tax system, net wealth tax, carbon tax, international tax cooperation, post-2015

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# 1. INTRODUCTION

The increasingly cooperative nature of wealth production and creation processes stands in sharp contrast with the growing concentration of wealth and income that may represent an inherent feature of capitalism (Piketty 2013). Redistributive policies are an essential component of strategies for reducing inequality and promoting sustainable development in its three dimensions: economic, social and environmental. They represent a powerful policy instrument for improving equality of outcome through the redistribution of income and, more importantly, for enhancing equality of opportunity through the redistribution of income-generating assets, such as human capital and wealth (including land and industrial and financial capital) across individuals as well as between the private and the public sector. Beyond their strong potential for reducing inequality, redistributive policies are also key for promoting values that are consistent with sustainable development and for shaping a socio-economic context and incentives that are conducive to financial stability and economic development, political inclusion, gender equality and social mobility, as well as environmental sustainability.

The large set of redistributive policy tools available to governments can be regrouped in three broad categories, including the provision of public goods, income redistribution and wealth redistribution. While adequate and sustained public expenditure is required for warranting access to social protection and social services, such as quality education and healthcare, government revenue can be collected in various ways, including through progressive taxation of income and wealth as well as of harmful environmental externalities arising from unsustainable production and consumption. Furthermore, under specific conditions, public ownership of income-generating assets, especially natural resources, can effectively socialize economic rents, increase revenue mobilization and potentially foster a less reckless exploitation and more sustainable management of finite assets to the benefit of current and future generation.

Yet, the approach to redistribution prevailing in many countries consists in a resource-constrained provision of public goods underpinned by insufficient redistribution of income, with progressive wealth redistribution remaining a major blind spot. Partly as a result of inadequate redistributive policies, inequality is rising in many countries, the underprovisioning and underfunding of public goods is widespread and externalities harmful to global commons, which are generated by the unsustainable exploitation of natural assets, are universally underpriced. Against this inconvenient backdrop, recurring projections (Piketty 2013, Stern report 2006, OECD 2012) highlighting the costs and consequences of inertia in economic, social and environmental terms resonate as a continuous invitation for renewed thinking and urgent action.

This paper calls into question the premises of the prevailing approach to redistribution in two different ways. First, it proposes an alternative approach to redistributive policies that encompasses income flows, but which is centred around the stock of income-generating assets. Conceptualizing redistributive policies from a stock-flow perspective highlights the central role of income-generating assets and wealth in particular as a determinant of income and resulting income and wealth inequality. This paper argues that overcoming the blindness to wealth of the prevailing approach is required for a more serious discussion about how to design redistributive policies in pursuit of development objectives (e.g., efficient taxation, progressive and increased revenue mobilization, poverty reduction, equality of opportunity,

etc.). Secondly, an asset-centred<sup>1</sup> analytical framework is better suited for conceptualizing redistributive policies in light of their linkages to equity and sustainable development. This paper argues that in a context characterised by growing sustainability challenges, such as rising wealth inequality and carbon emissions, and the upcoming transition from the MDGs to SDGs, redistributive policies can no longer be assessed exclusively in light of their impact on economic growth and must be shaped in pursuit of more important objectives.

The objective of this paper is to propose an asset-centred analytical framework for (i) mapping the most important redistributive policy tools that shape the distribution of income and income-generating assets across individuals as well as between the private and the public sector and (ii) outlining key linkages between redistributive policies, in-equity and un-sustainable development. The paper further aims at (iii) contrasting the potential scope of redistributive policies with the more narrow set of policies that have been implemented in most countries/regions over the last 30 years in order to (iv) derive recommendations for redistributive policies in support of greater equity and sustainable development in the post-2015 context.

Section 2 proposes an asset-centred analytical framework to clarify the role redistributive policies play in reducing (or increasing) inequality by redistributing income and income-generating assets in a progressive (or regressive) manner. It further presents stylized facts and suggestive evidence illustrating some key linkages to in-equity and un-sustainable development. Section 3 discusses trends in redistributive policies in an evolving intellectual, political and institutional context that is currently deeply influenced by the prevailing political consensus and commitment to private investment-led economic growth.<sup>2</sup> It discusses the MDG inflexion and its positive impact on public social spending, including education, health and social protection, but also stresses weaknesses of the MDG development agenda with regard to ensuring adequate and stable funding and addressing environmental sustainability issues. The section examines changes in the collection of non-tax revenue deriving from the accelerated exploitation of natural resources. The prominence of increasingly regressive tax structures leads to a discussion of factors subverting progressive revenue mobilization, such as slashes in wealth, top personal and corporate income tax rates, the increased use of regressive indirect taxes (unfortunately not targeting environmental externalities), and growing tax abuses, including harmful tax competition, tax avoidance and evasion by high net worth individuals (HNWIs) and transnational corporations (TNCs). The section also highlights redistributive policies that positively contributed to equity and sustainable development, especially in Latin America. Section 4 proposes recommendations for moving towards a framework enabling asset-centred redistributive policies promoting equity and sustainable development. It also emphasizes the limits of domestic policy initiatives and the need for increased international cooperation, notably regarding the taxation of mobile capital income and financial wealth of HNWIs and TNCs. Section 5 concludes.

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<sup>1</sup> There is an interesting literature on “asset-based” social policies that is divided in two main strands (see Prabhakar 2009 for a brief overview). One strand supports wealth redistribution on the grounds that citizenship bestows a set of rights upon all members of a political community. Another strand supports access to assets, because owning assets may change individual behaviour in ways that bring economic and social benefits. While this paper acknowledges the importance of “asset-based” policies, it also discusses the necessity of “income-based” policies. The term “asset-centred” is therefore preferred.

<sup>2</sup> The commitment to private investment-led economic growth is reflected in the preambles of leaders’ declarations published after meetings of global governance bodies. The Lough Erne leaders’ declaration (G8 2013), for instance, begins by stating that « private enterprise drives growth, reduces poverty, and creates jobs and prosperity for people around the world. Governments have a special responsibility to make proper rules and promote good governance. » The emphasis on private enterprise as the driver of development is generally less pronounced in the declarations of G20 leaders.

## **2. REDISTRIBUTIVE POLICIES, EQUITY AND SUSTAINABLE DEVELOPMENT**

### **2.1. An asset-centred analytical framework**

Figure 1 proposes an analytical framework for mapping most of the redistributive policy tools that are discussed in this paper as well as some of the key linkages to equity and sustainable development. This framework is centred on income-generating assets that play a key role in shaping income along with transfers and taxes.<sup>3</sup> Policy instruments have been regrouped in three broad categories, including the provision of public goods, income redistribution and wealth redistribution.

The asymmetric distribution of income-generating assets across individuals generates asymmetric labour and capital income flows, but both are shaped by redistributive policies that govern their structural distribution across private agents as well as between the public and private sector. Income-generating assets, which are a key determinant of equality of opportunity, include human capital embodied in people, such as education and knowledge, as well as property rights protecting accumulated wealth ensuring rents to owners of land and industrial and financial capital. While progress towards the MDGs has fostered human capital and improved its distribution across countries and social groups (UNDP 2012), wealth remains highly concentrated at the global level, with the top 1 per cent owning 40 per cent of global wealth (UNDP 2013) and the 85 richest individuals having an estimated net worth equivalent to that of the poorest half of the planet (Oxfam 2014). At the domestic level, wealth is similarly concentrated, with the top decile controlling between 70 per cent to 90 per cent of total national wealth in many countries (Davies et al. 2011, Piketty 2013).

In most countries, redistributive policies focus on the provision of public goods to enhance equality of opportunity and on income redistribution for funding the latter and reducing inequality of outcome. The MDGs strongly emphasized the need for increasing public social spending on education and health in particular in order to foster human capital, extreme poverty reduction and economic growth. Yet, narrow and weak political coalitions as well as insufficient economic development still prevent many countries from raising the tax revenue required to expand government services beyond basic security services protecting existing ownership and debt structures (Winters 2011, Graeber 2012) in order to fund transfers required to eradicate poverty, reduce inequality and promote social welfare. The monopoly of (legitimate) violence required for operationalizing the public provision of law and order through courts, police and prisons matters for redistribution in at least two ways that are often overlooked. First, in many countries public provision of law and order is primarily intended to protect existing property rights, which benefits a minority of wealth-holding individuals who would otherwise have to disburse private funds to protect their wealth. Secondly, the threat of the use of violence shapes individual behaviour so as to prevent any challenge to unfair contracts or to the existing ownership and debt structures.<sup>4</sup>

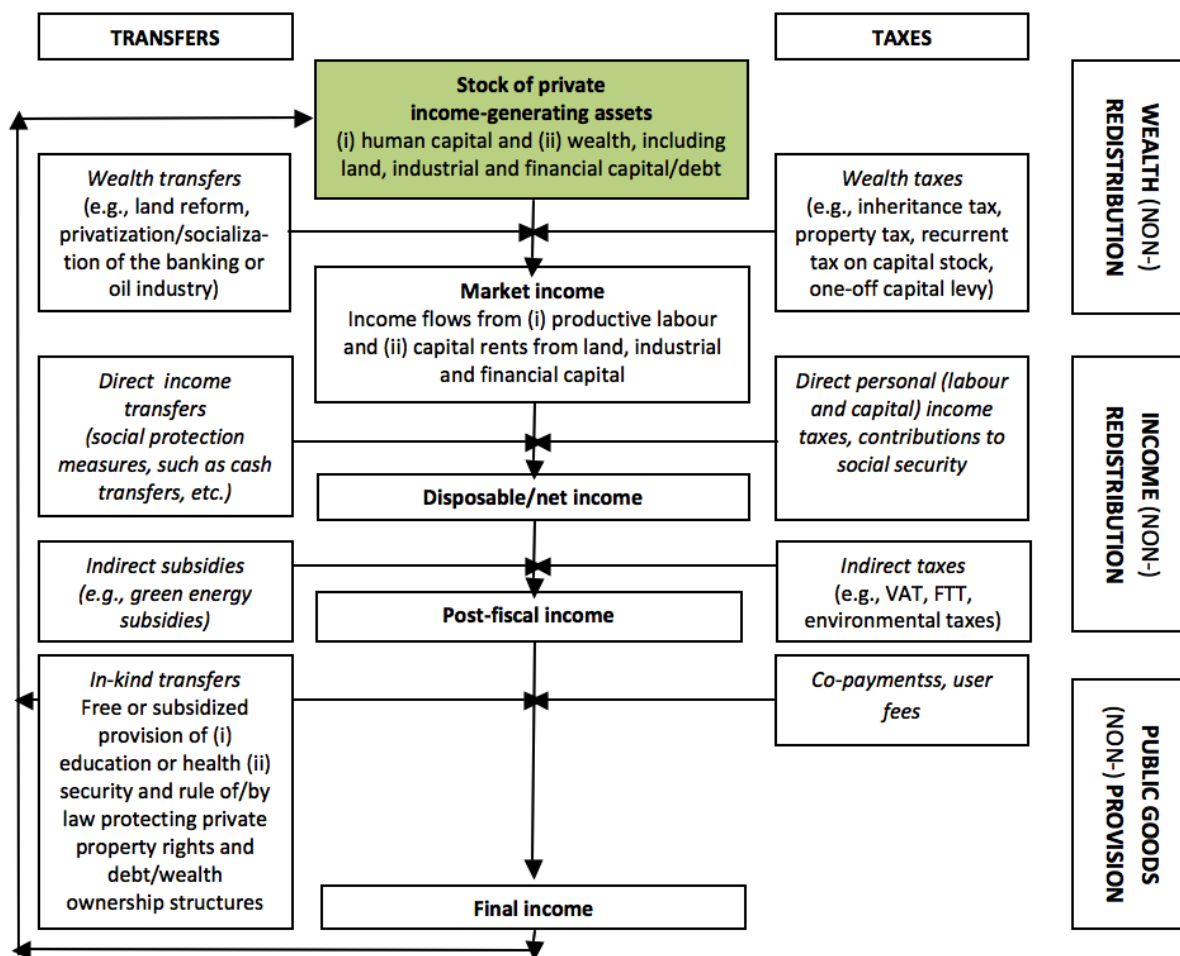
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<sup>3</sup> There is an interesting literature on “asset-based” social policies (see Prabhakar 2009 for a brief overview). While this paper acknowledges the importance of “asset-based” policies, it also discusses the necessity of “income-based” policies. The term “asset-centred” is therefore preferred.

<sup>4</sup> The provision of public goods that tend to increase or maintain inequality is often overlooked along with the repressive dimension of government. This is partly due to empirical hurdles. Recently, some researchers have

Progressive direct taxes revenue and direct transfers, which stabilize disposable income and thus protect vulnerable individuals against market fluctuations, are generally much higher in developed countries. As a corollary, the increased reliance of developing countries on regressive indirect tax revenue makes progressive transfers even more important for reducing inequality. Indirect transfers and taxes are far from irreconcilable with equity and sustainable development, however. For instance, value-added tax on luxury goods, financial transaction taxes, green energy subsidies, border carbon taxes and exponentially progressive taxes on frequent flyers (instead of air miles reward programmes) could foster equity and shape incentives for more sustainable production and consumption.

**Figure 1: Redistributive policy instruments determining the structural distribution of income-generating assets and income**



Source: Author. Note: VAT stands for value-added tax, FTT stands for financial transaction tax.

Wealth redistribution among private actors is generally ignored as a redistributive policy tool, despite its key role for fostering equality of opportunity through the unwinding of concentrated ownership structures, and its potential for enhancing economic efficiency and sustainable development. For instance, wealth transfers, such as land reform, can induce more efficient and sustainable land use (Sobhan 2010, Moyo 2013), and taxing wealth is of superior economic efficiency than taxing income, because it promotes labour income over

documented the relation between the rise in security services and inequality across a number of countries. See Bowls and Jayadev (2014)

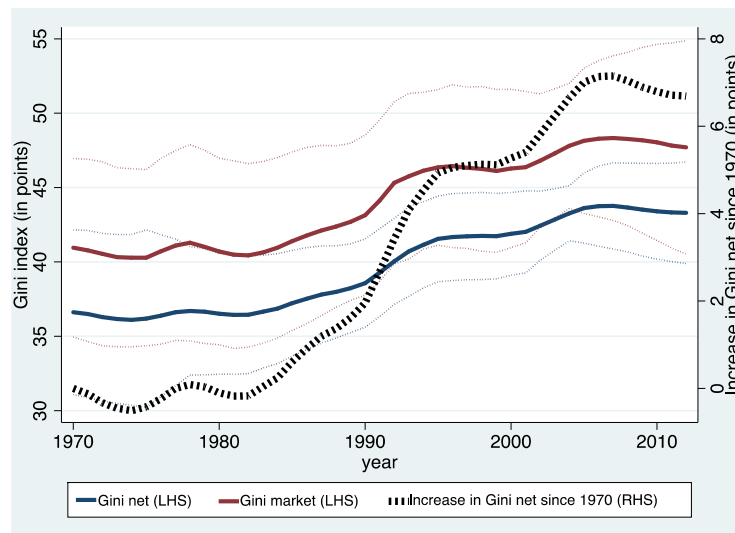
rent income and incentivizes wealth holder to invest their capital (Stiglitz and Dasgupta 1971, Piketty 2013). Wealth redistribution between the public and private sector is more common. Over the last decades, market-friendly policies led many countries to increasingly privatize public income-generating assets, but resource nationalism has also led a small number of countries to reappropriate profits/ownership of formerly privatized assets, socializing economic rents and scaling down the exploitation of natural resources to the benefit of current and future generation (see also United Nations 2014, chapter 2).

## 2.2. Stylized facts about redistributive policies and linkages to in-equity and un-sustainable development

### 2.2.1. The weakening impact of redistribution at the global level over time

The impact of redistributive policies on income inequality and sustainable development can be significant, but it varies across countries and over time as redistributive policies are shaped by domestic factors, such as demography, economic and political conditions, and further influenced by the international strategic and ideological context. At the global level, the impact of redistributive policies was strongly influenced by major wars, strategic shifts and ideological inflexions. Following a period of stronger economic growth and redistribution that reduced income inequality in many countries after the Second World War and during the first decades of the Cold War, the neoliberal policies initiated in Anglo-Saxon countries, Chinese market reforms and the fall of the Iron Curtain all weakened redistributive policies and their impact on rising income inequality.

**Figure 2: The weakening impact of redistribution and higher within-country income inequality at the global level (1970-2012)**



Source: Author. Note: Based on SWIID (version 4.1) and UNPOP data. Dotted lines indicate 95 per cent confidence intervals for market and net Gini coefficients. Global market and net/disposable inequality indices are computed as population-weighted averages of within-country Gini indices as defined in the SWIID database. See figure 1 for an illustration of the difference between market and disposable/net income.

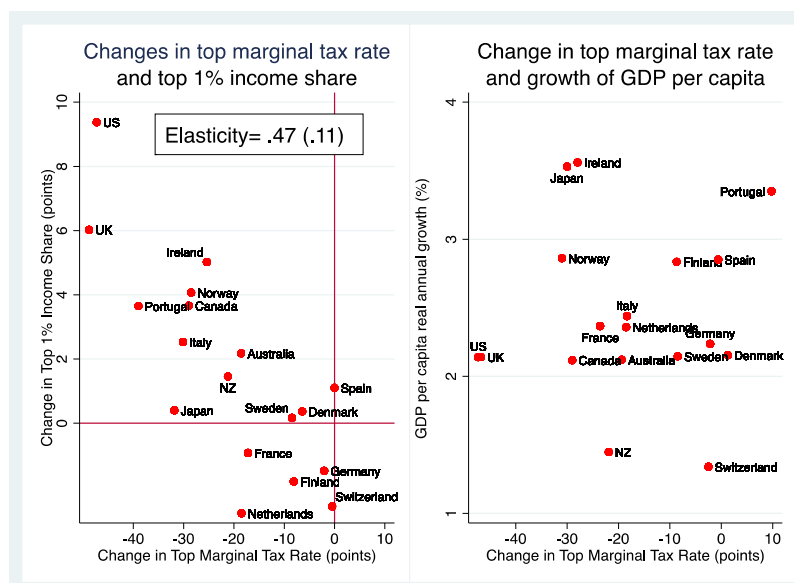
Figure 2 reflects the evolution of the population-weighted global averages of domestic market Gini (before direct taxes/transfers) and net Gini (after direct taxes/transfers) coefficients between 1970 and 2012. Both indices increased in tandem over that period as they were influenced by various factors, including redistributive policies. As market-friendly policies gained steam and institutionalized, market income inequality increased rapidly starting in the



mid-1980s, with slashes in top marginal income and corporate tax rates encouraging rising executive pay and shareholder dividends mostly accruing to the wealthiest (Piketty et al., 2014). As direct transfers were not stepped up to compensate for rising market income inequality, at least 75 per cent of the world population experienced higher net/disposable income inequality at the domestic level. On average, market and net Gini coefficients have increased by almost 7 points since the mid-1980s, reaching 47.7 points and 43.3 points in 2012, respectively.

On average, the reduction in income inequality that is observed when comparing market and net/disposable income distributions is mostly explained by direct transfers, which account for about 80 per cent of the reduction (IMF 2013a, Cornia 2012). This observation may at first be interpreted as a sign that direct transfers are much more efficient than direct taxes for reducing disposable/net income inequality, but such an interpretation overlooks several important points. First, taxes and transfers are not substitutes, and it is important that they complement each other in order to consistently reinforce the overall impact of redistributive policies. Secondly, direct transfers can be funded by direct *and* indirect tax revenue. The inequality-reducing effect of direct transfers should therefore be larger than the effect of direct taxes, especially in developing countries where indirect taxes generate a larger share of government revenue. Thirdly, the observation that direct taxes only account for about 20 per cent of the net/disposable income inequality reduction highlights how poorly progressive direct tax collection is in many countries. Finally, in addition to their impact on disposable/net income inequality, progressive direct taxes have the additional role of deterring excessive compensation, which has become a key driver of rising market income inequality in many countries (Piketty, Saez and Stancheva 2014, Alvaredo et al. 2013). Countries that have most extensively implemented neoliberal prescriptions to slash wealth, top personal and corporate income tax rates also experienced the most significant rise in top income shares since the early 1980s, without registering the promised higher economic growth (figure 3).

**Figure 3: Changes in top marginal tax rates, top 1 per cent income shares and real annual per capital GDP growth (1960-4 and 2005-9)**



Source: Piketty, Saez and Stancheva (2014). Note: the same pattern is observed over the 1975-2008 period (Piketty, Saez and Stancheva 2011). See also the World Top Incomes Database project: <http://topincomes.g-mond.parisschoolofeconomics.eu>. R2 is 0.56 in the left panel and =0.00 in the right panel.

Figures 2 and 3 both highlight a significant rise in income inequality over the decades, but both underestimate it for different reasons and may potentially downplay the efforts required for reducing inequality. Survey-based income inequality measures, such as Gini estimates in figure 2, often rely on data samples that truncate the top of the income distribution, because top incomes are under-represented in surveys or due to top-coding method shortcomings (Alvaredo 2010). Top income shares in figure 3 are estimated using non-truncated fiscal data, but under-reporting of income to tax authorities is common and tax evasion has grown exponentially over the last decade (Palan et al. 2010, Zucman 2013). Furthermore, top fiscal incomes generally only represents a tiny fraction of top effective economic incomes, which go largely untaxed, because tax avoidance schemes de facto exclude many capital income flows from the tax base. Consequently, measures imposing higher top marginal tax rates on fiscal income without strengthening its tax base, such as the Buffett rule, are of limited significance (Piketty 2013).

### **2.2.2. Redistribution of income , in-equality of outcome and un-sustainable development**

The redistributive impact of taxes and transfers is most significant in developed countries, in accordance with the Wagner Law, which observes that government revenue/spending increases steadily with GDP, because of the gradual formalization of the economy and the related greater ease to tax. Significant differences among countries with similar income levels, however, highlight the role of institutions, governance and political inclusion.

In developed countries, weaker taxes on top incomes reduced the ability of redistributive policies to contain excessive compensation, but social protection measures<sup>5</sup> stabilize the income of most vulnerable individuals and social groups, shielding them from extreme poverty and reducing income inequality to a limited extent. In Western and Northern Europe, for instance, government (tax and non-tax) revenue and expenditure amount to around 45 per cent of subregional GDP. Direct taxes and transfers alone reduce income inequality by around 15 Gini percentage points, about four times the global average (figure 4).

By contrast, in developing countries the predominantly rural and informal economic structures, weak tax administrations as well as the weaker and more narrow political coalitions often prevent the development of strong progressive redistributive institutions (Joshi et al. 2012), thus generating more unequal societies, where extreme poverty stands in sharper contrast with extreme wealth. Government (tax and non-tax) revenue and expenditure amount to between 20 to 35 per cent of GDP in most developing subregions, a larger share of it being spent on basic security and other core functions of government, inducing only a weak reduction in income inequality.

Countries with less developed redistributive policies consistently experience higher levels of income inequality, but outcomes further depend on the pattern of redistribution. Southern Africa and Southern Europe, for instance, have comparable levels of total revenue and

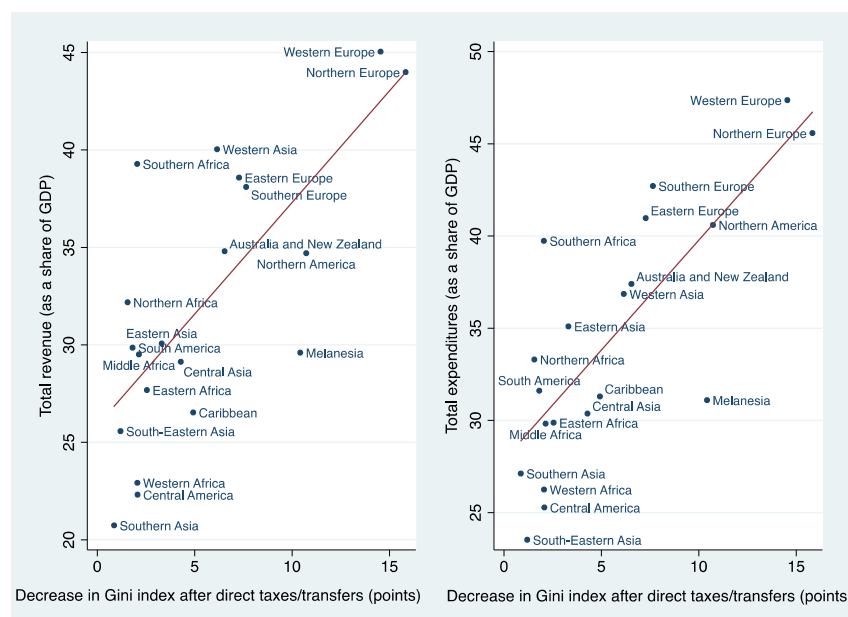
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<sup>5</sup> Social protection encompasses direct income transfers funded through contributory (social insurance) or non-contributory (social assistance) programmes. While social insurance generally only covers individuals active in the formal employment sector, social assistance potentially covers the entire population and is fundamental for reducing extreme poverty. Social protection includes transfers such as pensions, work injury and invalidity benefits, sick pay, maternity leave, unemployment benefits, child and family allowances, (non-) conditional cash transfers (CCT), food/cash for work, but also subsidized goods, such as food or housing.

expenditures amounting to around 40 per cent of subregional GDP, but their composition are much less progressive in the former. On the revenue side, Southern Africa is strongly reliant on regressive indirect taxes, such as value-added taxes, that penalize the poor. On the expenditure side, capital expenditures absorb a larger share of public spending, resulting in higher potential economic growth and, more tangibly, in weaker redistribution and extreme inequality of outcome.

Direct monetary transfers through social protection programmes are the most direct way to alleviate poverty, but insufficient transfers and coverage as well as discriminatory practices often leave large segments of the population in developing countries vulnerable to temporary economic risks and enduring extreme poverty. Furthermore, gender-blind approaches to social protection often directly discriminate against women in developed and developing countries. In addition to employment and wage discrimination experienced in the labour market, most women standing at the crossroad of paid work and unpaid care work suffer the injustice of social insurance schemes that assume full-time, formal and life-long employment as the norm (Razavi et al. 2012). As women represent a majority of the poor, increased gender awareness in the design of more ambitious social protection programmes is key for poverty reduction, gender equality and sustainable development.

**Figure 4: Redistributive policies and income inequality reduction across subregions (2006)**



Source: Author. Note: Based on data from SWIID (version 4.1), UNPOP and Torres (2013). Subregions are defined according to the UN definition (see <http://unstats.un.org/unsd/methods/m49/m49regin.htm>). The year 2006 was chosen, because Torres (2013) gathered accurate revenue and expenditure data for a large number of countries for the year 2006. All variables are population-weighted. Tax revenues include income taxes, payroll taxes, taxes on goods and services, trade taxes and other taxes, but exclude revenue from grants and non-tax revenue (e.g., revenue from oil, etc.). Current expenditures cover compensation of employees and social benefits, but exclude capital expenditures and interest payments. R2 is 0.52 in the left panel and 0.60 in the right panel.

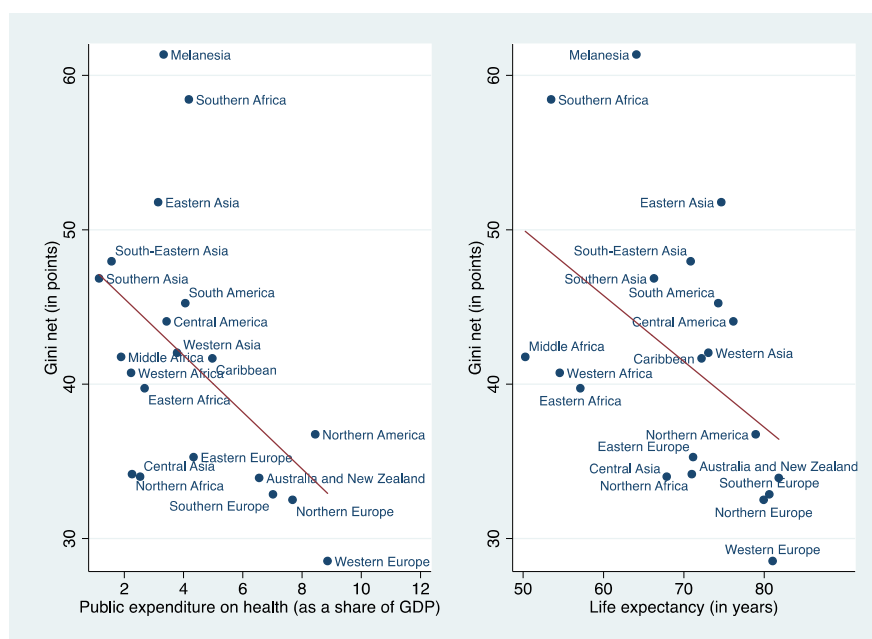
### 2.2.3. Redistribution of income-generating assets, in-equality of opportunity and un-sustainable development

#### *Human capital*

Redistributive policies can also foster equality of opportunity by shaping the distribution of income-generating assets, including human capital. Public spending on education and health, which are key for building up a strong and productive labour force, has gained prominence in the development debate in the wake of the Millennium declaration that enshrined education and health objectives at the heart of the international development agenda (e.g., ensure universal access to primary education and gender equality in secondary education, reduce child and maternal mortality). Yet, with a few exceptions, public social spending increased only modestly in most developing countries. In 2010, public spending on education ranged between 3 and 6 per cent of GDP in most developing subregions, while public spending on health was still inferior to 2 per cent of GDP in some developing subregions.

Increased public social spending generally fosters human development, but this link seems weaker in presence of high income inequality. Figure 5 shows that subregions with high income inequality are generally less successful in mobilizing resources for human development. Consequently, populations in these subregions face prospects of shorter life expectancy, one of the core-components of human development..

**Figure 5: Income inequality, public health spending (as a share of GDP) and human development across subregions (2010)**



Source: Author. Note: Based on WDI, SWIID (version 4.1) and UNPOP data. All variables are population-weighted. R2 is 0.31 in the left panel and 0.22 in the right panel.

Besides hampering resource mobilization for public social spending, inequality further exerts direct negative effects on health outcomes, with broader implications for sustainable development. Interestingly, almost all problems that are common at the bottom of the income ladder within countries are more common in more unequal societies. Among developed countries, where extreme poverty has already been eradicated, more unequal societies systematically experience more health and social issues, such as shorter life expectancy,

higher infant mortality, mental illnesses, such as drug and alcohol addiction, obesity, but also teenage births, lower levels of trust, social immobility as well as more homicides and higher incarceration rates (Wilkinson and Pickett 2011). The negative impact of inequality on health and social cohesion in rich countries signals that well-being is about more than escaping material poverty and significantly depends on social structures and symbolic hierarchies, which are most clearly reflected in the degree of income inequality. In developing countries where poverty reduction remains the main lever for improving health outcomes, policies reducing income inequality could contribute to simultaneously reducing poverty and improving health outcomes (Wilkinson and Pickett 2011).

Similar direct linkages exist between equity, education and sustainable development. A comparison of 13 developed countries highlighted that higher income inequality is consistently associated with lower inter-generational earnings and social mobility (Corak 2013). Additionally, spending on higher education in developed countries may be rising, but it is often biased towards elite universities that strengthen social stratification, social immobility and self-reproduction of the elite (Brezis and Hellier 2013). These findings all point at the limits of redistributive policies that aim at fostering sustainable development exclusively through human development, disregarding the role of income and wealth inequality as structural determinants of health and education outcomes across individuals and generations.

### ***Wealth, including land and industrial and financial capital***

Unsurprisingly, redistribution of other income-generating assets protected by property rights, such as wealth ensuring rents to owners of land and industrial and financial capital remains less prominent in domestic and international discussions. The absence of public debate on this issue is related to several factors, including poor political and media governance tempering the demand for information about the extent of wealth inequality, as well as insufficient awareness about the role of wealth inequality in perpetuating income poverty. It is also partly due to the widely held view that markets work efficiently and result in fair outcomes provided equality of opportunity, i.e. equal access to education, is upheld. Beyond the problem that equality in access to education remains incomplete in many countries and is often limited to primary or secondary education, this approach is based on an overly narrow definition of equality of opportunity, which unreasonably puts exclusive emphasis on human capital and ignores all other forms of capital that shape the opportunities that are available to individuals.

As mentioned above, wealth inequality is more pronounced than income inequality and represents an obstacle to sustainable development. In many countries, high concentration of land ownership contributes perpetuating inequality and eroding incentives for sustainable agricultural methods and land use (Sobhan 2010, Moyo 2013). Similarly, concentrated ownership structures of industrial or financial capital heighten risks of market power abuse and the unfair distribution of economic gains. Evidence further shows that returns to financial capital consistently increase with financial wealth to the point of reaching more than 10 per cent per year on average for fortunes totalling more than \$20 billion.<sup>6</sup> By channelling capital

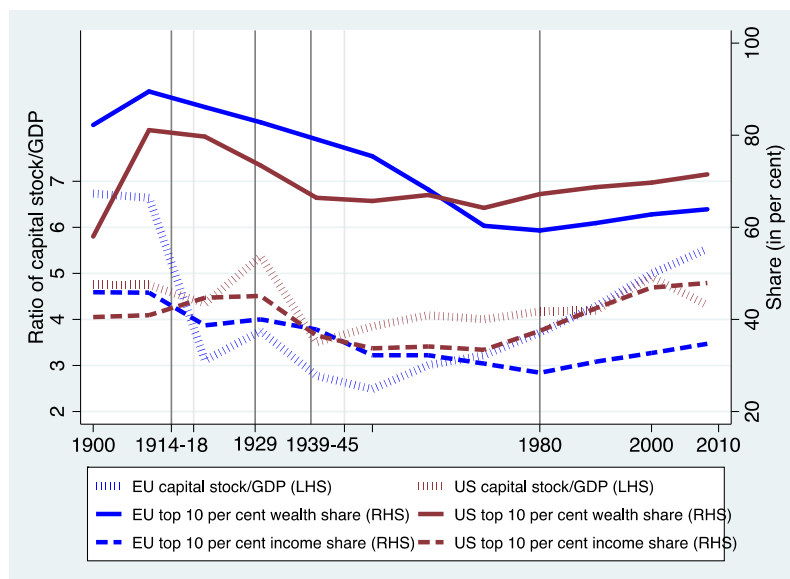
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<sup>6</sup> A transparent example is given by the capital endowment of universities in the United States. Information about those endowments and their returns is publicly available. In 2012, they ranged from \$11.5 million for North Iowa Community College to about \$30 billion for Harvard. Records show that over the period spanning from 1980 to 2010, returns on capital endowments inferior to \$100 million averaged 6.2 per cent, while returns to endowments superior to \$20 billion (Harvard, Yale and Princeton) averaged 10.2 per cent. The Forbes billionaires' list, which is published annually, also indicates larger fortunes tend to grow faster than smaller

income to the exclusive benefit of a wealthy minority, high financial wealth inequality nurtures explosive income and wealth inequality.

Wealth concentration can be particularly problematic when the after-tax return on capital ( $r$ ) is much higher than economic growth ( $g$ ), which is currently the case in many countries experiencing rising inequality. For instance, if  $r=5$  per cent and  $g=1$  per cent, the split between capital income and labour income will remain stable only as long as wealth holders consume 80 per cent of their capital rent and reinvest the remaining 20 per cent, but it will start growing if wealth-holders reinvest more than 20 per cent of capital income. Furthermore, if returns to financial capital consistently increase with financial wealth, wealth concentration may increase steadily even if the split between capital income and labour income remains stable at the aggregate level (Piketty 2013). While the capacity of governments to boost technological innovation and economic growth in the long run may be limited (and lower economic growth, especially in developed countries, may be required for the sake of climate stabilization), many governments have implemented policies boosting the after-tax return on capital over the last three decades, with little regard for equity and sustainable development, and mitigated or negative effects on long-term economic growth (Ostry and Berg 2011, Ostry et al. 2014).

**Figure 6: Capital stock accumulation, and the mutually reinforcing dynamic between wealth and income inequality in Europe and the United States (1900-2010)**



Source: Author based on Piketty (2013). Note: The EU regroups France, Germany, Sweden and the United Kingdom. Income shares are pre-tax estimates. Capital stock and the derived wealth shares include land and industrial and financial capital.

The reinforcing interaction between capital accumulation, income and wealth concentration is best documented in countries where inequality can be assessed based on long-term fiscal data capturing information about the top of the income and wealth distribution. Figure 6 illustrates how the Great Depression and wars depleted the aggregate capital stock in the first half of the twentieth century in the United States and especially in Europe as well as the resuming process of capital accumulation after the Second World War, which tends to increase the role

fortunes. This is true for fortunes accumulated over a lifetime as well as for inherited wealth (even if the methodology of the Forbes billionaires' list tends to underreport inherited wealth, which is more difficult to identify than corporate executive success stories reported in the media). See Piketty (2013).

of wealth as a determinant of income. Capital destruction unwounded wealth concentration in the United States, but wealth concentration declined further in Europe during the thirty glorious years (1945-1975). This period characterized by intense reconstruction efforts in combination with progressive taxation keeping after-tax returns on capital inferior to economic growth ( $r < g$ ), however, may be an exception rather than the historical norm. With weaker economic growth in the wake of the oil shocks and conservative reforms that boosted the after-tax return on capital ( $r > g$ ), rising income inequality first resumed in the United States around 1980, nurturing wealth concentration more intensively than in Europe, where conflicting national policy priorities and unravelling socio-democratic traditions slowed down the institutionalization of neoliberal ideas. Figure 6 represents the wealth and income share of the top decile in the United States and Europe, but recent changes are largely driven by changes in the top 1 per cent, which controls about half of the top decile's income and wealth share, including the vast majority of financial wealth and financial capital income. Consequently, absent a rehabilitation of progressive taxation robust enough to unwind concentrated ownership structures, income and wealth inequality may be bound to increase to the point of reviving patrimonial capitalism that predominated in many European countries in the 19<sup>th</sup> century (Piketty 2013), with a more globalized and financialized flavour, harming equality of opportunity and sustainable development.

#### **2.2.4. Redistributive policies and the un-sustainable use and in-equitable access to natural resources for present and future generations**

The potential for redistributive policies to promote environmental sustainability remains underexploited. In most countries, environmental taxes are closely tied to carbon sources, such as energy and vehicles, but they remain almost insignificant, especially in developed countries with the highest carbon emissions. At the same time, energy subsidies significantly subsidize the production and consumption of fossil fuels in many countries,<sup>7</sup> amounting to global expenses of \$1.9 trillion in 2011, the equivalent of 2.5 per cent of global GDP, or 8 per cent of government revenue (IMF 2013b). Higher environmental tax revenue is consistently associated with lower carbon emissions across all country income groups (figure 7). Hence, a rise in environmental taxes, including the creation of carbon border tax,<sup>8</sup> and a decline in fossil fuel subsidies would certainly foster more sustainable use of natural resources and help curbing negative externalities.

If left unchecked, however, the regressive impact of higher flat indirect environmental taxes targeting consumption at the end of unsustainable global value chains could potentially lock the poorest out of markets and deprive them from access to energy and other goods likely subject to elevated environmental taxes. Most countries could implement progressive taxes tied to individual consumption of some goods and services that are particularly harmful to the environment, such as flights (e.g., exponential tax on plane tickets instead of frequent flyers

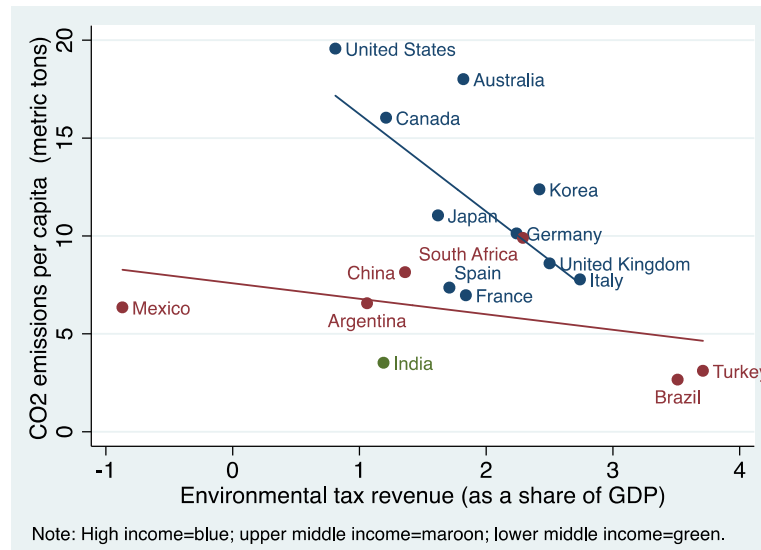
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<sup>7</sup> According to the International Energy Agency (IEA), several G20 countries significantly subsidize fossil-fuel consumption. In 2011, subsidy rates were estimated at 25.4 per cent in Argentina, 18.6 per cent in India, 18.4 per cent in the Russian Federation, 16.6 per cent in Mexico, 4.7 per cent in South Africa, 4.6 per cent in China, 0.3 per cent in Korea, and nil in other G20 countries. Furthermore, subsidization rates were above 50 per cent in Ecuador, Venezuela, Algeria, Libya, Egypt, Gulf Cooperation Council countries, Iraq, Iran, Turkmenistan and Uzbekistan. See <http://www.iea.org/subsidy/index.html>

<sup>8</sup> Trade liberalization and the expansion of increasingly segmented global value chains stimulated international merchandise trade and transportation services, which on average increase carbon emissions of goods that are traded internationally by 50 per cent compared to locally traded goods (Cristea et al. 2013). As internationally traded goods embody about 21 per cent of global carbon emissions (Peters and Hertwich 2008), international transportation of traded goods alone may contribute to more than 7 per cent of global carbon emissions (WESP 2013, Box II.1).

reward programmes) or secondary residences (Casal 2012). Equitable access to natural resources could be fostered by the progressive redistribution of environmental tax revenue as well as of proceeds of socialized natural resource rents, such as in Norway, where corporate profits in the oil sector are taxed at a rate of 78 per cent,<sup>9</sup> despite the relative difficult conditions for oil extraction, which are often invoked to justify the extensive privatization of natural resource rents in countries lacking good governance.

**Figure 7: Environmental tax revenue and carbon emissions in G20 countries (2010)**



Source: Author. Note: Based on data from WDI and OECD. Environmental tax revenue data is missing for Indonesia, the Russian Federation and Saudi Arabia. Environmental tax revenue mainly arises from energy and vehicle taxes, which are closely related to carbon emissions. The negative tax revenue in Mexico is due to the system stabilizing end-user prices of motor fuels, which is costly in years with high world-market fuel prices. R2 for high income countries is 0.42 and 0.23 for upper middle income countries; India is the only lower middle income country.

Alternative mechanisms, which may involve the more direct ownership and management of natural resources by public institutions driven by other motives than private profit maximization alone may also be required to avoid the breach of planetary boundaries and preserve the rights of future generations. The Yasuní initiative proposed by Ecuador in 2007, for instance, highlight how public ownership of natural resources could contribute reining in the excessive exploitation of natural resources, provided international cooperation can be stepped up to address international and inter-generational equity concerns. This initiative proposed that Ecuador refrains indefinitely from exploiting the oil reserves from three oil fields within the Yasuní National Park, in exchange for 50 per cent of the value of the income it would be forgoing (an estimated \$3.6 billion) from the world community. The Yasuní initiative offered the advantage of integrating many elements required for sustainable development, including ecosystem protection, climate change mitigation, and support for the rights of indigenous peoples, but it was finally abandoned in 2013 due to lack of funds raised (The Guardian, 19 September 2013). More recently, Norway's \$840 billion public Oil Fund, which owns on average 1.3 per cent of all listed companies, appointed a group of experts to examine whether the best strategy to address climate change is to divest from fossil fuel extraction or to define responsible criteria for exclusions (Financial Times, 28 February 2014). As technological progress is unlikely to deliver rapidly enough all the efficiency gains

<sup>9</sup> See Norwegian Ministry of Finance: <http://www.regjeringen.no/en/dep/fin/Selected-topics/taxes-and-duties/bedriftsbeskatning/taxation-of-petroleum-activities.html?id=417318>



required for the world to adopt a sustainable development path, higher environmental taxes and new ways to offset their regressive impact through redistribution and prevent excessive fossil fuel extraction will probably become prominent policy concerns in developed and developing countries in the years ahead.

### **3. REDISTRIBUTIVE POLICY TRENDS IN A CHANGING CONTEXT**

#### **3.1. The standard public economics approach to redistributive policies**

The standard public economics approach suggests that governments should intervene, including through redistributive policies, whenever markets fail, i.e., when markets undersupply or oversupply in relation to what is considered desirable (e.g., the development of strategic sectors, economic efficiency, social fairness, environmental sustainability). Market failures are very common and occur in case of imperfect competition, natural monopolies, asymmetric information, merit goods, pure public goods as well as positive/negative externalities.

In the wake of the Second World War, many governments pursued this approach to guide their redistributive policies and were strongly involved in managing the economy both in socialist and capitalist countries. Although most concerns were subordinated to the overarching objective of pursuing economic growth, redistributive policies were explicitly used to support industrial policies, ensure the provision of public goods and correct socially unacceptable outcomes through income redistribution and, to a lesser extent, wealth redistribution.<sup>10</sup> In developing countries, import-substitution and export-promotion strategies adopted after decolonization also required decisive policy interventions, legitimizing the active role of government in the economic sphere. The predominantly rural and informal nature of their economy and political economy factors partly inherited from the colonial era, however, prevented the development of redistributive policies and institutions.

#### **3.2. Shrinking government for private investment-led economic growth**

Starting in the late 1970s, the rise of trickle-down supply-side neoliberal economic ideas strongly influenced the conceptualization of economic policy-making in general and redistributive policies in particular. As the clout of business interests and pro-market ideas became increasingly dominant in many media and policy circles, government interventions were increasingly framed in the public discourse as inefficient market distortions preventing the optimal allocation of factors and income within domestic markets and across the global factory. By contrast and as a corollary, markets were portrayed as neutral and perfectly efficient, as if they could be disembedded from the broader social and political context. This shift in public discourse consecrated the role of private investment as the main driver of economic growth, technological progress and human development and further encouraged a minimalistic vision of government. The alleged inferior efficiency of government justified the near liquidation of asset-based public policy through extensive privatization of public income-generating assets (e.g., water supply, railroads, telecom, etc.) and the overall downsizing of income-based public policy induced by declining tax revenue. Lower total government revenue went hand in hand with lower expenditure and/or higher public debt (figure 8). These policies<sup>11</sup> resulted in the growing concentration of income-generating assets

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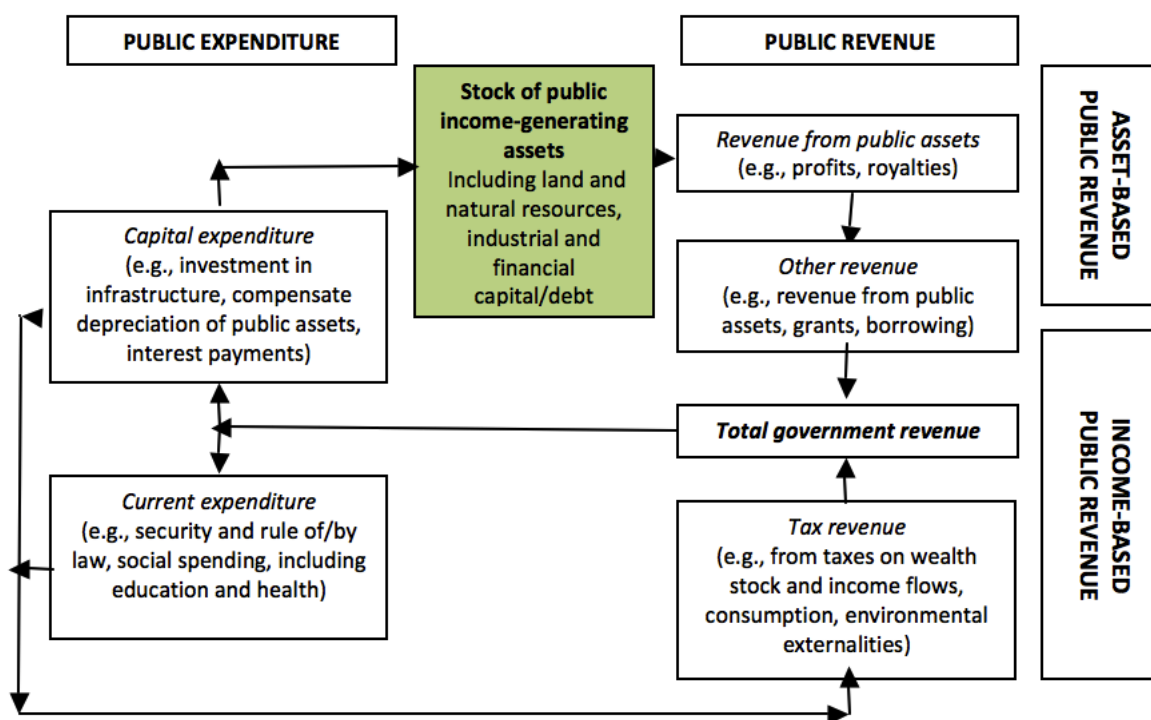
<sup>10</sup> For instance, in the United States, the top marginal income tax rate was raised from below 30 per cent in 1920s to more than 90 per cent in 1945 before declining gradually from 1964 onwards. Similarly, estate/inheritance taxes were raised from about 20 per cent in the 1920s to more than 70 per cent in the aftermath of the Great Depression before declining gradually from the 1970s onwards. Top income and inheritance tax rates display similar patterns in the UK and many other developed countries.

<sup>11</sup> These policies are sometimes coined as “starve-the-beast” strategy. The use of this metaphor in relation to budgetary politics has its origin in the United States, and it was first made by a White House official in 1985 (Bartlett 2007).

in a limited number of private hands,<sup>12</sup> weaker redistribution, rising income inequality and unsustainable development.

Emphasis on private investment further promoted a model of economic growth inducing larger cyclical swings and a more unequal income distribution, because of its bias favouring profit-making and higher income groups with the largest propensity to save and invest. According to proponents of private investment-led economic growth, enhanced economic efficiency and incentives for profit-seeking would necessarily generate additional economic gains, which would trickle-down through market interactions and benefit the broader population, making inefficient government-intermediated redistribution of income and wealth superfluous.

**Figure 8: Public revenue and expenditure by source and purpose**



Source: Author.

The success of the neoliberal approach among policy-makers is related to political economy factors as well as to its internal consistency and formal simplicity rooted in highly reductionist micro-founded economic models. It also stems from the widespread use by policy-makers of purely economic measures (e.g., corporate profits, GDP) as the ultimate but ill-conceived benchmark of progress (Stiglitz, Sen and Fitoussi, 2009). Indeed, theoretical economic models underpinning the neoliberal approach largely ignore the broader macroeconomic, social and environmental context. They do not take into account the role of income distribution in determining the level of domestic demand and economic stability. They also fail to acknowledge the existence of unequal initial endowments as well as environmental and other market failures that perpetuate unsustainable development, and which discriminatory taxation could seek to correct. The shortcomings of the neoliberal

<sup>12</sup> See Forbes (4 March 2013) “Inside the 2013 Billionaires List: Facts and Figures”. The Forbes Billionaires list now boasts 1426 names (with an aggregate worth of \$5.4 trillion) compared less than 100 billionaires throughout the 1980s.

approach, however, did not prevent it from gaining influence in many domestic and international institutions.

### **3.3.From expenditure cuts to increased social spending for the MDGs**

On the expenditure side, neoliberal policies inspired by the public choice economic school fostered a resource-constrained approach to development, often at the cost of fundamental human needs and socio-economic rights (Sobhan 2010). This approach entailed cutting public expenditure, including social spending. Throughout the 1980s and 1990s, many governments privatized social services and introduced user-fees for the public provision of education and health services along with deepening credit markets to ease the access of low income households to the resources needed for their human capital formation. Table 1 shows the general decline in public expenditures during the 1980s and 1990s and their subsequent rebound. Over that period public expenditures and social spending decreased across all regions, except in parts of Asia. The decline was most pronounced in transition economies where the political and economic collapse of the USSR in the early 1990s was followed by the extensive privatization of the means of production and social services, and an abrupt fall in social spending.

Yet, those attempts at financing human capital formation through out-of-pocket household expenditure adversely affected human capital investments by low-income households (Birdsall et al. 2011). Instead of enabling the economic gains created through a supposedly more efficient economic organisation to trickle-down to poorer and excluded social groups, these policies readily undermined the capacity of governments to redistribute those gains and further degraded the ideal of social solidarity between individuals and generations. The negative effects of this approach are most obvious in poorer countries experiencing developmental difficulties, but they are increasingly visible in many richer countries, including vulnerable democracies (Solt 2008; Bonica et al. 2013) where poverty and inequality are on the rise. Over the years, widespread popular discontent and criticism in certain academic and policy circles have become more vocal (e.g., Stiglitz 2003 and 2013).

The failures and the adverse social impact of neoliberal policies prepared the way for a different approach reflected in the adoption of the Millennium Development Goals (MDGs) by the UN General Assembly in September 2000. By placing extreme poverty reduction and several major education and health-related objectives at the heart of the development agenda, the international community acknowledged the key role of public social spending to foster human and economic development. In the wake of the MDGs, education and health became priority areas for public expenditure. The MDG inflexion also promoted the introduction of social protection, especially in the form of highly targeted conditional and non-conditional cash transfers, which currently benefit around 850 million people and positively contribute to reduce income poverty and inequality (Cornia 2012).

The inflexion in public social spending observed since the turn of the Millennium has its limitation, however. In many developing regions, public expenditure as a share of GDP is still inferior to its level in the 1980s. The scope for budget reallocation is thus strictly constrained. Furthermore, public social spending in developing countries has not increased faster than in developed countries, where public social spending represents about 25 per cent of GDP, 3 to 4 times more than in developing countries, where it hovered between 6.3 per cent of GDP in transition economies and 9.1 per cent of GDP in Latin America. Social protection, in particular, is much more developed in advanced economies. Consequently,

households in developing countries continue to bear a much larger share of the financing of health, education and social protection needs.

**Table 1: Public expenditure by region, 1980-2011  
(as a share of GDP)**

	Developed countries			Sub-Saharan Africa			Latin America and Caribbean		
	1980s	1990s	2000s	1980s	1990s	2000s	1980s	1990s	2000s
Total expenditure	43.3	40.3	40.2	27.8	25.5	25.6	22	18.7	21.2
<i>Social sector</i>	23	22.7	24.6	7.2	7.2	8	9.1	8.2	9.1
Education	3.7	4.4	4.9	4.3	4.1	4.2	3.3	2.7	3.4
Health	4.2	4.4	5.4	1.8	1.8	2.2	2.4	1.5	1.8
Social protection	15.1	13.9	14.3	1.1	1.3	1.6	3.4	3	3.9
	East, South, and South East Asia			Middle East and North Africa			Transition economies		
	1980s	1990s	2000s	1980s	1990s	2000s	1980s	1990s	2000s
Total expenditure	24.9	23	24	34.2	29	28.7	31.9	27.8	25
<i>Social sector</i>	5.7	5.9	6.9	9.1	7.9	9.1	9.7	6.5	6.3
Education	3	3.1	3.3	4.1	4.4	4.1	1.3	2.3	1.9
Health	1.2	1.3	1.4	1.6	1.6	1.7	1	1.6	1.3
Social protection	1.3	1.5	2.2	3.4	1.9	3.3	7.4	2.6	3.1

Source: Cornia (2013) WESS background paper. Note: Based on IFPRI SPEED database, which draws mainly on the IMF-GFS data. Data generally refers to the expenditure of the central government and only seldom those of general government. Social spending data does not include outlays on housing, nutrition, food subsidies and other less important items.

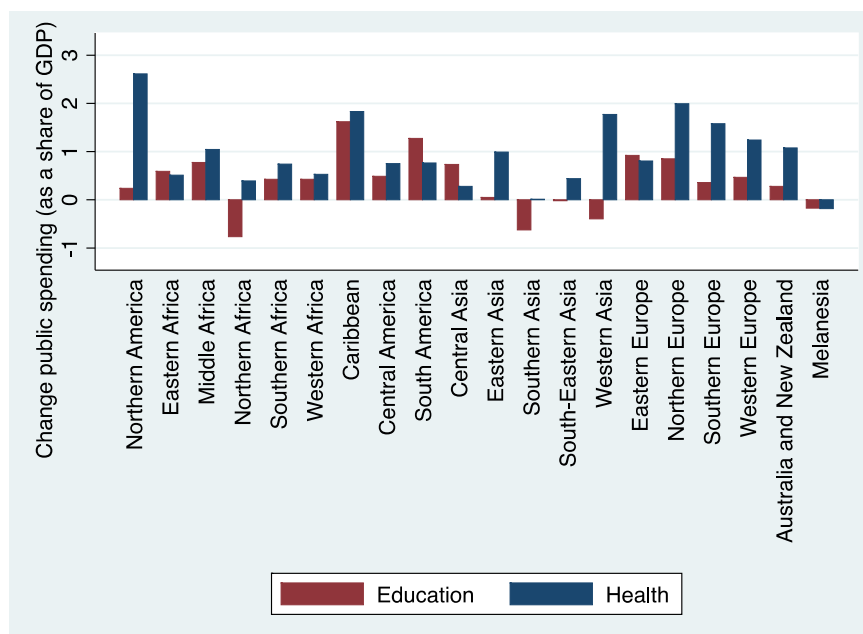
### 3.3.1. Public expenditure on education and health

Public social spending on education and health is now widely acknowledged as key for human and economic development and part of standard development strategies (United Nations 2013a and 2013b). The MDGs notably included goals, such as gender parity in secondary education enrolment rates or improving maternal health, which aimed at fostering human development and further overcome gender inequality, which hinders sustainable development.

Between 2000 and 2010, public spending on education and health were on the rise (figure 9), despite the effects of the global financial crisis. Public spending on education increased in most developing regions, including in sub-Saharan Africa and especially Latin America, where countries such as Argentina, Belize, Bolivia, Brazil, Chile, Columbia, Cuba, Ecuador, Mexico and Nicaragua all registered significant increases in public education spending. By contrast, public education spending decreased by up to 1 per cent of GDP in North Africa, Western Asia, Southern Asia as well as Melanesia. In the former two subregions, this decline may be related to youth discontent and the Arab Spring. More generally, however, this decline in the wake of the global financial crisis also hints at the enduring pro-cyclical nature of public social spending that derives from the resource-constrained approach prevailing in some larger countries, especially in Southern Asia (Sobhan 2010). In developed countries, public spending on education increased modestly during the last decade, especially in Northern and Eastern Europe (after a sharp decline in the latter during the 1990s), but rising income and wealth inequality and youth unemployment hint at the weak potential of policies

that focus exclusively on human development for equalizing opportunities and promoting sustainable development, but ignore the increasingly asymmetric distribution of wealth.

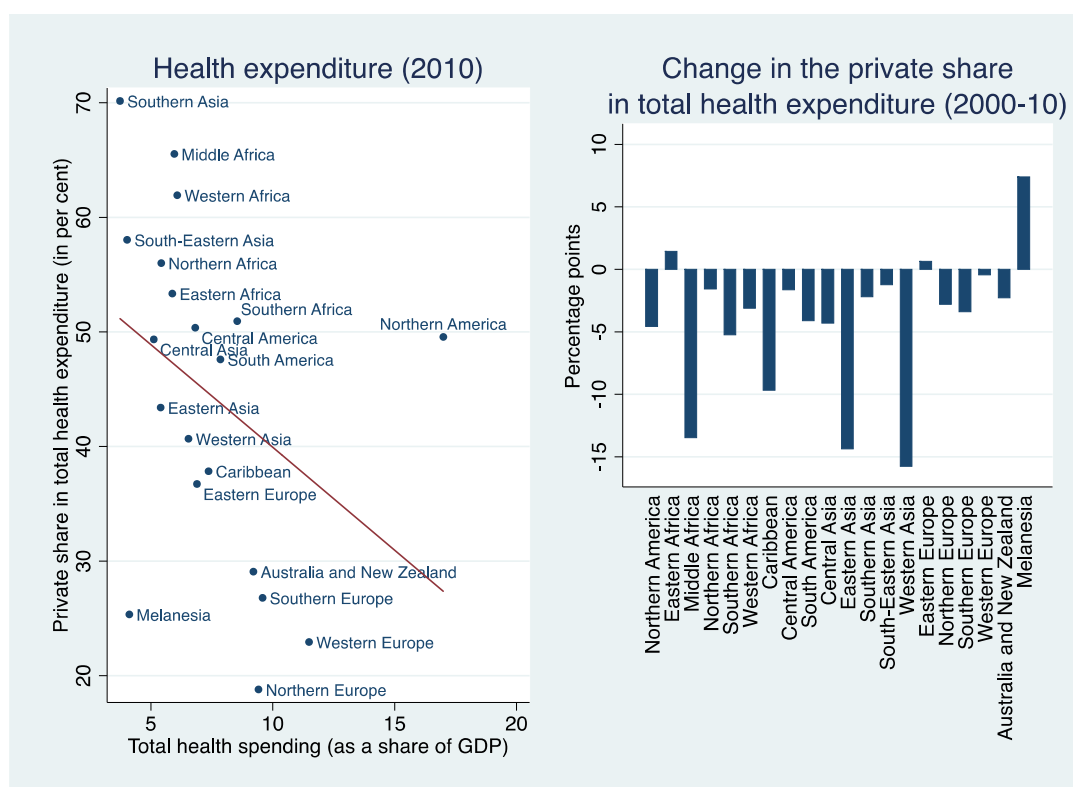
**Figure 9: Change in public expenditure on education and health across subregions (2000-2010)**



Source: Author. Note: WDI and UNPOP data. All variables are population-weighted. Refer to figure 5 for the level of public spending on education and health by subregion in 2010.

Differences in social spending between developing and developed countries are even more pronounced with regard to health than education. Public spending on health remains significantly higher in developed countries and expanded at a faster pace between 2000 and 2010, absorbing the majority of the increase in social spending in all developed subregions. Public health spending growth in developed countries is driven by ageing, but also by rising costs/corporate profits, especially in countries most reliant on private supply of health services. However, compared to developing countries, households tend to bear a smaller share of total health costs, except in Northern America (figure 10). In 2010, public health expenditure covered between 70 per cent and 85 per cent of total health expenditure in most developed countries, with notable exceptions such as the Russian Federation and the United States, where private health expenditures accounted for 41 and 54 per cent of total health expenditure, respectively. In most developing subregions, the majority of total health costs are borne by private households. In Southern Asia, the private share in total health costs was still as high as 70 per cent in 2010. Growing public spending on health over the last decade, however, slightly alleviated this burden across most developing subregions.

**Figure 10: Private and total health expenditure across subregions (2000-2010)**



Source: Author. Note: Data from WDI and UNPOP. All variables are population-weighted. R2 is 0.14 in the left panel.

### 3.3.2. Social protection

During the last decade, social protection expenditures<sup>13</sup> represented 14.3 per cent of GDP of developed countries, but only ranged between 1.6 and 3.9 per cent of GDP in developing countries (table 1). This major difference in public efforts aimed at stabilizing or raising disposable income of more vulnerable segments of the population largely explains why extreme poverty almost disappeared in developed countries. Raising the lowest incomes also reduces income inequality to some extent, but not to the extent of compensating excessive compensation at the other end of the income distribution, which is driving rising inequality in many countries (Alvaredo et al. 2013).

In developed countries, pensions absorb about 75 per cent of social protection expenditure. Over the last decades, rising expenditure on pensions through contributory and especially non-contributory programmes put an end to extreme poverty among elderly, which was widespread in many developed countries 50 years ago, but it did not prevent inequality from rising over the last decades. The significant resources allocated to social protection in developed countries ensure decent quality and coverage, but gender blindness in pension and other social protection programmes keep implicitly discriminating against women (Razavi et al. 2012).

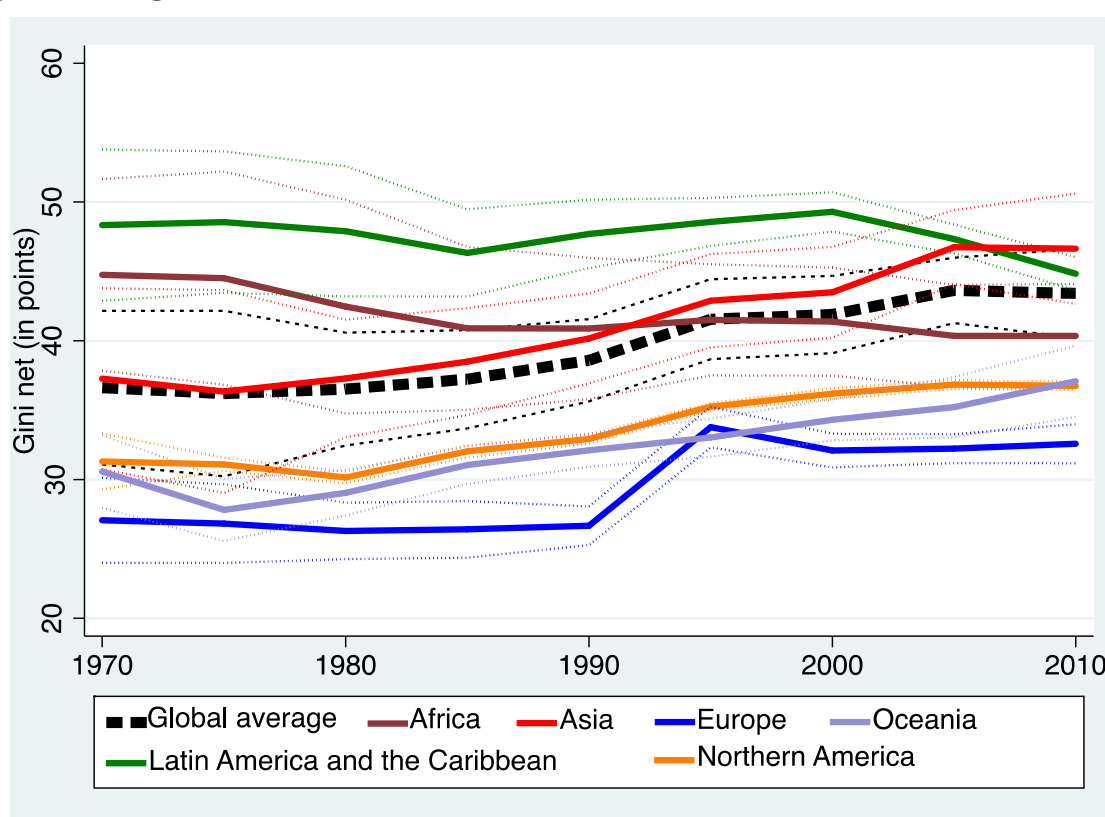
Unlike health or education, social protection is not mentioned explicitly in the MDG agenda, but the focus of MDGs on reducing extreme poverty enabled limited improvements in the

<sup>13</sup> See footnote 5 for a definition of social protection, including a non-exhaustive list of the areas it can potentially cover.

deployment of social protection in developing countries over the last decade. Overall, weaker public revenue mobilization put a strain on the range of social protection programmes that can be funded, as well as on their quality and coverage, including through discriminatory conditionalities imposed on potential social protection recipients. In most developing regions, the approach to social protection remains resource-constrained and pro-cyclical, as illustrated above in relation to public education and health spending, but there are important exceptions.

In Latin America, for instance, the rise of left-leaning governments since 2000 facilitated the progressive move towards a more rights-based approach to social spending, including social protection. Consequently, Latin America has become the developing region that spends most on social protection and, incidentally, it is also the only region that registered a steady and significant decline in poverty and income inequality since 2000 (figure 11).

**Figure 11: Regional net Gini coefficients (1970-2010)**



Source: Author. Note: Data from SWIID (version 4.1) and UNPOP. Regions are defined according to the UN definition (see <http://unstats.un.org/unsd/methods/m49/m49regin.htm>). Regional trends represent population-weighted within-country Gini coefficients averaged at the regional level, based on data that is interpolated and extrapolated in order to keep the pool of countries identical over time. The assumption that income inequality remained constant prior to the first observation/after the last observation tends to flatten regional trends, especially in the 1970s. As data is generally available very early on for the most populous countries and all variables are population-weighted, this pitfall has only limited consequences. Dotted lines indicate 95 per cent confidence intervals for net Gini coefficients.

A rights-based approach to social protection aims at providing broad social protection against significant risks, improving access to social transfers for those in need, and greater provision of public goods and services with the same quality standards for all social groups. Entitlements are based on citizenship and are conferred as rights, with a minimum of discretionary authority on the part of the agencies concerned. This principle has shaped a



number of new initiatives, such as a universal child allowance in Argentina, a universal old-age pension in Bolivia, and an old-age pension, and disability, sickness and maternity benefits in Brazil (ILO 2010). In parallel, key instruments of social policy for poverty alleviation and redistribution, including conditional cash transfers (CCTs), have been introduced in a number of countries. Non-contributory expenditures on social assistance in general, and CCTs in particular, appear to have been quite effective in protecting the poorest segments of society (Lindert, Skoufias and Shapiro, 2006; Cornia 2012), making the overall effects of redistributive policies more progressive.

In other regions, many countries have made limited progress in deploying social protection. In several transition economies of Central Asia, recent social transfer schemes have not been particularly effective in addressing the needs of poor households owing to their limited coverage and funding. Universal social welfare policies and transfer programmes inherited from the former Soviet Union are often poorly designed and not well funded, which means that meagre resources for social pensions are spread thinly over a large population (Gassmann, 2011). In the rest of Asia, CCT programmes targeting various categories of individuals, including elderly people, children and extreme poor have been implemented in urban and rural areas. Efforts to improve the livelihood of the poor were often accompanied by investments in infrastructure (transport, water and electricity, health and education) in urban and rural areas (ADB 2012a and 2012b).

In India, centralized implementation of social protection programmes mostly failed to satisfactorily reduce poverty or inequality (Nagaraj 2012). Flexible schemes implemented at a lower level of government with greater participatory and political oversight delivered contrasting outcomes. Kerala and West Bengal, for instance, are the two States experiencing most success at reducing poverty and inequality. Underlying this achievement are complex historical roots, including the political mobilization of lower castes and classes. This broadened political base has facilitated the democratic rise to power of a well-organized Communist Party, which implemented a variety of pro-poor public policies, including land reforms, higher investments in and better implementation of education and health policies, along with greater gender equality (UNRISD 2010).

In China, the accelerated modernization of economy has been accompanied by increased migration from rural areas. The inadequacy of the *hukou* system facilitated the emergence of urban poverty starting in the mid-1990s, which has imperfectly been addressed through reform of the social security system. Work-related social insurance programmes, in particular for urban residents, were redesigned. The coverage of the Minimum Living Standard Guarantee System has been growing since the late 1990s, particularly in the coastal areas, but a significant proportion of the eligible population remains uncovered in the western and central provinces, owing to insufficient funds at the disposal of local governments. However, as in Chongqing, certain local governments successfully managed to leverage public asset ownership to foster social protection and (more) equitable development in various ways (Box 1).

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## **BOX 1: CHONGQING'S "THIRD HAND" – AN EXPERIENCE IN LEVERAGING PUBLIC ASSETS FOR EQUITABLE DEVELOPMENT IN THE 21ST CENTURY<sup>14</sup>**

China has been one of the main drivers of rising inequality in Asia over the last decades, as its net Gini doubled in less than 20 years, rising from 31 points in the early 1980s to 55 points in the mid-2000s, before stabilizing at around 53 points in more recent years.<sup>15</sup> This rise in inequality occurred in a context of rapid structural transformation attributing a growing role to the invisible hand of the private sector. At the same time, major income-generating assets managed by state-owned enterprises (SOEs) converted into profit-making state-firms partly remain in the public domain. The continued major role of a public hand in gearing economic growth in China, however, was not sufficient to prevent the overall rise in inequality, which has been officially acknowledged to represent a major issue,<sup>16</sup> hinting at the limits of developing the economy by “letting some people get rich first.” However, in a context where divulging official inequality estimates has become a political embarrassment, the Chongqing province, emboldened by the success of its policies to reduce inequality, which some authors have coined as the “third hand”, became the country’s first province to publish its Gini coefficient in 2010. Its vow to reduce its Gini coefficient from 42 points to 35 points during the 12th Five-Year Plan (2011-2015) period is a testimony to the possibility of structuring policies around the objective of reducing income inequality.

The approach of Chongqing to reduce inequality is anchored in factors specific to the Chinese context as well as in determinate policy action. Like many other Chinese local governments, Chongqing articulated its development strategy around efforts to draw in outside investment and land financing. In the 2000s, it pursued a strategic development plan to attract “dragon head enterprises” expected to spearhead growth in strategic sectors, such as information technology, car production or pharmaceuticals. Simultaneously, it extensively used the anticipated appreciation of land earmarked for development to fund urban development. While such strategies have been implemented extensively across China, the effective socialization of derived economic gains has not always materialized as successfully as in Chongqing.

The originality of the Chongqing equitable development strategy lies in its use of a third hand, whose main instruments are restructured SOEs that are enabled to evolve in a competitive market environment, but which strive for social equity and public benefit rather than corporate profits alone. The origin of Chongqing’s approach to SOEs lays in the way the Chongqing government dealt with bad debts crippling banks and SOEs in the late 1990s to restructure them into marketized firms. Instead of letting SOEs go bankrupt or injecting massive amounts of government money into those firms (as most developed countries did during the global financial crisis), Chongqing seized this opportunity to take over unprofitable banks and enterprises at a discounted price, pooling those assets in a newly created government-owned asset management company (Chongqing Wealth). It then reorganized those assets and introduced eight restructured SOEs in the market environment. However, those marketized SOEs remained officially dedicated to public benefit in the areas of urban development, express highway development, high-level highways, real estate, city transport development, energy resources, water affairs (including water resources development, water supply, sewage treatment, and hydroelectric projects), and water conservancy (including irrigation).

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<sup>14</sup> This box draws heavily on two articles by Huang (2011, 2012), which provide an in-depth analysis of the specificity of the Chongqing equitable development strategy.

<sup>15</sup> Standardized disposable/net income gini estimates are from SWIID (version 4.1) database.

<sup>16</sup> In the 17th Party Congress report of 2008, the original phrase of “efficiency first, equity second” was discarded in favor of “greater emphasis on equity in redistribution” signaling a definite leftward correction. Chongqing has in fact been the main test-point designated by the Party central for that reorientation. See Salidjanova 2013.

Between 2002 and 2009, Chongqing's SOEs assets appreciated by a record 620 per cent. Conserving those restructured SOEs fully in the public domain fostered equitable development in various ways. First, it avoided privatizing those rents, in accordance with Sun Yat-sen's idea that the appreciation in the value of land should belong to the public, especially when the value of such assets increases faster than wages. Secondly, revenues generated by land value appreciation and profitable SOEs enabled the government to increase social spending, including social protection, education and health and improve public services. Finally, by waving the necessity for SOEs to maximize dividends for shareholders, it enabled marketized SOEs to pursue strategies fostering the broader public good instead of profit alone. For instance, as inequality reached record levels across China in the early 2000s, the Chongqing SOEs undertook the construction of inexpensive public rental housing for 3 million people, especially for peasant migrant workers, whose rights are severely constrained by the *hukou* system and who suffer most from rising inequality.<sup>17</sup>

The Chongqing experience illustrates the potential for policy interventions to reduce inequality and may inspire policy-makers in countries disposing of similar ownership structures (Klimina 2011). It also highlights the potential for asset-based public policy to reduce income inequality and share the benefits of economic development in a more equitable way than markets, while fostering efficient management (Shi and Liu 2012). By maintaining public ownership of the land in the primary market as well as in the secondary market through public ownership of marketized SOEs, the Chongqing government effectively socialized economic gains that could have been easily privatized. Public ownership of the SOEs further illustrate the potential of multi-level firm governance structures involving a plurality of stakeholders to reflect not only the interests of capital holders, but also the interest of workers (Dugger 1987, 1998) as well as broader social and environmental concerns.

\*\*\*\*\*END OF BOX \*\*\*\*\*

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In most sub-Saharan African countries, social protection was close to non-existent until recently (Palacios and Pallarés-Millares, 2000). In the 2000s, several countries introduced social protection programs targeting elderly people, children and the extreme poor, but the coverage, quality and level of assistance is often insufficient (Barrientos et al. 2010, Niño-Zarazúa et al., 2012). Several programmes in Central, East and West Africa are financed largely by official development assistance (ODA) and in many cases reflect the influence of international organizations and changing donor priorities shifting their support from emergency and humanitarian aid to social protection. These experiences benefited recipient countries and suggest that even in poor countries it is politically, fiscally and administratively feasible to implement minimalistic social protection programmes provided ODA promises are met (Giovannetti and Sanfilippo, 2011).

In summary, the MDG inflexion represented a positive step towards rehabilitating progressive redistribution. Yet, the lack of sufficient resources for social spending across most developing regions, its pro-cyclicality and vulnerability to exogenous factors in combination with enduring poverty and rising inequality also clearly highlight a major limitation of the current approach. By focusing on raising public social spending, but neglecting to raise sufficient revenues in an equitable manner through progressive income and wealth taxation, most countries failed to provide redistributive policies with a solid backbone.

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<sup>17</sup> There were about 150 million migrant peasant workers in China in 2009. Chongqing had a population of 33 million in 2009, including 23 million of registered peasants, a fraction of which are peasant migrant workers.

### **3.4. The neoliberal tax legacy and regressive revenue mobilization**

As noted above, the standard public economics approach to redistributive policies envisioned a role for discriminatory taxation in order to achieve certain industrial, distributional or environmental objectives. Neoliberal ideas profoundly altered this approach to taxation by framing government economic interventions and progressive taxation in particular as inefficient distortions discouraging economic activity. Consequently, the overall objective assigned to tax reform was to shrink government and remove so-called distortions.

In developed countries, tax reforms led to a substantial decline in tax revenue and to more regressive tax structures, shifting the tax base away from progressive wealth and income taxes, especially capital income taxes, towards regressive consumption taxes penalizing lower income households. Such reforms also found an echo in developing countries, where international donors and institutions, such as the IMF and the World Bank, encouraged many governments through repeated recommendations and conditional loans to embrace the same approach.<sup>18</sup> In the wake of trade liberalization, tax reform in developing countries often emphasized regressive consumption taxes as a means to replace falling trade tax revenue, with mitigated results, especially in low-income countries (Baunsgaard and Keen 2010). Quick fixes, such as the creation of semi-autonomous revenue agencies (SARAs) focusing on value-added taxes, for instance, allowed to rapidly raise revenue in some developing countries, but they failed to do so in a progressive manner and further locked-in administrative structures that were not conducive to adequate and progressive revenue mobilization and the development of modern integrated public administrations, which are required for state-building and sustainable development (Prichard 2010).

As this neoliberal tax legacy hampers resource mobilization, the MDGs emphasized the need for increasing ODA and finding elusive innovative financing sources (United Nations 2003, 2008). In the meanwhile, the enduring weakness of tax administrations is reflected in the continuous need for ODA, especially in LDCs, and resource-constrained approaches to public social spending as well as in the current debate on tax avoidance and evasion by TNCs and HNWIs exploiting tax havens and offshore financial centers to accumulate extreme wealth. This sheds crude light on the inability of tax authorities of least developed, developing and developed countries to tax the richest elements of their societies according to their ability to pay and raise sufficient revenue to progress more decisively towards sustainable development objectives.

#### **3.4.1. Total revenue, including non-tax revenue from natural resources exploitation**

Throughout the 1980s and 1990s, total government revenue (as a share of GDP) declined hand in hand with cuts in public expenditures. Comparable revenue data for developing countries is hardly available prior to 1990, but table 2 captures the final years of a declining trend in total revenue, which bottomed at the end of the 1990s across most regions before picking up in the early 2000s. However, in developed countries and many parts of Asia, total revenue at the end of the 2000s remained inferior to its level 20 years earlier. Despite this decline, total revenue in developed countries amounted to 41.3 per cent of GDP on average in 2010, up to twice as much as in some other regions.

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<sup>18</sup> About 50 per cent of all adjustment loans provided by the IMF and the World Bank between 1979 and 1989 included conditions relating to fiscal reforms, and more than 50 per cent included conditions relating to both trade reforms and the rationalization of government finances, which had tax reform elements (Webb and Shariff, 1992).

**Table 2: Public revenue by region, 1991-2010**  
(as a share of GDP)

	Developed countries				Africa			
	1991-5	1996-0	2001-5	2006-10	1991-5	1996-0	2001-5	2006-10
<b>Total revenue and grants</b>	43	42.7	41.4	41.3	22.1	21	23.8	28.2
<b>Tax revenue</b>	37.9	36.6	36	36	16.4	15.8	17.3	19.1
<i>Indirect taxes</i>	7.4	7.8	7.8	7.7	9.7	9.4	9.1	9.6
VAT	6.3	6.7	7	7.1	4.4	4.4	4.9	5.4
Border tax	1.1	1.1	0.8	0.6	5.3	5	4.2	4.2
<i>Direct taxes</i>	12.9	12.3	12	12.2	4	4.2	5.1	6.2
Personal income tax	10.2	9.2	8.8	8.7	1.5	1.8	2.8	2.8
Corporate income tax	2.7	3.1	3.2	3.5	2.5	2.4	2.3	3.4
<i>Social contributions</i>	10.9	10.3	10.1	10	2	1.8	2.3	2.7
<i>Other tax revenue</i>	6.7	6.2	6.1	6.1	0.7	0.4	0.8	0.6
<b>Other revenue</b>	5.1	6.1	5.4	5.3	5.6	5.3	6.5	9.1
<b>Memo item: Ratio of direct to indirect taxes</b>	1.74	1.58	1.54	1.58	0.41	0.45	0.56	0.65
	Latin America				East, South and South-East Asia			
	1991-5	1996-0	2001-5	2006-10	1991-5	1996-0	2001-5	2006-10
<b>Total revenue and grants</b>	21.3	22.7	23.9	27.3	20.9	19.6	19.2	20.7
<b>Tax revenue</b>	15.4	16.6	17.7	19.8	15.1	15	15.9	17.9
<i>Indirect taxes</i>	6.5	7	7.7	8.5	6.9	6.2	6.7	7
VAT	4.7	5.4	6.4	7.3	4.5	4.5	5.2	5.6
Border tax	1.8	1.6	1.3	1.2	2.4	1.7	1.5	1.4
<i>Direct taxes</i>	2.8	3.3	3.7	4.8	4.8	5.4	5.4	6.2
Personal income tax	0.8	1.1	1.5	1.8	1.8	2.3	1.9	1.9
Corporate income tax	2	2.2	2.2	3	3	3.1	3.5	4.3
<i>Social contributions</i>	2.9	2.8	2.8	3.1	0.7	1.2	2.2	3
<i>Other tax revenue</i>	3.2	3.5	3.5	3.4	2.7	2.2	1.6	1.7
<b>Other revenue</b>	5.9	6.1	6.3	7.5	5.8	4.6	3.3	2.8
<b>Memo item: Ratio of direct to indirect taxes</b>	0.43	0.47	0.48	0.56	0.7	0.87	0.81	0.89
	MENA				Transition economies			
	1991-5	1996-0	2001-5	2006-10	1991-5	1996-0	2001-5	2006-10
<b>Total revenue and grants</b>	28.5	30.3	34.6	35.8		28	29.9	34.2
<b>Tax revenue</b>	5.5	5.9	6.5	6.9		27.2	26.9	29.9
<i>Indirect taxes</i>						10.9	12	14.1
VAT						8.8	10.1	12.2
Border tax						2.1	1.9	1.9
<i>Direct taxes</i>						4.9	5.1	6
Personal income tax						2.2	1.8	2.7
Corporate income tax						2.7	3.3	3.3
<i>Social contributions</i>	1	2.1	1.8	3.8		8.5	8.6	9.2
<i>Other tax revenue</i>						2.9	1.2	0.6
<b>Other revenue</b>	22	22.2	26.3	25.1		0.8	3	4.4
<b>Memo item: Ratio of direct to indirect taxes</b>						0.45	0.43	0.43

Source: Based on UNCTAD (TDR 2012). Note: Compulsory social security contributions paid to general government or to social security funds under the effective control of government form an important part of government revenue and, although they are not treated so in the SNA, many analysts consider the payments as being analogous to a tax on income and so part of a country's overall tax revenue.

In developing regions such as Africa, Latin America, Western Asia and in transition economies, rising total revenue over the last decade partly resulted from growing other (non-tax) revenue derived from higher commodity prices, improved terms of trade, increased exploitation of natural resources, as well as from deliberate policies aiming at appropriating a larger share of the commodity bonanza for government. Western Asia has long been deriving a majority of its revenue from oil exports, but Africa registered the largest increase in other (non-tax) revenue over the last decade, which rose on average by 2.6 GDP points to 9.1 per cent of GDP around 2010, representing almost a third of total revenue.

The exploitation of natural resources generates revenues accruing to governments in the form of either profit of (partly) state-owned enterprises or royalties and taxes paid by private companies. Rapidly growing demand from Asian markets and rising commodity prices over the last decade accelerated the exploitation of natural resources, especially in sub-Saharan Africa, where the share of the mining and oil sector now weighs more than a quarter of GDP in 9 countries, and about half of GDP in Angola, the Republic of Congo, Equatorial Guinea, Gabon and Mauritania (table 3). Although the most common range for royalty rates is around 5 per cent to 10 per cent, royalty rates were often well below that common range in a number of African countries in previous decades (Baunsgaard, 2001), highlighting the extreme extent to which natural resource rents are privatized.

**Table 3: Mining and oil sector as a share of GDP in selected sub-Saharan African countries (1990-2010)**

Country	1990	2010	Country	1990	2010	Country	1990	2010
<i>(a) share &gt; 20%</i>			<i>(b) share between 10-20 %</i>			<i>(c) share between 5-10%</i>		
Angola	30.5	46.9	Burkina Faso	3.5	10.5	Ivory Coast	3	6.4
Chad	4.5	38.4	Burundi	9.5	10.9	Ethiopia	6.5	6.4
Congo DR	16	31.8	Cameroon	11.3	9	Ghana	4.4	8.9
Congo Republic	46	66.4	Guinea Bissau	10.1	4.8	Malawi	6.7	3.9
Eq. Guinea	12.6	46	Guinea	18.3	18.2	Mozambique	8.6	8.7
Gabon	34.7	50	Liberia	...	11	Sierra Leone	12.6	3.5
Mauritania	11.6	51.8	Mali	2.4	12.3	Tanzania	8.3	7.9
Nigeria	47.5	27.7	South Africa	6.3	9.9	Uganda	9.7	5.8
Zambia	19.3	25.8	Sudan	...	17.6	Zimbabwe	3.2	9.9
<b>Average</b>	<b>24.7</b>	<b>42.7</b>	<b>Average</b>	<b>7.7</b>	<b>11.6</b>	<b>Average</b>	<b>7</b>	<b>6.8</b>

Source: Cornia (2013) WESS background paper. Note: Data from WDI. Data for another 13 countries with a share of resource rents below 5 percent of GDP show mixed trends.

The most controversial attempt to socialize rents from natural resource exploitation probably comes from Latin America, where the Venezuelan Government nearly doubled royalty payment in the oil sector from 16 per cent to 30 per cent in 2001. Strong international reactions and criticism followed, but did not fully prevent further countries from exploring new paths challenging neoliberal wisdom about the best way to exploit natural resources and attract foreign direct investment. Since 2006, a number of countries in Latin America, Africa as well as Australia have revised their fiscal regimes and attempted to renegotiate contracts with TNCs in the extractive industries with the objective of striking a better balance between

generating income from the exploitation of natural resources with the help of FDI, and appropriating a larger share of the derived rents for the government.<sup>19</sup>

### **3.4.2. Insufficient tax revenue, its composition and regressive tax structures**

#### ***Insufficient tax revenue***

Tax revenue followed a trend similar to total revenue, except in developed countries, where tax revenue declined steadily and only stabilized at an average level amounting to 36 per cent of GDP in 2010. Despite this decline, tax revenue as a share of GDP in developed countries still represented almost twice the average prevailing in most developing regions. As noted by the G20, about half of sub-Saharan African countries still mobilise less than 17 per cent of their GDP in tax revenue, below the minimum level of 20 per cent considered by the UN as necessary to achieve the MDGs (G20 2011). Yet, as reported in table 2, tax revenue as a share of GDP remains below 20 per cent in many Asian and Latin American countries, partly because of widespread subsistence production, limited income, large informal sectors, weak administrative capacity and political economy factors maintaining tax revenue composition and tax schedules regressive.

#### ***Regressive revenue composition and tax schedules***

The ratio of direct to indirect tax revenue reported in table 2 is a good indicator of the progressivity/regressivity of tax systems. Over the last decades, this ratio steadily declined in developed countries and in transition economies, driven by increasingly regressive tax structures. In developed countries, top marginal personal and corporate income tax rates decreased on average by about 20 per cent in OECD countries between 1980 and 2012, while the average value-added tax rate increased by about 8 per cent (figure 12).

Neoliberal ideas were also influential in Eastern Europe and the former Soviet Union, where many countries increased indirect taxes while adopting flat personal and corporate income tax rates promoted by the OECD to strengthen profit incentives and attract foreign direct investments (table 4). Flat income tax rates represent the least progressive form of direct income taxation and a complete turn away from the ideal of vertical equality (i.e., higher income implies higher taxes rates).<sup>20</sup> While Baltic countries retained the highest pre-reform flat tax rate and increased the no-tax area (thus making the tax schedule comparatively progressive), other countries adopted very low flat tax rates. Additional countries (such as Serbia and Hungary) also introduced a flat tax, though several others (Czech Republic,

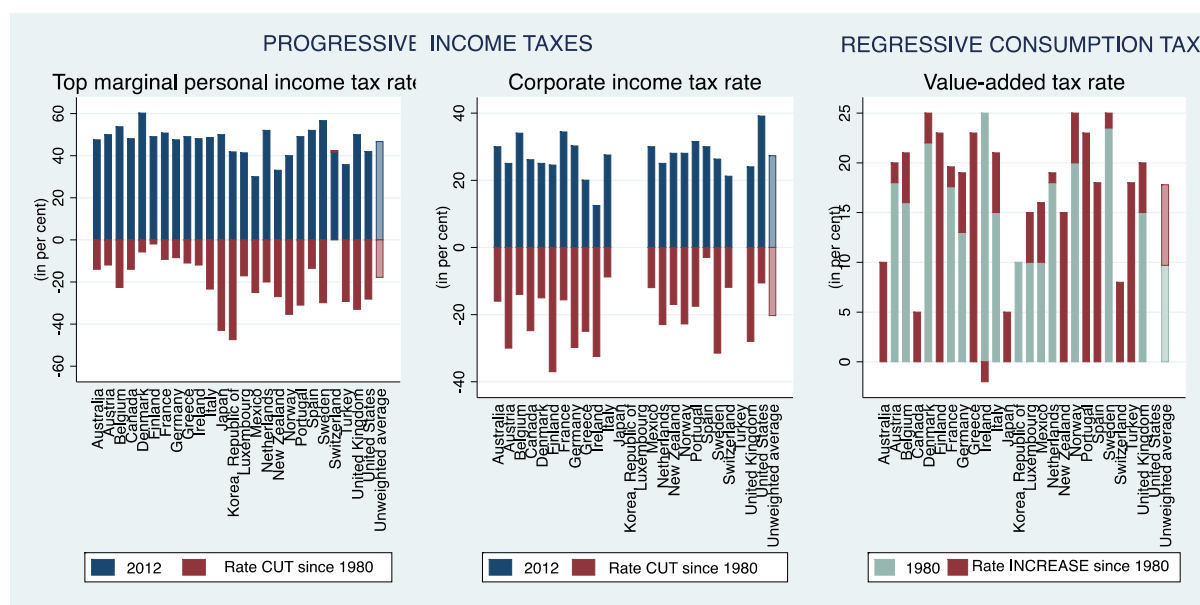
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<sup>19</sup> Abundant anecdotal evidence of contract renegotiations that started after 2006 is reported in UNCTAD TDR 2010 (Chapter V). Many of these renegotiations resulted in positive, but rather minor revisions of contract terms to the benefit of governments. In unstable countries, such as Madagascar or the DRC, implementation was delayed. Overall, governments in poor countries have very low discount rates, which lead them to value highly an immediate increase in revenue, even if the increase is minor and jeopardizes the possibility of increasing revenue in the future. This economic issue is further often compounded by poor governance and lack of transparency (Africa Progress Report 2013) that facilitate the privatization of natural resource rents. By contrast, richer countries with higher discount rates and more transparent governance mechanisms are often in a position to socialize a larger share of natural resource rents. Norway, for instance, appropriates about 78 per cent of natural resource (oil) rents to the public.

<sup>20</sup> Proponents often argue that flat tax schedules improve horizontal equality (i.e., individuals with similar income should pay the same amount of taxes), but horizontal inequality is caused by tax loopholes and exemptions, not by progressive income tax schedules. They also argue that flat tax rates are easier to handle and that monitoring their implementation is less costly for tax administration, but the deployment of information technologies largely discredited this argument.

Slovakia and Iceland), which had initially adopted such an approach subsequently abandoned it.

**Figure 12: The shift towards regressive tax structures in OECD countries (1980-2012)**



Source: Author. Note: OECD data. Data on corporate income tax rate is missing for Japan, the Republic of Korea, Luxembourg and Turkey in 1980. Data on the VAT tax rate is missing for the US, where its implementation varies across States.

**Table 4: Flat tax rates in Eastern Europe and the former Soviet Union**

Country	Year of adoption	Personal income tax rates		Corporate income tax rates		Changes in basic allowance
		Before	After	Before	After	
Estonia	1994	16 – 33	26	35	26	Increase
Lithuania	1994	18 – 33	33	29	29	Increase
Latvia	1997	10 – 25	25	25	25	Reduction
Russia	2001	12- 30	13	30	35	Increase
Ukraine	2004	10 -40	13	30	25	Increase
Georgia	2005	12 -20	12	20	20	Eliminated
Romania	2005	18 -40	16	25	16	Increase
Macedonia	2007	15- 24	12	15	12	Unchanged
Kazakhstan	2007	5- 20	10	30	30	Increase
Czech Rep.	2008	12 -25	15	24	22	Increase
Bulgaria	2008	10-24	10	10	10	Eliminated

Source: Keen, Kim and Varsano (2008).

By contrast, the ratio of direct to indirect tax revenue slightly increased in developing regions. This increase was mainly driven by corporate income tax revenue, which rose by about 1 per cent of GDP across all regions over the last 2 decades, a moderate increase given the extensive privatization and the significant expansion of the private sector in many countries during that period. Overall, regressive indirect taxes are used so extensively that they still represent the main source of government revenue, and direct tax revenue continues to represent only a fraction of the indirect tax revenue across all developing regions and in transition economies (table 2).



### ***Steps towards more progressive tax systems***

The progressive or regressive nature of tax systems, however, relies on a multitude of factors that are imperfectly captured by the ratio of direct to indirect tax revenue, and some countries have taken progressive steps during the last decade, especially in Latin America. The new approach in that region was inspired by the search for greater tax equity and the principle of fiscal exchange, according to which governments can raise taxes if, at the same time, they raise the quantity and quality of services provided to a broad spectrum of the population (Cornia 2014).

In Latin America, for instance, value-added tax rates were mostly left unchanged, but excises on luxury goods were increased in some countries. Many countries placed more emphasis on progressive income taxation. For instance, the 2007 Uruguayan tax reform introduced *ex-novo* a progressive personal income tax, but only a flat corporate income tax. Other countries introduced a minimum tax on firms to strengthen the collection of corporate income tax (e.g. Mexico) or lowered the income per capita at which the highest direct marginal tax rate is applied. Most governments eliminated a long list of exemptions, deductions and tax holidays benefiting TNCs, which had been introduced in the 1980s and 1990s to attract foreign investments without yielding the desired effects. Presumptive taxation was also strengthened due to the inability of the tax administration to ascertain the assets and income of potential taxpayers, and was levied on an estimate of the person/firm's income made by the tax authorities on the basis of objective indicators of gross turnover (e.g. assets, number of employees, electricity consumption). The strengthening of presumptive taxation was accompanied by a simplification of taxation of self-employed taxpayers. For instance, in 1998 Argentina tax authorities integrated social security payments, income tax, minimum tax on assets and value-added tax. Several Latin American countries further introduced a surrogate tax on financial transactions yielding 0.3 to 1.9 per cent of GDP. Standard theory suggests that this tax is distorting and leads to financial disintermediation. Yet, it can also be seen as a second best policy instrument to tax wealth and capital income, which otherwise would escape taxation (Cornia 2014).

### ***Declining environmental tax revenue in developed countries***

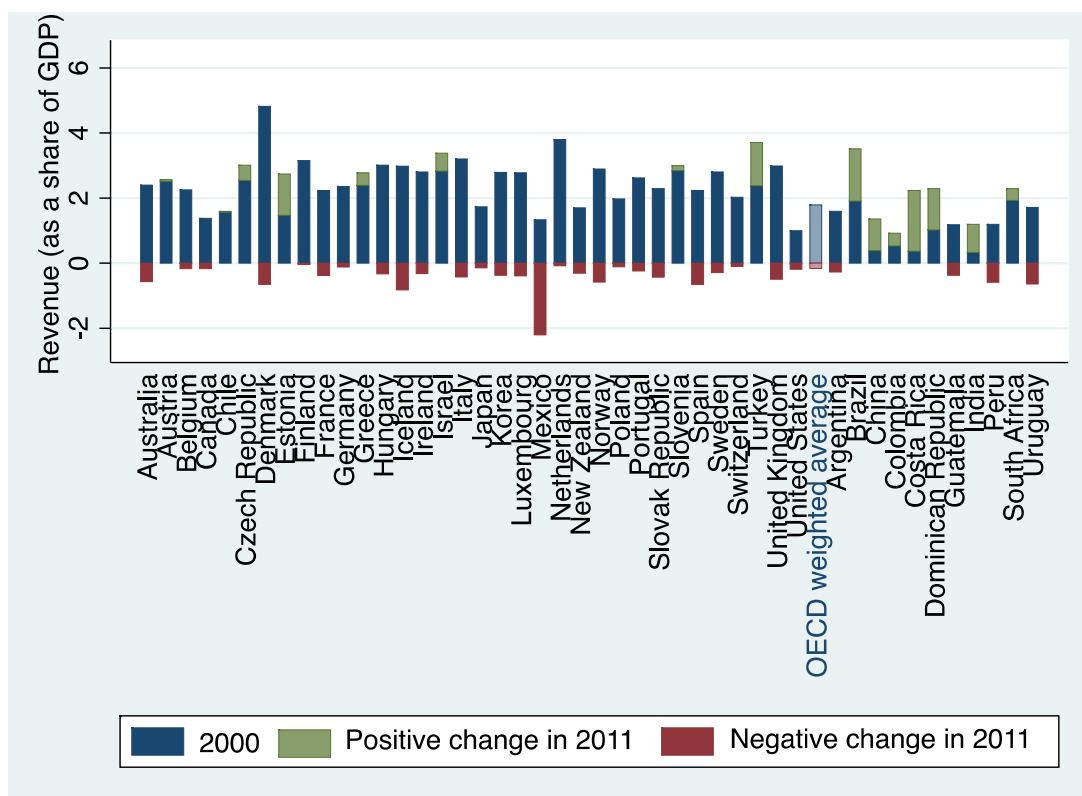
Several Latin American countries, such as Brazil, Costa Rica and the Dominican Republic significantly increased environmental tax revenue between 2000 and 2011, collecting revenue in excess of 1.6 per cent of GDP, the OECD average in 2011 (figure 13). Other developing countries, including China, also made progress during the last decade, but still collect little revenue. More worryingly, environmental tax revenue declined in most OECD countries, including those with highest carbon emissions, such as the United States, Canada, New Zealand or Australia, mainly due to the failure of policy-makers to index tax rates and keep up with inflation. Several European countries<sup>21</sup> have created carbon taxes and the United Kingdom even labelled it a “climate change levy”. These taxes, however, have yielded very little revenue, not so much because of their deterring effect on carbon emitters, but because of the extremely low tax rates imposed on carbon externalities.

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<sup>21</sup> Denmark, Finland, Germany, Ireland, Italy, the Netherlands, Norway, Slovenia, Sweden, Switzerland and the United Kingdom.

Many countries refrain from levying more significant environmental taxes to avoid dealing with their redistributive implications. Furthermore, exemptions are often granted to energy-intensive industrial sectors to foster their international competitiveness (OECD 2006, 2010). Instead of being submitted to taxes redistributing revenue from the private to the public sector, corporations have increasingly been submitted to market-based solutions, such as cap-and-trade or emissions trading systems (ETS) and offsetting mechanisms, which redistribute revenue among corporations only. The Kyoto Protocol laid the foundation for implementing these solutions globally, but only a minority of countries have committed to binding carbon emissions reduction targets.<sup>22</sup> Furthermore, the overly generous allowance of free emission permits to corporations has kept carbon pricing well below \$50 per ton, is considered by many climate experts as a minimum for enabling structural economic transformations required for a transition towards a sustainable development path. For instance, in the oldest and largest ETS established by the European Union in 2005, carbon prices mostly hovered between €10 and €15 during the last 5 years, and even collapsed to €3 in early 2013. Consequently, most environmental taxes are levied in a regressive manner, weighting mostly on households rather than corporations, whose incentives are only weakly affected by environmental redistributive policies.

**Figure 13: Environmental tax revenue (2000-2011)**



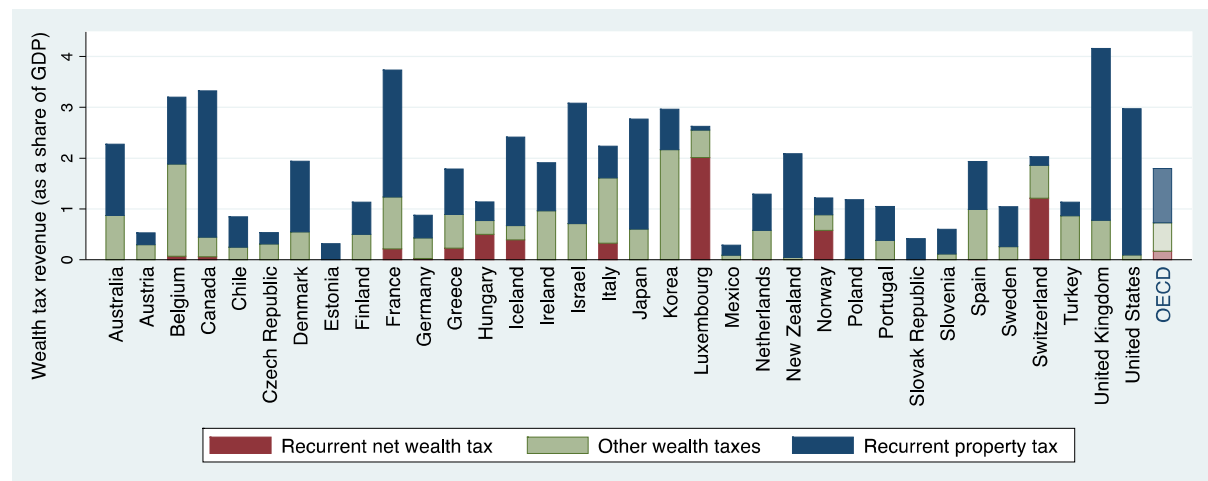
Source: Author. Note: OECD data. Environmental tax revenue mainly arises from energy and vehicle taxes, which are closely related to carbon emissions. Revenue from environmental taxes does thus not correspond to a single category of tax revenue in table 2, and splits between value-added tax and other tax revenue.

<sup>22</sup> Developing countries and major developed countries, such as Canada, Japan, New Zealand, the Russian Federation and the United States are not bound by any reduction targets

### *Dwindling recurrent net wealth taxes*

The base of net wealth taxes encompasses all forms of capital, including financial capital concentrated in the top centile. Net wealth best reflects the ability to pay of individuals, which is supposed to be a founding principle of tax collection, and it further represents a considerable potential source of revenue given that the value of accumulated capital stock is worth several times that of GDP in most countries (see capital stock to GDP ratios in figure 6). Consequently, net wealth taxation is essential for reducing inequality of outcome and enhancing equality of opportunity. Yet, as reported in the last IMF Fiscal Monitor (2013) offering a brief survey of wealth taxes in general, only two small countries in the OECD impose recurrent net wealth taxes generating more than 1 per cent of GDP, Luxembourg and Switzerland (figure 14). Furthermore, many countries abolished them over the last 15 years. Iceland and Spain reintroduced them in the wake of the financial crisis, but recurrent net wealth taxes are generally inexistent or very low (table A1).<sup>23</sup>

**Figure 14: Wealth tax revenue composition in OECD countries (2011)**



Source: Author. Note: Based on OECD data. Wealth tax revenue enters the category of other tax revenue in table 2.

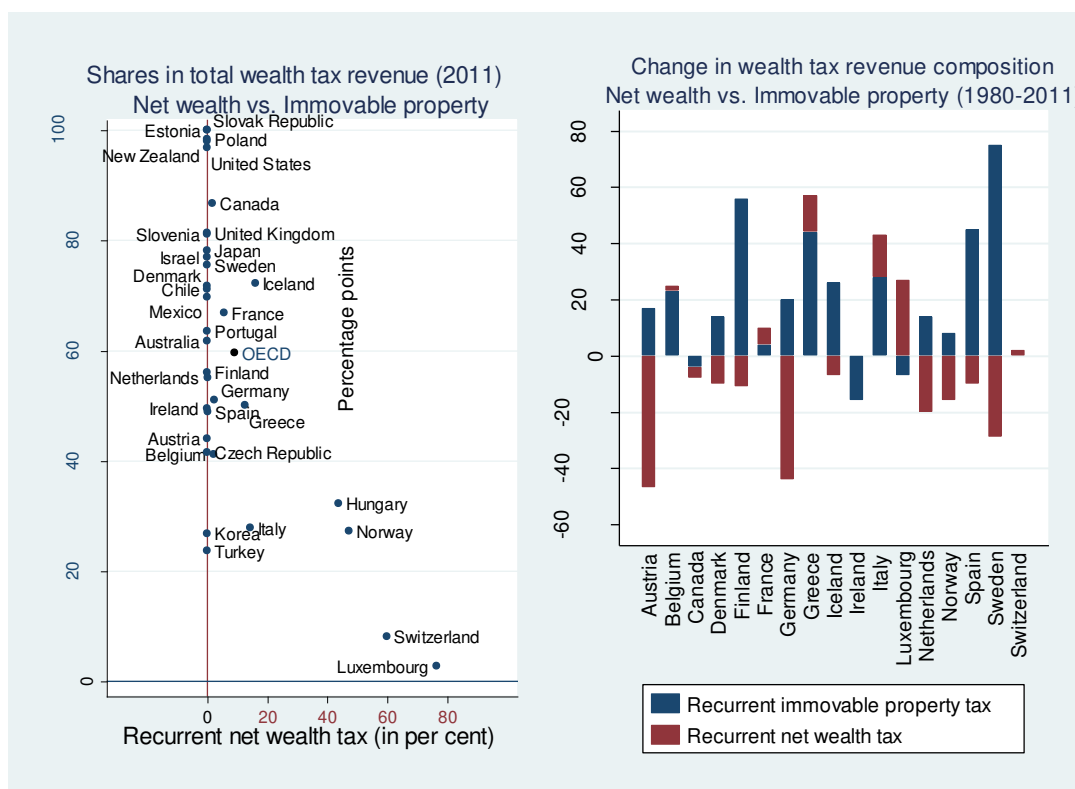
Meanwhile, immovable property has become the main base for wealth taxation in developed as well as in some developing countries (Norregaard 2013) and recurrent property taxes account for the bulk of wealth tax revenue (figure 15). Revenue generated by taxes on land and residential property is most significant in Anglo-Saxon countries, where it almost accounts for the totality of wealth tax revenue. Property tax revenue generally accrues to local authorities using it to fund local public goods, which is often viewed as improving governance and accountability (IMF 2013a). However, with the growing spatial segregation and gerrymandering reinforcing the clustering of communities according to their income level, the use of property tax revenue to fund local public goods also limits their progressivity, which could be enhanced by central wealth redistribution. Indeed, in presence of spatial segregation along income lines, the fine line between local public goods available

<sup>23</sup> Table A1 in annex lists the main top personal income and wealth tax rates in selected OECD countries. It illustrates the variety of situations, but also highlights the extent to which capital income can benefit from exemptions as well as the near disappearance of wealth taxes. It should be noted that personal taxation does not apply to economic income, but only to fiscal income, which sometimes only represents a fraction of economic income, due to tax evasion or tax avoidance schemes involving, for instance, trusts and foundations hiding the identity of the beneficial owner.

to all social groups and club goods available only to the most affluent is becoming blurred. Furthermore, the extent to which property taxes weigh on renters and owners remains debated, casting further uncertainties concerning their progressivity (Norregaard 2013).

Other wealth taxes arise from various sources, including inheritance, gift and estate taxes, but the bulk of other wealth tax revenue arises from taxes on financial and capital transactions, including various taxes on immovable and other property sales, including the well-known financial transaction tax (FTT). Proponents of the FTT view it as a kind of value-added tax on financial consumption, which could rein in financial speculation, volatility and instability, rather than a genuine wealth tax, but it undoubtedly is a progressive tax. FTT are in place in many countries, though at very modest levels compared to regular value-added taxes. Yet, its opponents argue that the FTT is detrimental to actors engaging in financial transactions as well as to overall economic efficiency. In the wake of the global financial crisis, the idea of introducing a EU-wide FTT resurfaced. In December 2012, 11 members of the EU, including Germany, France, Italy and Spain, adopted a plan for a FTT, which would rein in unproductive speculation, encourage the financial sector to engage in more responsible activities geared towards the real economy, and further raise about 35 billion euro in tax revenue every year. However, no final agreement has so far been reached on the details of this plan and financial interests remain strongly opposed to its implementation.

**Figure 15: Rising immovable property tax revenue as a substitute for dwindling net wealth tax revenue in OECD countries (1980-2011)**



Source: Author. Note: Based on OECD data. Panel B covers a limited number of countries, because many countries never levied any recurrent net wealth taxes between 1980 and 2011 (i.e., Australia, Japan, Korea, Mexico, New Zealand, Portugal, Turkey, United Kingdom and United States) and data is missing in 1980 for other countries (i.e., Chile, Czech Republic, Estonia, Hungary, Israel, Poland, Slovak Republic, Slovenia).

### **3.4.3. International tax abuses: harmful tax competition, tax avoidance and tax evasion**

Progressive taxation has been undermined by domestic reforms in many countries, and it was further subverted by finance-led globalization promoting harmful tax competition, tax avoidance and evasion by TNCs and HNWIs. Tax abuses have existed for a long time, but they have grown exponentially in recent decades, supported by financial liberalization, information technology progress and a global wealth defence industry employing a growing number of accountants, legal and financial experts (Palan et al. 2010, Winters 2011). As noted by the IMF (2013) “recognition that the international tax framework is broken is long overdue. Though the amount is hard to quantify, significant revenue can also be gained from reforming it. This is particularly important for developing countries, given their greater reliance on corporate taxation, with revenue from this taxation often coming from a handful of multinationals”.

Following a request by G7 leaders in 1996, developed countries acknowledged for the first time that tax competition could be harmful, pointing fingers both at tax havens and other countries offering harmful preferential regimes leading the tax rate race-to-the-bottom (OECD 1998). Tax havens are commonly understood to be countries that, in exchange for a fee, use one principal asset, their sovereignty, to serve a non-resident constituency by offering strong protection of banking and corporate secrecy combined with low or nil taxation. However, havens are part of a wider system of offshore tax and regulatory avoidance, in which different countries offer various interacting facilities. Tax havens may appear small and insignificant, but they play an important role in the world economy, by undermining regulatory and taxation processes and skewing the distribution of costs and benefits of globalization in favour of the wealthy few (Palan et al. 2010).

The project launched by the 1998 OECD report was significantly modified by a change in US policy, when the new Bush administration accepted arguments that the initiative as first formulated, to cover preferential tax regimes, entailed dictating tax policy to other states. The project then refocused on obtaining information from tax havens, pursued at first through negotiation of bilateral tax information exchange agreements (TIEAs), which was a very slow process. Tax havens also pointed out that the major financial centres themselves offered corporate secrecy, and did not collect information on payments to non-residents. A major step was the US Foreign Account Tax Compliance Act (FATCA) of 2009, but although it applied even to non-US banks if they have US clients, it still did not extend to non-US taxpayers. However, when the US authorities began negotiating agreements with other states to help enforce FATCA, some asked for reciprocity, so the net began to be widened, and gradually bank account reporting requirements are becoming multilateralized. A significant step was taken in 2010, when the multilateral Convention on Mutual Administrative Assistance in Tax Matters was thrown open to all states. Finally, the G8 summit meeting in 2013 agreed to establish a new global standard of multilateral and automatic exchange of tax information, as well as transparency of beneficial ownership. , the IMF stopped monitoring this emerging issue at the dawn of the financial crisis.

Yet, the issue of tax abuses facilitated by tax havens and OFCs has never been so prominent. Tax havens alone account for around 50 per cent of all international banking lending and 30 per cent of the world’s stock of foreign direct investment (Palan 2010). Private and corporate wealth stashed in tax free zones may have reached between \$20 trillion and \$32 trillion

according to some estimates (The Economist 16 February 2013, Tax Justice Network 2012)<sup>24</sup> and may continue expanding continuously as long as tax abuses remain profitable.<sup>25</sup>

Unrecorded wealth of such magnitude represents a major revenue loss for tax administration and further biases the debate about income inequality. If this unreported wealth earned a very modest rate of return of just 3 per cent, and a modest tax of 30 per cent imposed on this income would generate yearly tax revenues of \$190-280 billion – roughly twice the amount OECD countries spend on all overseas development assistance around the world.<sup>26</sup> The imposition, a capital gains tax, an inheritance tax or a recurrent net wealth tax would further boost this figure considerably (Tax Justice Network 2012). It would also contribute reducing income inequality and possibly extreme wealth in the longer run. In the meanwhile, the growing magnitude of unrecorded wealth and income flows further introduces a downward bias in all widely used inequality measures. Claims of declining inequality should therefore be taken with caution.<sup>27</sup>

The financial crisis revealed that tax havens and OFCs thriving on complexity, opaque networks and arbitrage are inextricable from the shadow banking nexus lying at the heart of the crisis (Palan and Nesvetailova 2013). Facing fiscal difficulties and popular discontent, G20 leaders rapidly announced in April 2009 a crackdown on harmful tax competition and financial secrecy in order to protect their public finances and curb tax abuses.

Since then, different actors subsequently launched several initiatives to tackle tax abuses. The Financial Stability Board, for instance, initiated work on a global Legal Entity Identifier (LEI), a reference code to uniquely identify a legally distinct entity that engages in a financial transaction. This could help track all financial flows, even in secrecy jurisdictions. In 2013, the G20 pledged to establish a system for the automatic exchange of tax information.<sup>28</sup> In February 2014, it adopted a standard (OECD 2014) to be implemented by G20 countries and possibly other countries by the end of 2015.<sup>29</sup> The OECD further developed an action plan to tackle base erosion and profit shifting (BEPS) by TNCs, which aims to make major reforms to international corporate taxation. However, these initiatives are still under development and even once proposals are put forward, implementation will be challenging. In particular, the capacity constraints of poorer countries will have to be addressed in order to ensure that they are able to participate, and ensure that they can contribute effectively to reining in tax abuses and reducing inequality (Moore 2014).

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<sup>24</sup> The financial wealth of HNWIs (households) illegally escaping taxation amounts to \$5.9 trillion according to Zucman (2013), but this estimate excludes non-financial wealth, such as real estate, yachts or art collections that remain non-declared to fiscal authorities in the residence country. It further excludes corporate financial and non-financial wealth accumulated in shell companies through practices flirting with illegality. In 2012, the amount of indefinitely reinvested foreign earnings of American transnational corporations alone waiting for a tax holiday to repatriate profits was estimated at more than \$1.95 trillion (USPIRG 2013).

<sup>25</sup> According to Global Financial Integrity (2012), illegal capital outflows linked to crime, corruption, and tax evasion cost the developing world \$858.8 billion in 2010.

<sup>26</sup> In 2012, members of the Development Assistance Committee (DAC) of the OECD provided \$125.6 billion in net official development assistance (ODA), representing 0.29 per cent of their combined gross national income (GNI), a -4.0 per cent drop in real terms compared to 2011.

<sup>27</sup> See discussion in section 2.2.1..

<sup>28</sup> Tax annex to the Saint Petersburg G20 leaders' declaration (September 2013).

<sup>29</sup> Communiqué of the Meeting of the G20 Finance Ministers and Central Bank Governors – Sydney, Australia, February 23, 2014. Available at: <http://www.g20.utoronto.ca/2014/2014-0223-finance.html>

## **4. TOWARDS A FRAMEWORK ENABLING ASSET-CENTRED REDISTRIBUTIVE POLICIES FOR EQUITY AND SUSTAINABLE DEVELOPMENT**

Redistributive policies and trends described in the previous section are characterised by features that mostly derive from a neoliberal policy framework, including a resource-constrained approach to public goods provision, regressive revenue mobilization weighting increasingly on consumption instead of high incomes and concentrated wealth, insufficient concern for environmental issues, and a move away from asset-based public revenue. Overall, this framework resulted in weaker redistribution, mild poverty alleviation, rising income inequality, widespread tax abuses and extreme wealth concentration. In this context, renewed thinking about opportunities to foster redistributive institutions and policies through domestic reforms and international cooperation is required in order to advance towards an alternative framework enabling redistributive policies for equity and sustainable development.

Operationalizing redistributive policies in pursuit of economic, social and environmental sustainability represents a major intellectual and political challenge, because it requires shifting away from the prevailing development paradigm using private investment-led economic growth as its ultimate but ill-conceived benchmark of progress (Stiglitz, Sen and Fitoussi 2009) towards a sustainable development paradigm that better acknowledges the importance of non-market interactions for collective well-being and planet-sensitive development. Consequently, such a shift requires actively challenging discourses that deny the central role of equity for sustainable development as well as reforming unfair or dysfunctional economic and political governance processes that fail to reflect the increasingly cooperative nature of wealth production and creation at the domestic and international level.

### **4.1. Redefining equity and development in sustainable terms**

#### **4.1.1. Focusing on asset inequality, not income poverty**

Equity is generally defined in terms of equality of opportunity, rather than equality of outcome, but both are interdependent in practice. Redistributive policies for reducing inequality generally combine in-kind transfers with direct and indirect transfers. The deliberate omission of wealth redistribution as a means for equalizing opportunities, however, signals the priority most countries give to alleviating income poverty over addressing underlying asset inequality. Absent governance reforms enabling a broader use of redistributive policies to correct unequal asset endowments, income poverty is likely to endure, and asset inequality to the benefit of a wealthy few is bound to continue rising.

#### **4.1.2. Enabling trade-offs between economic growth, social equity and environmental sustainability**

Recent experiences of simultaneous rapid economic growth and declining inequality, especially in Latin America, and abundant older examples among Asian Tigers and developed countries, are a testimony to the fallacy of the trade-off between economic efficiency and equity assumed by neoliberal economists, who uncritically extrapolate a micro-economic theoretical construct onto entire societies and countries (Stiglitz 2013, Ostry et al. 2014). A shift away from the development paradigm subordinating social and

environmental concerns to the overarching objective of (private investment-led or demand-led) economic growth is imperative to enable sustainable development. Indeed, while the individual or collective pursuit of economic gains may generate public benefits, they also nurture economic, social and environmental instability at the cost of vulnerable social groups and future generations. Moving towards a sustainable development paradigm enabling trade-offs between economic growth, social equity and environmental sustainability is therefore desirable. The latter is especially important in developed countries with the highest carbon footprint.

### **4.1.3. Redefining the metrics of equity and development**

New metrics for equity and development are required for operationalizing such a paradigm shift based on informed policy decisions. GDP growth per capita is frequently viewed as evidence of declining inequality and sustainable development, even though it provides information neither about equity nor about sustainable development. GDP per capita doesn't contain any information about income distribution and thus requires making the implicit value judgment that the marginal social utility of income is constant (e.g., an extra \$1 of income to a rich heir is worth as much as an extra \$1 of income to hard-working parents at the poverty line). Synthetic measures of income inequality, such as the Gini, are suited for descriptive purposes, but their abstract nature fails providing insight about the sources of rising income inequality (labour or capital income), which is important for devising policy solutions. Therefore, efforts should be undertaken to produce new metrics able to highlight parameters that matter for understanding of the dynamics of inequality (e.g., top income shares by source of income, wealth shares, Palma income and wealth ratios) as well as for economic justice and good governance. Similarly, promoting sustainable development would be facilitated by the use of more relevant welfare metrics, such as environmental-economic accounting, instead of purely economic measures such as GDP, which ignore the broader social and environmental context (Stiglitz et al. 2009).

## **4.2. Building institutions and designing policies enabling asset-centred redistributive policies for equity and sustainable development**

As acknowledged by the G20, revenue mobilization was already insufficient in many developing countries to fund progress towards MDGs (G20 2011), and significant additional efforts are likely to be required for the post-2015 sustainable development agenda if it is to aim at fully eradicating extreme poverty and at addressing salient social and environmental challenges, such as high income inequality and the breach of planetary boundaries. Progress towards equity and sustainable development is therefore conditional on building institutions and designing policies that enable stepping up revenue mobilization along with progressive redistribution of income and income-generating assets among individuals and, under specific conditions, also between the private and public sector. Absent such progress, development efforts will remain dependent on elusive international development aid and/or regressive debt-financing (Hager 2013).

### **4.2.1. Modernizing tax administration for increased and progressive tax revenue mobilization**

Increased and progressive mobilization of tax revenue is essential, but some developing and least developed countries with large rural and informal sectors still lack the administrative capacity to levy progressive taxes. It first requires building more developed redistributive institutions, including competent tax administrations able to handle complex information and



create domestic wealth registers, which is key for progressive tax collection as well as economic analysis and planning (Chaudhry 1997). Such efforts can further act as a catalyst for demands for greater accountability, transparency and better governance, which would strengthen the role of civil society and state-building (Prichard 2009, Joshi et al. 2012). Development assistance and capacity development in this area is therefore key for remediating the need for ODA in the longer term.

#### **4.2.2. More progressive tax systems for reducing inequality of outcome**

In addition to addressing medium-term institutional and administrative capacity constraints hampering revenue mobilization, tax reform should make tax systems more progressive while simultaneously strengthening incentives for sustainable production and consumption. This requires shifting the tax base from consumption and low incomes towards higher incomes, which largely derive from capital income, and especially towards wealth and environmental externalities.

Flat indirect taxes are acknowledged to be regressive, but they nevertheless represent a major source of revenue in most developing countries (table 2) struggling with high inequalities. Taxes on labour income are often described as discouraging work, but high marginal tax rates fulfil the essential role of deterring excessive compensation that has contributed to the great escape of the top 1 per cent (figure 3). To resorb rising income inequality, it may be required to bring top marginal tax rates to their optimal level, which some economists estimate at around 70 per cent (Piketty et al. 2014). It is also urgent to close deliberate loopholes and exemptions that significantly depress the effective tax rate imposed on capital income and to combat tax avoidance and evasion in ways that effectively suppress opportunities for HNWIs and TNCs to declare fiscal incomes and profits representing only a fraction their economic income.

#### **4.2.3. Shifting the tax base towards wealth for enhancing equality of opportunity**

Wealth best reflects the ability to pay of individual, which is a founding principle of taxation. In most countries, capital stock often represents a multiple of annual income flows, which further keeps rising along the capital accumulation process, representing a significant untapped tax base. As wealth is highly concentrated in all countries, including developed countries with more egalitarian wealth distribution (figure 6), capital income flows only accrue to a wealthy few. Wealth concentration is thus not only a major driver of rising income inequality, but also a foundational socio-economic structure sustaining the reproduction of inequality over time. The negative structural weight of wealth concentration on inequality across individuals and generations is all the more determinant when the rate of economic growth drops below the after-tax return on capital ( $r > g$ ).<sup>30</sup>

Higher wealth taxes (especially recurrent net wealth taxes and inheritance taxes) therefore represent the tool of choice for redistributive policies aiming at improving equality through increased and progressive tax revenue mobilization. In addition, wealth taxes have the virtue of encouraging work income over rent income and to incentivize capital owners to make productive investments, which will need to be stepped up significantly for achieving

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<sup>30</sup> Piketty (2013) proposes an exhaustive discussion of this issue. See the brief and simplified discussion on this topic around figure 6.

structural economic transformations that are required for bringing the global economy on a more sustainable development path.

Wealth taxes currently only target immobile capital in most countries, mainly through residential property taxes. Yet, extreme wealth is mainly accumulated in financial assets, which are often wrapped in opaque ownership structures hidden in tax havens and OFCs, out of reach of domestic tax administrations. While domestic regulators could increase wealth taxes, including on mobile capital, part of the targeted tax base will escape their authority in absence of an internationally coordinated and comprehensive crackdown on financial secrecy and harmful tax competition. As opportunities for tax evasion and tax avoidance remain abundant, some economists have stressed the advantages of imposing a one-off wealth levy, whose costs to some wealth owners may be inferior to the cost of relocating (Bach et al. 2011, Bach 2012, Eichengreen 1991). However, given the technical feasibility of implementing capital income and wealth taxes at the domestic and/or global level in presence of financial transparency, priority should be given to overcoming existing political obstacles in the medium term. Ongoing initiatives for the automatic exchange of information (AEOI) and creating registries disclosing beneficial ownership of trusts and other shell structures are thus of fundamental importance for enabling governments to tap the huge potential of wealth as a tax base.

According to some estimates, imposing a 1 per cent tax on the net wealth of the richest decile could raise tax revenue amounting to one per cent of GDP in many countries. Given the very high concentration of wealth, simply raising this rate to 2 per cent on the richest centile would already double the revenue raised (IMF 2013a). However, in order to contain extreme wealth (which mostly consists of mobile financial capital) and reduce inequality, tax rates would have to keep pace with the growing returns to wealth. As the greatest fortunes expand at an average rate of around 10 per cent or more, a global annual tax on financial capital would have to follow a progressive schedule taxing net wealth at a rate of at least 10 per cent above a certain threshold.<sup>31</sup> High wealth taxes are probably the only means for gradually reducing extreme inequality that has developed over the last decades of financial globalization.

#### **4.2.4. Shifting the tax base towards environmental externalities for incentivizing sustainable production and consumption, and shorter value chains**

The tax base should also decisively shift towards environmental externalities, especially carbon emissions strengthening global warming, without depriving the poor from access to energy and other markets. Yet, flat regressive environmental taxes on energy and vehicles currently mostly weight on poorer households. By contrast, corporations in developing and developed countries are often submitted to special regimes, such as fossil fuel subsidies, exemption from energy taxes or participation in market-based solutions (ETS and offsetting mechanisms), which have so far kept the price of carbon emissions too low for incentivizing transformations in unsustainable production structures.

Unsustainable production and consumption has increased in recent decades with the rapid expansion of global but segmented value chains fostering polluting merchandise transport. On average, international merchandise transport increases the carbon emissions that are embedded in produced goods by 50 per cent (Cristea et al. 2013), so that the transport of internationally traded merchandise may already account for more than 7 per cent of global

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<sup>31</sup> See also section 2.2.3, footnote 6.

carbon emissions (WESP 2013). As long as the cost of transport will not outweigh be profits arising from the exploitation of cross-country labour cost differential, global value chains will pursue their expansion and contribute to rising carbon emissions in the transport sector.

In order to promote more sustainable production and consumption patterns<sup>32</sup> without burdening poorer households, efforts should be made to levy progressive environmental taxes tied to individual consumption of some luxury goods and services that are particularly harmful to the environment. Some of them would be easy to implement, such as taxes on flights (e.g., exponential tax on plane tickets instead of frequent flyer reward programmes) or on secondary residences. Gasoline consumption could also be taxed in a progressive manner tied to individual consumption through the use of credit cards tracking purchased quantities (Casal 2012).

Furthermore, ways to implement border carbon taxes should be investigated so as to prevent the further development of unsustainable global value chains thriving on environmentally harmful but labour cost-saving trade in intermediate and final goods. With the growing necessity to significantly reshape unsustainable production and consumption behaviours and patterns, the ability of higher taxes to send clearer and steadier signals across the economy and to generate revenue that can be recycled to achieve distributional objectives may become more important than market-based solutions that redistribute gains within the corporate sector, but which have so far failed to generate price signals inducing structural transformation.

#### **4.2.5. Socializing natural resource rents and/or ownership to ensure sustainable use and equitable access for present and future generations**

Equitable access to natural resources could be fostered by the progressive redistribution of environmental tax revenue as well as of proceeds of socialized natural resource rents, such as in Norway, where corporate profits in the oil sector are taxed at a rate of 78 per cent and transferred to an intergenerational solidarity fund. The timid push back against the privatization of natural resources in Africa and Latin America illustrates the untapped potential for boosting government non-tax revenue by appropriating a larger share of natural resource rents to the public sector through nationalization or renegotiation of contract terms. The Ecuadorian Yasuni proposal also highlights the particular role public ownership of hydrocarbon resources could play in limiting their growing exploitation harming climate stability and sustainable development, instead of leaving decisions concerning their exploitation in the hands of market forces. The failure of the Yasuni initiative, however, highlights the need for increased international cooperation, especially with regard to climate financing.

#### **4.2.6. Redistributing income-generating assets for economic democracy and sustainable development**

Conditions for implementing wealth transfers between social groups or between the private and public sectors are always country-specific, but such transfers may be necessary in some countries for promoting equity and sustainable development. Redistributing land property rights to small farmers, for instance, can reduce income poverty and inequality in a sustained

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<sup>32</sup> Moving the global economy towards an environmentally less unsustainable development path that contains global warming within a range of 2 degree Celsius requires that developed economies reduce their carbon emissions by 80 per cent by 2050. Such a reduction is impossible without significant transformations in production structures and consumption behaviours, including in developing countries.

manner and is further conducive to the use of more sustainable agricultural methods. Corporate ownership and governance structures involving a diversity of stakeholders (e.g., cooperatives, firms with multi-level ownership) can also foster economic democracy (Wilkinson and Pickett 2014) and strategies pursuing collective interests instead of private profits alone.<sup>33</sup> The successful socialization of land valuation gains and the use of marketized SOEs for pursuing public policy objectives in Chongqing (box 1) illustrates how government can leverage publicly owned assets for economic growth and social equity in an efficient but more sustainable way than private actors.

#### **4.2.7. Investing in people: a rights-based approach to human development**

A more equal distribution of income-generating assets together with increased and progressive revenue mobilization is essential for enabling a rights-based approach considering human development as a fundamental right. The MDGs contributed to draw attention on the central role of asset inequality in the restricted sense of human capital as a determinant of income poverty and slow economic development. Increased public social spending improved access to education and health services, and social protection programmes further shielded some of the most vulnerable social groups from extreme poverty, but the prevailing approach to human development in many countries remains resource-constrained. This particularly affects the coverage and quality of social protection programmes, which still partly exclude or discriminate against vulnerable social groups least integrated in formal employment structures, such as elderly people or women. Increased and progressive revenue mobilization may facilitate a gradual political transition towards a rights-based approach and contribute progressing towards development objectives.

### **4.3. Fostering international cooperation**

#### **4.3.1. Bridging the gap with ODA for public social spending and revenue mobilization**

The transition towards more asset-centred redistributive policies can be done by individual countries, but enhanced international cooperation is desirable on several fronts. ODA commitments should be met to accelerate progress towards the MDGs, and development assistance for developing countries should aim at empowering local actors. In countries most reliant on foreign aid, development assistance should contribute improving revenue mobilization capacity. Such assistance is required for boosting the capacity of weakly developed tax administration to handle complex information and cross-check data from different sources in order to diversify the tax base away from regressive consumption taxes towards more progressive taxes (Prichard et al. 2012).

Development aid could also assist tax administration in auditing TNCs, whose transfer mispricing schemes may cost developing countries up to \$160 billion per year in foregone tax revenue, almost the amount of annual ODA (Christian Aid 2009). Capacity building efforts for setting up the administrative structures and procedures will also be required for enabling developing countries to participate in the automatic exchange of information (AEOI) that is progressively being established at the international level and to track costly tax abuses.<sup>34</sup>

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<sup>33</sup> See Dugger 1987, Sobhan 2010, Klimina 2011, Shi and Liu 2012. See also the UNRISD project on *Potential and Limits of Social and Solidarity Economy*: <http://www.unrisd.org/sseconf>

<sup>34</sup> Revenue losses arising from illicit capital flows are estimated by the UN to amount to \$50 billion per year for Africa (United Nations Economic Commission for Africa 2013), and may thus cost several hundred billion per year to the developing world.

#### **4.3.2. Promoting financial transparency to prevent tax abuses by HNWIs and TNCs**

A key ingredient to all tax abuses by HNWIs and TNCs is financial secrecy, which has become increasingly indefensible, based on moral as well as legal, political and economic arguments. Facing the magnitude of wealth that remains out of reach of tax authorities<sup>35</sup> and the impact of tax abuses on the capacity of governments to uphold their human rights obligations, the distinction between legal tax avoidance and illegal tax evasion that is blurred by secrecy and conflicting rules across jurisdictions appears futile and indefensible (IBAHRI Task Force 2013). Financial opacity also played a key role in the run up to the global financial crisis. Indeed, many special purpose vehicles amassing bad debt were often registered in secrecy havens, out of sight of tax administration and of regulators (Palan et al. 2010, Palan and Nesvetailova 2013).

Consequently, global governance bodies initiated work for improving financial transparency, which requires the possibility for authorities to identify (i) financial flows as well as (ii) related parties. Recently, the Financial Stability Board established a Global Legal Entity Identifier Foundation (GLEIF) and is working on the introduction of a legal entity identifier (LEI). Confidentiality of the reference data, particularly ownership information, may represent a hurdle in some countries. Most countries have regulatory reporting requirements, making it unlikely that an entity engaged in financial markets will have the ability to hide its existence. It is, however, possible that entities are allowed to keep their relationships with other entities confidential (Powell et al. 2011).

The adoption of FATCA by the United States and the concessions obtained from champions of financial secrecy, such as Luxembourg or Switzerland, concerning the AEOI illustrated that legal domestic confidentiality provisions can be overcome under certain political circumstances.<sup>36</sup> This example encouraged similar EU-wide efforts and led world leaders to formally pledge to establish a new global standard of multilateral and automatic exchange of information, as well as transparency of beneficial ownership (G8 2013, G20 2013).<sup>37</sup> Taken together, the LEI and the creation of a global register of beneficial ownership of trusts and other shell companies would enable a useful AEOI between multilateral parties, and could open up the possibility for a recurrent domestic or global capital tax for reducing inequality.

Currently, exchange of information still occurs mostly on a bilateral basis and on request. The multilateral Convention on Mutual Administrative Assistance in Tax Matters (developed jointly by the Council of Europe and the OECD) provides a basis for exchange of information

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<sup>35</sup> See discussion under point 3.4.3.

<sup>36</sup> FATCA provisions would impose sanctions on banks unwilling to automatically exchange information about their US clients with their domestic regulator and the US Internal Revenue Service, amounting to 30 per cent of the profit made on their business in the United States.

<sup>37</sup> The G8 Lough Lerne Declaration mentions 10 points, including the following: 1. Tax authorities across the world should automatically share information to fight the scourge of tax evasion. 2. Countries should change rules that let companies shift their profits across borders to avoid taxes, and multinationals should report to tax authorities what tax they pay where. 3. Companies should know who really owns them and tax collectors and law enforcers should be able to obtain this information easily. 4. Developing countries should have the information and capacity to collect the taxes owed them – and other countries have a duty to help them. 5. Extractive companies should report payments to all governments - and governments should publish income from such companies. 6. Minerals should be sourced legitimately, not plundered from conflict zones. 7. Land transactions should be transparent, respecting the property rights of local communities.

on request without the need for a bilateral double tax treaty, but AEOI requires a supplementary agreement to establish procedures. To remediate this shortcoming, the G20 asked for a common reporting model, including a Model Competent Authority Agreement, and endorsed a new Standard for Automatic Exchange of Financial Account Information (OECD 2014) at the G20 Finance Ministers and Central Bank Governors' meeting in February 2014.

The potential non-universality of this initiative and possible exemptions could drastically limit its impact, however. Indeed, as has already been observed in the past the non-universal automatic exchange of banking information may result in the mere shifting of funds towards jurisdictions not committed to transparency (Johannesen and Zucman 2012) while the non-exhaustive AEOI may foster the development of para-financial businesses performing similar types of functions.<sup>38</sup>

Developing countries that are not yet involved in these multilateral initiatives have a significant stake in ensuring they can share the benefits from automatic information exchange among G20 countries. Tax abuses are particularly widespread in rapidly emerging economies that are increasingly important sources of offshore private wealth (Global Financial Integrity 2012), and need to build up more sophisticated tax administrations in order to tackle enduring mass poverty (FitzGerald 2012). For these countries, a uniform multilateral automatic information exchange system could positively affect their ability to address offshore tax evasion and, further, could serve to improve the structure of their domestic information reporting and withholding regimes more generally.<sup>39</sup>

Meanwhile, most financial TNCs would also benefit from a single internationally consistent system for cross-border tax administrative assistance, as this would avoid a situation in which they are required to implement multiple different systems in order to satisfy different sovereigns' demands. Therefore, although their starting points are different, both financial TNCs and developing countries have a shared interest in a single, uniform, broadly multilateral regime for addressing offshore accounts (Grinberg 2013).

### **4.3.3. Addressing harmful tax competition to combat tax avoidance**

While financial transparency may curtail widespread tax evasion among HNWIs,<sup>40</sup> financial transparency is not enough to address tax avoidance by TNCs and HNWIs. As acknowledged by the OECD, TNCs represent the biggest demand for tax avoidance, just before HNWIs (OECD 2009), who incidentally also benefit most from corporate tax avoidance resulting in

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<sup>38</sup> The Economist recently reported on the rapid development of an international network of Über-warehouses allowing individuals to stock their wealth formerly stored in banks in storage facilities located in tax-free airport zones. While those zones are intended for temporary transit of merchandise, they are being expanded and transformed in luxury warehouses in a growing number of countries, including Switzerland, Luxembourg, Singapore and many other OFCs (The Economist, 23 November 2013, "Über-warehouses for the ultra-rich").

<sup>39</sup> For some LDCs the technical capacity to engage fully in automatic information exchange is not likely to be in place for the foreseeable future. For these countries, though, it may be possible to provide information and technical assistance in a manner that allows for risk-based auditing, while exempting local financial institutions serving only domestic markets from the broader international regime.

<sup>41</sup> See the research project on "Secrecy for sale: inside the global offshore money maze" done by the International Consortium of Investigative Journalism that revealed the so-called "Offshore Leaks". Available: <http://www.icij.org/offshore>

<sup>41</sup> Transfer mispricing in the extractive sector causes a significant income loss for developing countries, because of the importance of the oil and mining sector in some developing economies, but mispricing is often most blatant in other sectors, where there are no reference market prices, unlike for most commodities.

higher shareholder payouts. The IMF (2013) also noted “recognition that the international tax framework is broken is long overdue. Though the amount is hard to quantify, significant revenue can also be gained from reforming it. This is particularly important for developing countries, given their greater reliance on corporate taxation, with revenue from this taxation often coming from a handful of multinationals”.

Tax abuses by TNCs have long perverted efforts of sovereigns to avoid double taxation of TNCs profits in different jurisdictions, resulting instead in widespread double non-taxation. This has been an issue for developing countries in the extractive sector, but also in other sectors.<sup>41</sup> Transfer mispricing and profit shifting more generally has also become a major issue in developed countries, where profitable TNCs paying little or no taxes in times of austerity caused popular discontent followed by several parliamentary inquiries.<sup>42</sup> Consequently, G20 leaders acknowledged that passive tolerance of massive corporate tax dodging undermines public trust in the tax and political system and initiated work through the OECD Committee on Fiscal Affairs (CFA) towards reform of the current international tax system.<sup>43</sup> Non-OECD G20 member countries were accepted as full members of OECD working parties on BEPS, and the OECD pledged to consult with developing countries, but it is unlikely to prioritize them. In October 2013, the UN Tax Committee decided to set up a subcommittee on BEPS, which will provide feedback to the OECD project from a developing country perspective, as well as consider possible remedies for BEPS that go beyond the remit of the OECD project (Picciotto 2014).

The OECD approach aims at fixing the current system without moving away from the separate entity approach that lies at the heart of harmful tax competition and aggressive corporate tax avoidance. The separate entity approach is rooted in a willful ignorance of economic realities and its willingness to treat TNCs as a multitude of separate entities, despite their integrated governance structure and strategy defined by a single CEO. This approach finds its origin in the first model tax treaties formulated by the League of Nations in 1928, at a time when TNCs were a nascent phenomenon. Today, TNCs intermediate about half of international trade and a significant share of foreign direct investment and financial transactions. By granting TNCs the privilege to have their entities taxed separately, based on how the TNCs decide to allocate its profits across entities, the separate entity approach creates incentives for countries to engage in harmful tax competition, which stimulates aggressive tax avoidance limited only by rules that can quickly be circumvented. In this context, the basic scheme for TNCs tax avoidance consists in two steps. First, TNCs create subsidiary companies or entities in low tax jurisdictions or tax havens, either to carry out activities (such as services) or to act as holding companies owning assets such as intellectual property rights, bonds, or shares. Secondly, by operating fictitious intra-group transactions for which there is often no reference market at arbitrary prices, i.e., transfer mispricing, TNCs can shift profits from high-tax to low tax jurisdictions, thus lowering the TNCs’ overall taxes.

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<sup>41</sup> See the research project on “Secrecy for sale: inside the global offshore money maze” done by the International Consortium of Investigative Journalism that revealed the so-called “Offshore Leaks”. Available: <http://www.icij.org/offshore>

<sup>41</sup> Transfer mispricing in the extractive sector causes a significant income loss for developing countries, because of the importance of the oil and mining sector in some developing economies, but mispricing is often most blatant in other sectors, where there are no reference market prices, unlike for most commodities.

<sup>42</sup> Parliamentary inquiries, e.g., “Offshore Profit Shifting and the U.S. Tax Code -- Part 1 (Microsoft & Hewlett-Packard)” or “Offshore Profit Shifting and the U.S. Tax Code -- Part 2 (Apple Inc.)”, US Senate Permanent Subcommittee on Investigations, 2012; UK Parliament (2013). Tax Avoidance - Google. London, House of Commons, Committee of Public Accounts 9th Report 2013-14.

<sup>43</sup> Tax annex to the Saint Petersburg G20 leaders’ declaration (September 2013).

In July 2013, the OECD presented an Action Plan for addressing "Base Erosion and Profit Shifting" (BEPS) over the next 2 years. This plan is structured around 15 point actions, including 6 horizontal actions and 9 substantive reform topics (OECD 2013). In summary, the horizontal actions aiming at improving coordination include a study on the digital economy, which enables a growing number of tax abuses, as the collection of better data on the extent of international tax avoidance. Two more actions aim at improving transparency through the development of model provisions for disclosure of aggressive tax planning strategies and improved transfer pricing documentation requirements. The latter is potentially very significant, as it has become linked with the mandate to establish a global template for multinationals to prepare and submit a country-by-country report for all countries where they do business, creating the possibility of consolidating those reports on a worldwide basis and enhance financial transparency.

Among the substantive action points, the first four aim at establishing coherence of international tax standards, starting with hybrid mismatches<sup>44</sup> and controlled foreign corporations (CFCs) rules.<sup>45</sup> The plan also envisions to tackle harmful preferential tax practices by reviving a forum that was abolished a decade ago and to make proposals limiting deductibility of interest and other payments to related entities. Next, the plan aims to more closely align the allocation of income with the economic activity that generates that income through anti-abuse provisions to be included in bilateral tax treaties. One option would be to amend the model treaty promoted by the OECD by including a clear statement that all income must be taxed somewhere, which is not currently the case. Anti-abuse provisions are further intended to clarify the definition of and attribution of profits to a permanent establishment. This point is potentially contentious, because the authorized OECD approach treats a permanent establishment like a corporate subsidiary. Yet, some OECD countries and most developing countries that mainly host TNCs oppose this approach, which favours destination countries over source countries. Three action points concern the perennial problem of transfer pricing, and aim to continue and extend the revision of the Guidelines already under way since 2010, concerning the attribution of income to intangibles, which include intellectual property rights. This has become an intractable issue because the OECD approach has exacerbated the difficulties created by the separate entity/arm's length principle, by fetishizing the very concept of intangibles. The oligopolistic profits of TNCs are to a great extent due to their control of superior know-how, but a firm's knowledge or know-how is very much a result of synergy, and it is very hard to value the different contributions of different parts of the firm to that whole (Picciotto 2014).

While the OECD Action Plan represents a step forward, it may also be a step backward. Indeed, in the 1960s the OECD already attempted to tighten rules to prevent base erosion and profit shifting, based on the separate entity approach. This attempt failed subsequently, as illustrated by the double non-taxation of TNCs exploiting the structural weakness of the separate entity approach. By contrast, alternatives based on a single entity approach, such as unitary taxation (box 2), could tackle harmful tax competition and tax avoidance at their core, by acknowledging that TNCs are single entities and anchoring taxation in observable

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<sup>44</sup> Hybrid mismatches are entities (e.g., corporations) or instruments (e.g., bonds) that have a different legal status in different countries, thus allowing entities to be dual resident, or instruments to be treated differently, for instance, as debt in one country and equity in another.

<sup>45</sup> Controlled foreign corporations (CFCs) rule allow the home states of parent companies of TNCs to tax profits of CFCs, provided they derive from passive income and the CFC is in a low-tax jurisdiction. This point, however, mostly concerns developed countries, which have outbound investment.



variables,<sup>46</sup> such as physical capital, labour and sales, instead of legal fictions and artificially priced intra-group transactions for which there is often no reference market.

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**BOX 2: UNITARY TAXATION AS AN ALTERNATIVE TO THE CURRENT INTERNATIONAL TAX REGIME – HOW TO NEUTRALIZE CAPITAL MOBILITY FOR CORPORATE TAXATION PURPOSES?**<sup>47</sup>

The present international tax regime finds its origin in the first model tax treaties formulated by the League of Nations in 1928. This regime was essentially territorial and primarily designed to cope with the taxation of cross-border portfolio investment. At the time, the nascent issue of TNCs and foreign direct investment was treated as an exception that could be ignored or dealt with unilaterally at the national level. In the following decades, TNCs developed and increasingly structured themselves so as to minimize their tax bill (generally around a finance company located in a low-tax jurisdiction funding limited risk contract providers in higher-tax jurisdictions). The tolerance by governments of the legal fiction allowing TNCs to treat affiliates as independent entities also enabled them to abuse of the weakly defined arm's length principle (ALP) through transfer pricing manipulations in order to shift profits to low-tax jurisdiction where no or little real economic activity was taking place. In 1962, the United States enacted measures to include in the profits of a US parent company the income of its affiliates formed in low-tax countries, if they fall within the definition of a controlled foreign corporation (CFC). For an entity to be treated as a CFC, it must be owned or controlled by a small number of persons resident in the home state; its income should derive from a passive business; and it must be located in a low-tax jurisdiction. Many OECD countries adopted similar rules. CFC rules were progressively circumvented (income deriving from financing activities can be treated as active income, preferential tax agreements between TNCs and average/high-tax jurisdictions have proliferated, etc.) to the point where the international tax regime has effectively regressed back to a territorial tax regime. The international tax regime became even less fit for purpose (Picciotto 2013) as the share of income generated by intellectual property rights and services became more significant and easier to shift across countries in the digital era. The tolerance of corporate tax avoidance in the current regime causes significant revenue losses for developing and developed countries, but it also undermines the legitimacy of taxation in general. It further nurtures enormously wasteful expenditures by both firms and governments, distorts investment allocation decisions of TNCs as well as the level playing field between TNCs and local competitors that are subject to taxation.

As an alternative to the OECD approach of mending the current regime with regulatory patches without changing its core that was designed in the 1920s, unitary taxation appears as an approach better suited to the contemporary global and partly weightless economy, which makes it difficult to attribute the exact geographic origin of TNCs' income. Indeed, implementing unitary taxation does not require attributing profits to a specific affiliate nor estimating the price of intra-firm transactions, which are key for TNCs to shift profits across jurisdictions. Unitary taxation only requires knowing the total profits of TNCs, their structure, and the location of some key real variables (i.e., its physical assets, number of employed workers, labour costs and final sales), which are currently mostly unknown to tax authorities. In order to organize a transition to a UT regime starting at the national level, the first of three primary requirements would be to compel TNCs to submit combined and

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<sup>46</sup> Most current apportionment formulas do not include intangible assets in the assets factor, thus reducing the potential for manipulations related to the current practice of TNCs, which systematically register profitable property rights in low-tax jurisdictions. However, the sales factor in apportionment formulas includes both sales from services and tangible goods. Furthermore, special formula rules for financial institutions in the US, Canada and Switzerland include intangibles in the assets factor. The EU Common Consolidated Corporate Tax Base (CCCTB) has a separate asset called a "financial asset" which is in the special formula for financial institutions.

<sup>47</sup> Based mostly on research conducted in the framework of the project on the Unitary Taxation of Transnational Corporations with Special Reference to Developing Countries. More information available at: <http://www.ictd.ac/en/unitary-taxation-transnational-corporations-special-reference-developing-countries>

country-by-country reporting (CCBCR) to tax authorities in the countries where it owns affiliates<sup>48</sup> and eventually make the accounts of TNCs available to the public. The second step consists in defining a profit apportionment formula, allocating the taxable base to countries according to the location of TNCs' physical assets, employed workers/payroll expenditures and final sales. Each government would thus retain the sovereign right to set its own corporate tax rate and impose it on the share of TNCs' profits associated with its jurisdiction. A dispute resolution mechanism should also be put in place in order to deal with eventual conflicts, and its decisions should be made public.

Unitary taxation at the state and provincial level already exists in several federations, such as Switzerland, Canada, the United States, and Argentina. The EU is currently working to define a Common Consolidated Corporate Tax Base (CCCTB). As resistance from offshore financial centers such Ireland, Luxemburg and the Netherlands was overcome after the global financial crisis, the European Commission adopted a proposal for a CCCTB in March 2011 and submitted this to the inter-institutional decision-making procedure. It was approved, with some proposed amendments, by a large majority in the European Parliament, and the Economic and Social Committee gave its opinion. Since then, it has been under technical examination by the Council. Three different Presidencies have produced Compromise proposals with significant revisions, and technical work is ongoing, now focusing on the common tax base. The apportionment proposed in the project would allocate TNCs' profits to EU countries according to the value of their physical assets (1/3), payroll expenses (1/6) and number of employees (1/6), and sales (1/3). This is similar to the formulas existing in federal countries, with the exception that the allocation key of the number of employees was complemented by payroll expenses in order to take into account the wide wage level disparities across the EU. Other regions/economic communities are interested by the idea of progressively moving towards UT as it would prevent harmful tax competition. Like in federal states currently implementing UT, profit apportionment formulas could allow for sector-specific variations. Other regional economic communities, such as ASEAN, the East African Community (EAC) and Mercosur and the Andean Community, are also considering a unitary approach as they move forward in their economic integration agendas.<sup>49</sup> These examples, however, only illustrate the possibility of UT applied on a "water's edge" basis (as opposed to a worldwide basis). Consequently, intra-group transactions between various affiliates of a TNC located inside and outside those jurisdictions still take place according to ALP.

Worldwide combined reporting used to be mandatory in several States of the United States, including California, before political pressure financed by transnational financial groups (notably Barclays) led State authorities to make it optional. Today, mandatory worldwide combined reporting<sup>50</sup> only exists in Alaska in the oil, gas and pipeline sector.<sup>51</sup> Despite a recent corporate legal challenge, the Alaskan Supreme Court recently issued a decision in *Tesoro Corp v. Alaska*<sup>52</sup> solidifying the application of worldwide combination of a unitary business and formula apportionment with respect oil, gas and pipeline companies (Siu et al. 2014b). The prevailing consensus, however, including the IMF, the

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<sup>48</sup> The Tax annex to the Saint Petersburg G20 leaders' declaration (September 2013) do not mention CCBCR explicitly, but the G20 required the creation of a common template for companies to report to tax administrations on their worldwide allocation of profits and tax.

<sup>49</sup> For a comprehensive survey and detailed description of single-country and regional unitary taxation systems and initiatives, see Siu et al. (2014a).

<sup>50</sup> If the tax base for a multinational is consolidated through a worldwide approach (often referred to as worldwide combined reporting) all of its income (and losses), both domestic and foreign-sourced, are pooled together for apportionment among the worldwide taxing jurisdictions, which have some economic connection to the income. It is important to note that under the worldwide approach, the inclusion of worldwide income requires inclusion of foreign losses and foreign factors of production in the apportionment formula. This broader consolidation affects the total income to be apportioned as well as the percentage of apportionment of that total income and may not necessarily result in double taxation.

<sup>51</sup> There are fifteen American states where worldwide combined reporting is permitted or required in certain circumstances: Alaska, California, Colorado, District of Columbia, Idaho, Illinois, Massachusetts, Montana, Nebraska, New Hampshire, North Dakota, Utah, Vermont, West Virginia, and Wisconsin.

<sup>52</sup> Case No. 6838, Alaska Supreme Court (October 25, 2013).

OECD and the UN, considers that UT based on the single entity approach is still a radical alternative that may involve more “guesswork” than the ALP principle deriving from the separate entity approach. Certain issues remain even with UT, such as how to define affiliates or how to solve possible conflicts with existing double tax agreements, which may hypothetically result in the double taxation of TNCs. The Alaskan example, however, illustrates the feasibility of unitary taxation applied on a worldwide basis. Furthermore, the major threat to the existing international tax regime and public finances remains double non-taxation of profitable TNCs, and it may take decades before TNCs move from paying no taxes to paying more than due taxes.

\*\*\*\*\*END OF BOX \*\*\*\*\*

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#### **4.3.4. Taxing mobile capital (unilaterally) to eradicate extreme wealth and reduce international inequality**

Ending financial opacity and harmful tax competition is essential for enabling progressive taxation of mobile capital and hidden wealth and contributing to eradicate extreme wealth and reduce international inequality. To a large extent, progress towards these objectives is dependent on international cooperation. There are long-standing proposals for the establishment of an international tax organization, most notably from the UN High-level Panel on Financing for Development (the Zedillo Commission) in 2001. The Panel proposed the creation of such an organization, with a mandate, not only to compile and share tax information and monitor tax developments, but also restrain tax competition among countries and arbitrate country tax disputes (United Nations, General Assembly, 2001). However, this was not included in the Monterrey Consensus, reflecting resistance by the developed countries. Equally, many countries would like the UN Tax Committee to be enhanced to an inter-governmental political body, but OECD countries persist in blocking efforts to achieve this upgrade. Consequently, most reform efforts are undertaken on an ad hoc basis by G20 countries with the assistance of the OECD. The dominant role of the developed countries in international tax governance has resulted in a primacy of their interests over developing countries.

Absent a proper institutional context for an inclusive dialogue on international tax coordination, unilateral initiatives are essential for shaking inertia and attempting to initiate system-wide change. Unilateral initiatives can have significant impact, as illustrated by the US FATCA legislation, which inspired willingness to cooperate at the international level in order to crack down on financial secrecy enabling tax evasion by HNWI. As explained in box 2, developed and developing countries have the possibility to uproot harmful tax competition by abandoning the prevailing separate entity approach to taxing TNCs and unilaterally adopting a single entity approach to implement unitary taxation. Experiences in several US States, including Alaska today, show that mandatory unitary taxation on a worldwide basis can be implemented unilaterally to efficiently neutralize harmful tax competition that otherwise enables mobile corporate capital to avoid taxation.

## 5. CONCLUSION

This paper discussed challenges and opportunities facing redistributive policies in support of sustainable development based on an asset-centred analytical framework. It first attempted to define the potential scope of redistributive policies and linkages to assets, equity and sustainable development. It then surveyed major trends in redistributive policies during the last three decades, before suggesting steps that may be implemented at the domestic level in order to move towards a framework enabling asset-centred redistributive policies for equity and sustainable development. It further discussed ongoing coordination effort at the international level to promote financial transparency, which is a prerequisite for tackling harmful tax competition and taxing mobile capital and financial wealth.

Section 2 showed that the impact of redistributive policies declined over the last 3 decades, contributing to a significant increase in average within-country income inequality at the global level. It outlined a simple analytical framework for conceptualizing redistribution from a stock-flow perspective (figure 1), stressing the importance of income-generating assets as a determinant of income inequality. It further highlighted the positive association of large public sectors and income inequality reduction, as well as the key role of public social spending on human development. It also pointed at the shortcomings of approaching equality of opportunity exclusively in terms of human capital without acknowledging the fundamental role of income-generating assets, such as land and industrial and financial capital in shaping opportunities available to individuals. It briefly discussed the possible role of environmental taxes in containing unsustainable production and consumption and the necessity to foster sustainable use and equitable access to natural resources for present and future generations, possibly by placing privatized natural resources back under public ownership.

Section 3 briefly reviewed major trends in redistributive policies over the last 3 decades, stressing the modest pick up in public social spending in the wake of the Millennium Declaration as well as the neoliberal tax legacy holding back governments from using taxes in a more discretionary manner to reduce inequality and promote sustainable development. More specifically, it pointed at the extensive privatization of natural resource rents; the poorly progressive tax revenue composition prevailing in many developing countries compared to developed countries; the generalized decline in environmental tax revenue arising mostly from indirect energy taxes burdening households, while the corporate sector often benefits from subsidies, exemptions or is submitted market solutions (emissions trading systems and offsetting mechanisms) that significantly underprice production carbon emissions. It also illustrated the widespread flattening of personal and corporate income schedules and the near abandoning of net wealth taxes in developed countries, along with the rising magnitude of tax abuses, including harmful tax competition, tax avoidance and tax evasion. Beyond those general trends, this section also highlighted positive developments, particularly in Latin America, where progress towards a rights-based approach to human development and the search for greater tax equity based on the principle of fiscal exchange led to significant inequality reduction during the last decade.

Section 4 proposed several steps formulated in general terms for moving towards a framework enabling asset-centred redistributive policies for sustainable development. It stressed the conceptual weakness of income poverty reduction approaches ignoring the structural role of asset inequality, especially wealth, as well as the need to collect more

relevant data on income and wealth inequality and to move away from purely economic metrics as a benchmark of progress in order to reduce inequality and operationalize policies in support of sustainable development. It then outlined some key elements for building institutions and designing policies enabling asset-centred redistributive policies, such as developing modern tax administration, especially in developing countries lacking the capacity to collect progressive taxes, which hampers their development and exacerbates their dependence on possibly unstable external sources of funding. It stressed the need for governments to move from a resource-constrained approach to human development towards a rights-based approach acknowledging the most fundamental socio-economic rights of their population. On the taxation side, it noted that shifting the tax base towards environmental externalities arising from production and consumption, including through a border carbon tax, would contribute altering the unsustainable expansion of global value chain, which thrive on international labour cost differential and tax avoidance opportunities, while stimulating international trade and polluting merchandise transport. Shifting the tax base towards net wealth, especially financial capital, which best reflects the ability to pay, further represents the only means to eradicate extreme wealth and reduce asset inequality underpinning enduring mass income poverty. Wealth redistribution could further be fostered by the transfer of income-generating assets, such as land and industrial and financial capital. Land reform and policies supporting cooperatives and other types of institutional arrangements enabling economic democracy therefore represent an important pillar of wealth redistribution, along with the socialization of natural resource rents and/or public ownership to ensure a more equitable access to natural resources for present and future generations.

Finally, the section also stressed the necessity of stepping up ODA, while empowering local actors, including in their effort to bolster weak tax administrations so as to become less dependent on external funding and more accountable to citizens. It noted that international cooperation is essential for combatting financial secrecy and implementing reform towards financial transparency (e.g., LEI, AEOI, disclosure of beneficial owners) enabling taxation of mobile capital, which is key to tax justice and inequality reduction. Political obstacles to the implementation of such steps were not discussed, but would of course need to be taken into consideration in their specific national context. While progress under the umbrella of global governance bodies regarding the reform of the international financial and tax system is slow and far from warranted, the converging interests of many developed and developing countries as well as financial TNCs could open the way to positive changes. Additionally, efficient solutions to taxing mobile corporate capital, such as unitary taxation (box 2), can be implemented unilaterally by developed and developing countries.

## ANNEX

**Table A1: Main personal tax rates in selected countries**

Country	INCOME (NON-) REDISTRIBUTION		WEALTH (NON-) REDISTRIBUTION	
	Top income tax rate <sup>(*)</sup>	Tax on capital gains <sup>(***)</sup>	Net wealth tax	Inheritance and Gift taxes
<b>Australia</b>	46.5	Chargeable to income tax Gains on assets held since before 1985 not chargeable. Since 1999, 50% discount on gains (net of losses) for assets held for more than a year. Discount not available to companies. Further 50% relief for small business assets.	None	None
<b>Canada</b>	46.4	Chargeable to income tax Only 50% of the gain is chargeable Relief up to CAD 375 000 (after 50% reduction above) for shares in small companies and land and assets used for farming.	None	None
<b>France</b> <sup>(*)</sup>	45.8	Chargeable to capital gains tax Sale of real estate is taxed at 16%. The gain is reduced by 10% for each year after the 5th year that the asset is held. Sale of shares is taxed at 18%. Shares held for 8 years or more are exempt from tax. Gains arising from disposals of other assets are taxed at 16%. The gain is reduced by 10% for each year after the 2nd that the asset is held. Social charges of 11% are levied on top of the above rates.	Rate: 0.55% -1.8% Tax applies to all non-exempt assets if their value exceeds threshold of EUR 770 000	Rate: 0.55% -1.8% Tax applies to all non-exempt assets if their value exceeds threshold of EUR 770 000. Inheritance Tax: 5% - 60% Same rate structure for inheritance and gifts. Lower rates and greater exemptions (e.g. EUR 151 950 where the donee is a parent of child of the donor) apply to close relatives with the highest rate (60%) applying to gifts to unrelated persons.
<b>Germany</b>	47.5 <sup>(*)</sup>	Chargeable to income tax if taxable. Taxable capital gains are, especially, gains arising from the disposal of business assets, gains arising from the disposal of real estate held by not more than 10 years and all gains arising from the disposal of shares. Gains arising from the disposal of portfolio shares are taxed at a flat rate of 26.4% 40% of gains arising from the disposal of other shares are exempt from tax.	None (abolished in 1997 <sup>(*)</sup> )	Rates: 7% - 50% Same rate structure for inheritance and gifts determined by the relationship between the donor and donee as well as by the value of the inheritance/gift. Exemption of EUR 500 000 where donee is the donor's spouse and EUR 400 000 where donee is a child.
<b>Ireland</b> <sup>(*)</sup>	41	Chargeable to capital gains tax Rate: 20% 40% rate applies to disposals of certain foreign life assurance policies and foreign investment products.	None	Rate: 20% Larger exemptions apply to close relatives than unrelated persons (e.g. EUR 521 208 where the donee is a child of the donor). Relief is available for legacies comprising agricultural or business property, reducing the

				market value by up to 90%
<b>Italy</b>	44.9	Chargeable to income tax Only 40% of the gain arising from the disposal of 'qualifying' shares (essentially, more than an insignificant proportion of the voting or capital rights in the company) is chargeable to income tax. Gains arising from the disposal of 'non-qualifying' shares are taxed at 12.5%. Gains arising from the sale of real estate, held for less than 5 years, is taxed at 20%	None	Rate: 4% - 8% Lower rates and greater exemptions apply where the donee is spouse or linear descendant of the donor (e.g. exemption of EUR1 million) with a higher rate and no exemption applying to gifts to unrelated persons. (reintroduced - 2006)
<b>Japan</b>	50	Chargeable to income tax. Real estate is taxed separately. Property held for less than 5 years is taxed at 39% and more than 5 years at 20% Gains arising from disposals of shares are taxed at 20%	None	Rate: 10% - 50% depending on the property value Exemption: JPY 50 million, plus JPY 10 million for each statutory heir.
<b>Mexico</b>	28	Chargeable to income tax. Disposals of property are taxed at either 28% of the net profit or 25% of the gross sales proceeds Different rules apply to different types of assets e.g. individuals realising capital gains from the alienation of real property must make an advanced payment for each disposal. Exemption for gains arising to resident individuals from the disposal of shares in Mexican companies listed on the Stock Exchange.	None (abolished in 2007)	None
<b>New Zealand</b>	39	Capital gains are generally not taxable. Exceptions include gains from the sale of land acquired for the purpose of disposal, which are chargeable to income tax.	None	Gift duty: 5% - 25% Rate is determined by the value of the gifts. Exemption for gifts below NZD 27 000
<b>Netherlands</b> (*9)	52	Capital gains are generally not taxable. Sales of significant (> 5%) shareholdings in a company are taxed at 25% The net asset value of savings and investments is taxed annually at an effective rate of 1.2%	None (abolished in 2001)	Rates: 5% - 68% Same rate structure for inheritances, gifts and transfers determined by the category of recipient. Exemption of EUR 532 570 where recipient of legacy is the surviving spouse (from 1 January 2009).

<b>Norway</b>	40	Chargeable to income tax at 28% Holiday homes are exempt from tax if they have been held for at least 5 years and have been used by the owner for at least 5 of the 8 years prior to sale.	State tax: 0.4% Municipality tax: 0.7% Applies to wealth in excess of NOK 470 000	Rates: 6% - 15% (6% - 10% for inheritances and gifts to children and parents) Applies to transfers in excess of NOK 470 000 Applicable rate is determined by the relationship between the donor and donee and the amount received.
<b>South Africa</b>	40	Income tax rates apply. Only 25% of the gain is chargeable. Annual exclusion of ZAR 15 000.	None	Estate duty: 20% Exempt amount: ZAR 3.5 million
<b>United Kingdom</b> (*10)	40.0 <sup>(*11)</sup>	Chargeable to capital gain tax. Rate: 18% <sup>(*12)</sup> Annual exemption of GBP 9 600. 'Entrepreneurs' relief of [4/9 x gain] for disposals of a business, or assets used in a business, with a lifetime limit of GBP 1 million	None	Inheritance Tax: 40% No gift tax but there is an advance charge of 20% on settlement of certain trusts. Up to 100% relief for legacies of business and agricultural assets. Exemption: GBP 312 000; full exemption where recipient of legacy is surviving spouse
<b>United States</b>	41.85 <sup>(*13)</sup>	Chargeable to income tax Reduced rates (5% and 15%) for disposals of long-held assets by individuals in the lowest two income tax brackets.	None	Rates: 18% - 50% Lifetime excluded amount: USD 3.5 million Property passing to a spouse is exempt

Source: OECD (2009) "Engaging with High Net Worth Individuals on Tax Compliance".

\*1 Combined state and federal tax.

\*2 "Income tax rates apply" indicates that the capital gain is assessed separately to income tax but applies the same rate of tax.

\*3 In general, gains arising from the disposal of the taxpayer's main residence are exempt from tax. The precise rules differ by jurisdiction.

\*4 The top federal rate is 29% with provisional rates ranging from 10.0% in Alberta to 24.0% in Québec.

\*5 In 2008 France extended its range of tax reliefs for foreign executives working in the country. With effect from 1 January 2008, foreign workers who have not been resident in France for the 5 years immediately preceding the commencement of their employment or assignment qualify for tax benefits for a maximum of 6 years. These benefits include: tax exemption on the incentive / relocation payment (referred to as the 'impatriate premium'); 30% of remuneration exempted from French income tax; tax relief of 50% on French income tax due on non-French sourced dividends, interest and capital gains realised on shares of non-French companies and an exemption from French wealth tax for a maximum period of 6 years on overseas wealth.

\*6 The top rate of 47.5% includes solidarity surcharge. A flat rate of 26.4% (25% income tax plus solidarity surcharge) exists for 'income from capital assets' (e.g. dividends and portfolio interest).

\*7 Wealth tax has not been applied since 1997 owing to a Federal Constitutional Court decision, which held that the valuation rules used violated the constitution.

\*8 Ireland operates a remittance basis of taxation for non-domiciled individuals. Accordingly for these individuals income tax applies only to Irish-source income together with any foreign income that is remitted to Ireland.

\*9 The Netherlands offers an income tax reduction for certain foreign individuals commencing employment in the Netherlands. Individuals with skills not or scarcely available in the Dutch labour market can benefit from up to 30% of their total remuneration being tax free for the first 10 years of their stay in the country. Skilled workers may include, for example, a senior executive of an international group with at least 30 months' experience.

\*10 Individuals not domiciled in the United Kingdom are taxed on their worldwide income and gains unless they claim for taxation on the remittance basis. Where an individual has been resident in the United Kingdom for more than 7 of the preceding 10 years, they will only be able to claim the remittance basis of taxation if they pay an annual charge of GBP 30 000 in respect of the foreign income and gains they leave outside the United Kingdom. In addition, those electing for



taxation on the remittance basis do not qualify for tax-free allowance for income tax (GBP 6 035) or capital gains tax (GBP 9 200).

\*11 Proposals have been announced in the United Kingdom's Budget (23 April 2009) to increase the rate of income tax to 50% for those earning in excess of GBP 150 000 with effect from April 2010.

\*12 Where there has not been a distribution of monies within 6 years by trustees of an offshore trust realising a capital gain, an effective rate of 28.8% will apply to subsequent distributions of capital to UK resident and domiciled individuals.

\*13 This rate is the top statutory personal income tax rate also used in the OECD Taxing Wages (2008) publication using a worker living in Detroit, Michigan. The rate is the sum of the federal top statutory personal income tax rate of 35%, the statutory rate levied by the state of Michigan of 4.35% and by the city of Detroit of 2.5%.

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