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Role of Income Taxes in Redistributive Fiscal Policy

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What do we know about progressive taxation in developing countries?

Challenges for making income taxes more progressive in developing countries

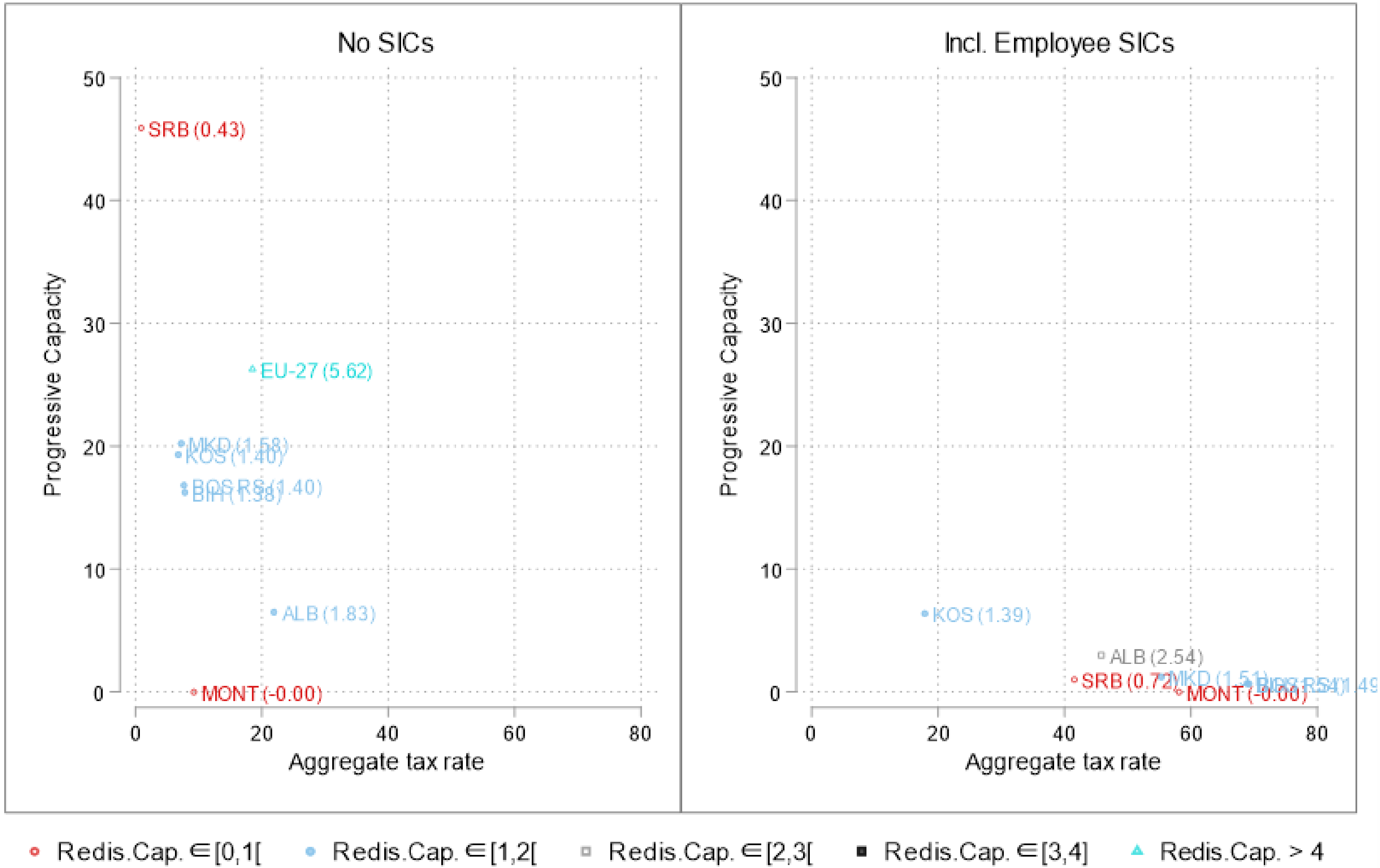
- Personal income taxes (PITs) in Developing Countries (DCs) are often progressive by law, mostly on labor income
    - Capital income in DCs is largely untaxed, or taxed lightly and at flat rates

- Revenue contribution of PITs in DCs is low, relative to advanced economies, and relative to other taxes levied by DCs

- Some progress has been made in PIT revenue in the past two decades, but hard to qualify it:
    - It matters whether it is due to increased labor taxation, or some other non-labor taxes, such as those on capital
    - Analyzing revenues is also complicated by how much of it is related to funding public wages with debt and revenue from natural resources
    - Progress made seems to be almost entirely due to economic factors, rather than policy factors
    - Country experiences differ

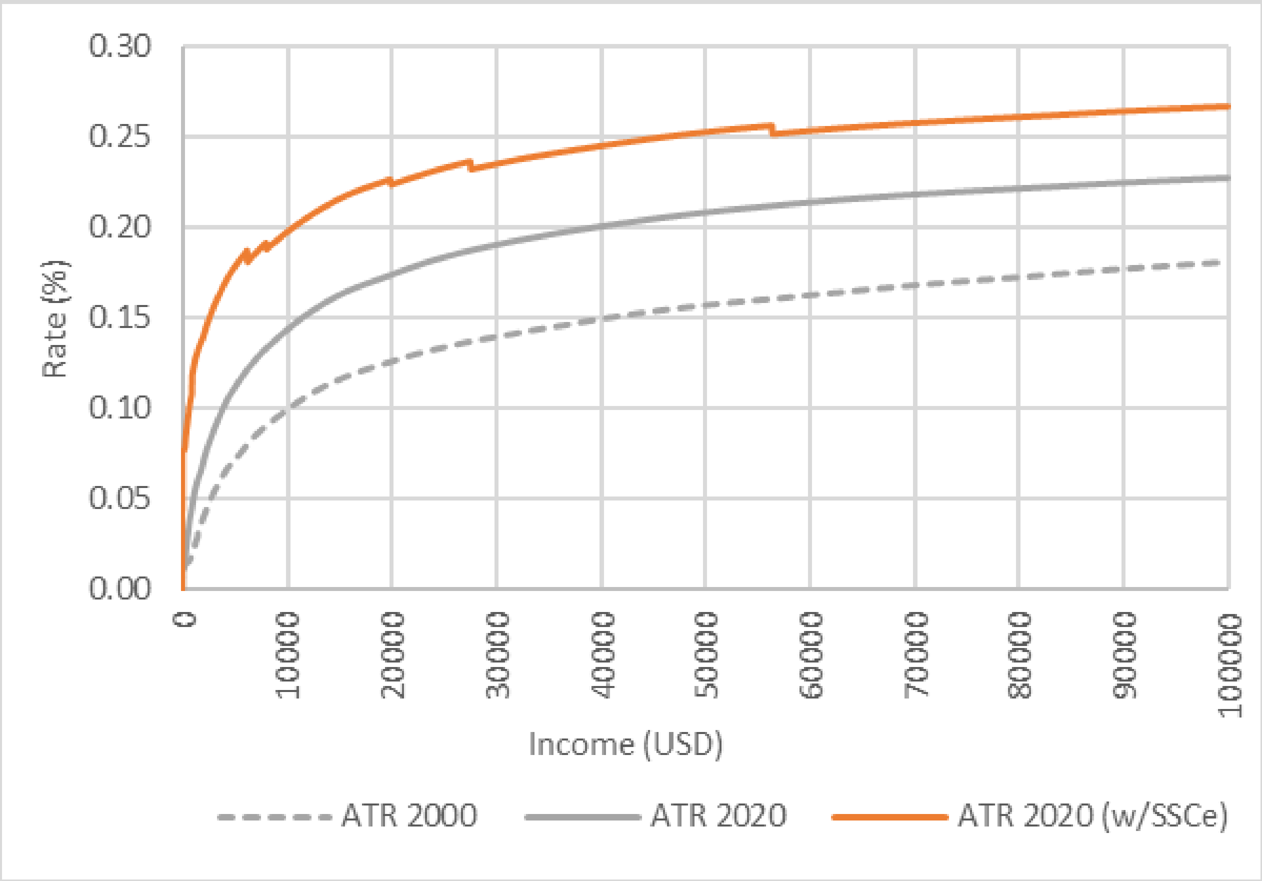
- Issue may not matter if other taxes are spent on progressive spending
    - But do all taxes have the same long-term effect on state building?

Western Balkans: It is easy to achieve progressivity of PITs; harder to do when social insurance contributions are added to the tax rate; and much harder to achieve meaningful redistributive capacity



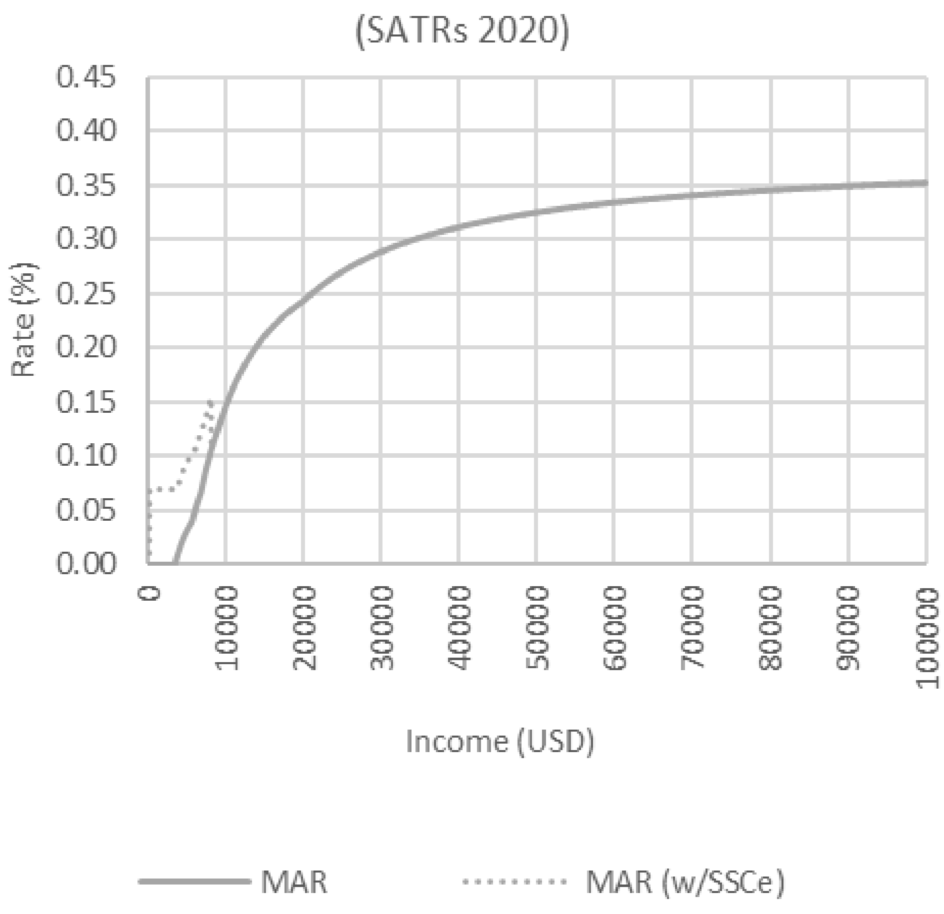
Progressivity of income taxes in MENA is steep at low-income levels

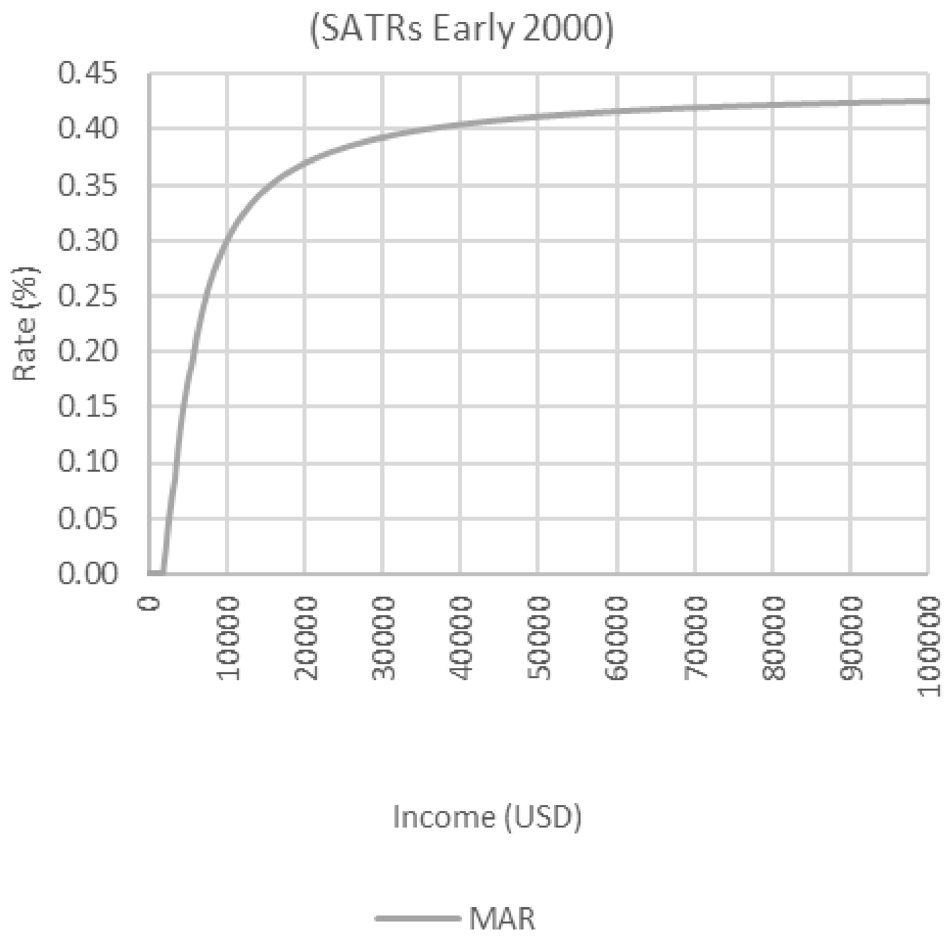
It has been made even steeper in the past two decades



Development in personal income tax in Morocco: 2000 vs. 2020

A flatter ATR schedule in 2020, but SSC design remains an issue for incentives at very low-income levels





Conclusions

PITs are progressive "on paper", but are much harder to make progressive effectively

- Much is related to the taxation of capital income
- Changing labor market structures and digitalization raise issues regarding the meaning of labor income for tax purposes

Progress in making PITs more progressive has been virtually absent or slow

- Size of PIT contribution and relative share of labor (including SSCs) vs. capital taxes matter

Can countries better succeed by focusing more on progressive spending, while raising revenue through regressive or flat taxes?

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Thank You!

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