

Rising inequality and the future of capital taxation

**An interview with Pascal Saint-Amans,
Director of the Centre for Tax Policy and Administration, OECD**

Governments throughout the world are increasingly concerned with rising inequality. In much of the developed world the period from the Second World War to the early 1980s saw diminished inequality. This has reversed since that time. Many emerging economies are also experiencing growing disparity of incomes. Grant Wardell-Johnson of KPMG Australia asked Pascal Saint-Amans, Director of the Centre for Tax Policy and Administration at the OECD a number of questions concerning this issue.

KPMG

**Inequality is making headlines across the world at the moment?
Do you think the world is experiencing rising inequality? Why?**

Pascal

Yes, inequality is rising across the OECD. But the picture is not as straightforward as is sometimes presented. We need to pay attention not just to inequality within countries – which is rising, but also to inequality between countries – which is falling. Moreover, there are large differences across the OECD – the picture in some countries such as the US, where there is larger rise in inequality, is different from some European countries, where the rise has been more modest.

There are a lot of factors which can explain why inequality has increased. Top income households have pulled away from the rest of the income distribution in many countries. This is true with respect to income, but even more so with respect to wealth. There is rising inequality in salaries, which could mean that top managers and professionals are taking a large share of the productivity gains. But the gap between those who earn mostly capital income and those who earn wage income also needs to be considered.

Inequality also needs to be considered from the perspective of businesses. OECD research suggests that some firms at the frontier have increasing market power, with big increases in growth and productivity, while many more companies lag behind – which are often SMEs.

KPMG

Should inequality be a cause for concern for policymakers? Should the focus not be more on raising growth rather than reducing inequality?

Pascal

It should be a cause for concern. Inequality is concerning not only in its own right, but also because of the negative knock-on effects on opportunities and social mobility, which will affect growth negatively. For example, increasing inequality has negative impacts on productivity, which can become a drag on growth. This can occur in different ways. Those with low incomes are less likely to be able to afford to educate themselves or start a business, so inequality can reduce the opportunities for success where it is most needed.

Policymakers should focus more on “equality of opportunity” than is the case at present. This raises the question of how can we make sure that our societies have sufficient social mobility – how do we make sure children of poor economic backgrounds have an opportunity to become successful?

Wealth inequality is a result of both income inequality and also differences in inherited wealth. Stagnating wages for low and middle income earners in some countries such as the US has resulted in low saving rates for the low and middle income class. This leads to increased wealth inequality. Evidence shows that the returns on savings are increasing with the amount of wealth. So the wealthier can afford to take more risk, and so earn higher returns on savings. So inequality can feed inequality, which makes these problems more challenging to solve.

KPMG

Do you think this rise is transitory, or is it on a long-term structural basis?

Pascal

There are definitely a lot of structural factors that have given rise to increased inequality. There are multiple causes, but technological change, increased financialisation, globalisation have all played a role. Many OECD countries have reduced income tax progressivity compared to say thirty years ago, which is also a factor.

However these changes are by no means inevitable. Better policies can always have an impact. We are now seeing that the role of technology in driving inequality is also not fixed. While it is common to think about technological changes as having hurt the low-skilled the most, future technological changes like machine learning could actually impact professionals like doctors and lawyers more.

KPMG

How does all this change policy settings for raising tax revenue? The OECD has said for the last 40 years that we should have lower taxes on capital income because it leads to greater capital accumulation. Should this now be re-assessed in an environment of rising inequality?

Pascal

The OECD is a diverse group of countries, and there are no one-size-fits-all solutions. Different countries may need to adjust their policies in different ways. However, based on our research I would say that it is not necessarily that capital should be taxed more, but it should definitely be taxed more coherently. This is even more important in the aftermath of the BEPS project. The BEPS project has levelled the playing field and changed the world around corporate tax. But it also means that how capital is taxed at the personal level is more important than ever.

There is a strong case for capital tax reform in many OECD countries. Many different assets are taxed in many different ways, and at many different rates. This raises the complexity of tax systems, and makes taxation more inefficient because the mix of assets becomes distorted. The way we tax capital can also be regressive. For example, many countries provide tax deductions for pension contributions. But these deductions can benefit top earners more, and may not benefit those with low incomes at all.

Our research has also shown that in many countries dividends are taxed more heavily than capital gains. So those who can retain income inside companies for longer can pay less in tax over time. These situations, where a wide variety of different rates apply depending on the asset or the holding period, make tax systems inefficient. They also make them regressive as well, not least because those on higher incomes and with more wealth can engage in tax-planning to pay less. So our advice is to get the cohesion of capital taxation right.

KPMG

How does the OECD's international tax work fit into this picture? Do you think there is scope for an international capital tax?

Pascal

The OECD's international tax work is very important in this area. The reason is that international tax evasion is regressive. Those with high levels of income and wealth can in many cases shift income and assets overseas to avoid paying tax. A new paper by [Alstadsaeter, Johannesen and Zucman](#) has suggested that when offshore tax evasion is taken into account, income inequality is even worse than suggested by other estimates. Tax evasion damages not just equality but also trust: citizens perceive the tax system to be unfair. So tackling tax evasion – which we're doing through our work on exchange of information – is key to making the international tax system more transparent, while also addressing some of these inequality issues.

A key concern with having one overall international capital tax is that different countries have different tax mixes; they have different levels of development, and different mixes of social policies. So the same rate of capital tax will not work for everyone. But the huge success of the work of the OECD over the last few years is getting all parties around the table on an equal footing to cooperate to end hiding wealth and avoiding tax.

KPMG

So do you think that capital taxation will remain the key tax tool for reducing inequality?

Pascal

The important thing is to look at the whole tax system. There are no silver bullets. Capital taxes matter, but in terms of overall revenues they are actually relatively small compared to some other categories, and in terms of inequality they are by no means the whole puzzle. The OECD's work on tax and inclusive growth argues that yes, capital taxes and looking at the top of the income distribution are absolutely important, but the rest of the tax system, and the rest of the income distribution, are important too.

KPMG

So what else can the tax system do to reduce inequality?

Pascal

The key aspect is that prevention is better than cure. So when tax systems put the right incentives in place so that everyone is able to see their before-tax incomes grow, then that means that we need less redistribution through tax-and-transfer systems to achieve equity goals. There are many policy reforms that can help this.

Policymakers can reduce the income tax burden on those with low skills to make sure that they have incentives to work and that firms have incentives to hire them. They can have a look at social contributions: many countries finance large welfare states through social contributions which place a big burden on those with low incomes – but social spending can often be financed more effectively through VAT, as is the case in France. Many countries also need to reform labour taxes so that those in newer 'gig' jobs and those in insecure work are not at a tax disadvantage compared to those in traditional jobs.

Most tax systems provide incentives for capital investment and R&D, to raise investment in physical and knowledge capital. These policies raise productivity and are very important. However, countries also need to consider what their tax systems are doing to incentivise investment in human capital too – especially when technology is rendering many workers' skills obsolete. Tax systems can do more to stimulate life-long learning.

A core concern is always the issue of equality of opportunity. Policies to address this could include raising inheritance taxes to address inherited wealth inequality. But taxes that are not commonly associated with reducing inequality like VAT and property taxes can be an important part of the policy mix as well, especially where they pay for high-quality government spending on education, which can raise opportunities for everyone.

Contact us



Grant Wardell-Johnson
Partner,
Economics & Tax Centre

T: +61 2 9335 7128

E: gwardelljohn@kpmg.com.au



David Linke
National Managing Partner,
Deals, Tax & Legal

T: +61 2 9335 7695

E: davidlinke@kpmg.com.au



Carlo Franchina
Tax Advisory Leader,
Deals, Tax & Legal

T: +61 8 9263 7239

E: cfranchina@kpmg.com.au

KPMG.com.au

The information contained in this document is of a general nature and is not intended to address the objectives, financial situation or needs of any particular individual or entity. It is provided for information purposes only and does not constitute, nor should it be regarded in any manner whatsoever, as advice and is not intended to influence a person in making a decision, including, if applicable, in relation to any financial product or an interest in a financial product. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

To the extent permissible by law, KPMG and its associated entities shall not be liable for any errors, omissions, defects or misrepresentations in the information or for any loss or damage suffered by persons who use or rely on such information (including for reasons of negligence, negligent misstatement or otherwise).

© 2017 KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. Liability limited by a scheme approved under Professional Standards Legislation. November 2017. QLD N16117TAX