

Socioeconomic Impacts of Indirect Taxes

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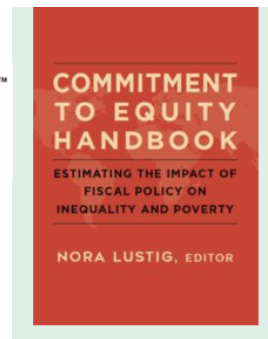
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How—and from whom—a government collects and replenishes public revenues will make a significant difference to incomes and the consumption patterns among individuals and households. Whether or not a revenue-collection instrument can be targeted also matters a great deal for inequality and impoverishment created by fiscal policy. Indirect taxes on consumption activity—customs duties, value-added taxes, excise taxes, sales taxes—are not usually administered flexibly; that is, all individuals with at least some market-based consumption activity pay indirect taxes.¹ Indirect

Taken from Ch. 7 in



Indirect Taxes are popular

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Tulane University database (commitmenttoequity.org/datacenter) shows:

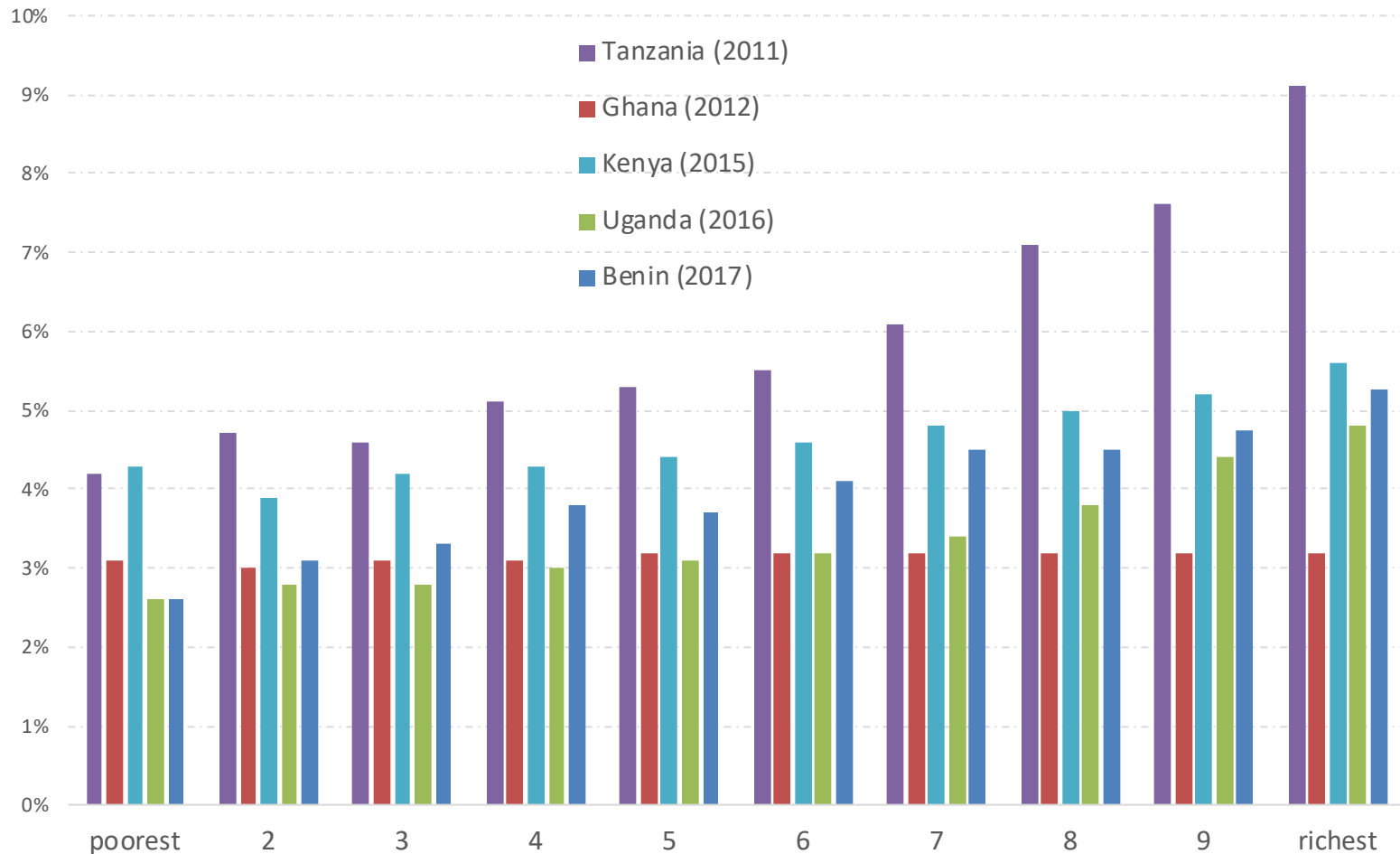
- in 60 country-year pairs (GNI per capita <\$PPP 20,000), indirect taxes account for 56 percent of all revenues from taxes
- in 15 country-year pairs (with GNI per capita <\$PPP 5,000): indirect taxes account for 60 percent of all revenues from taxes
- in 60 country-year pairs (GNI per capita <\$PPP 20,000), VAT + Excise taxes account for 60 percent of all taxes allocated to individuals in CEQ Assessments and/or Fiscal Incidence Analyses

Indirect Taxes are mechanically regressive and increase poverty

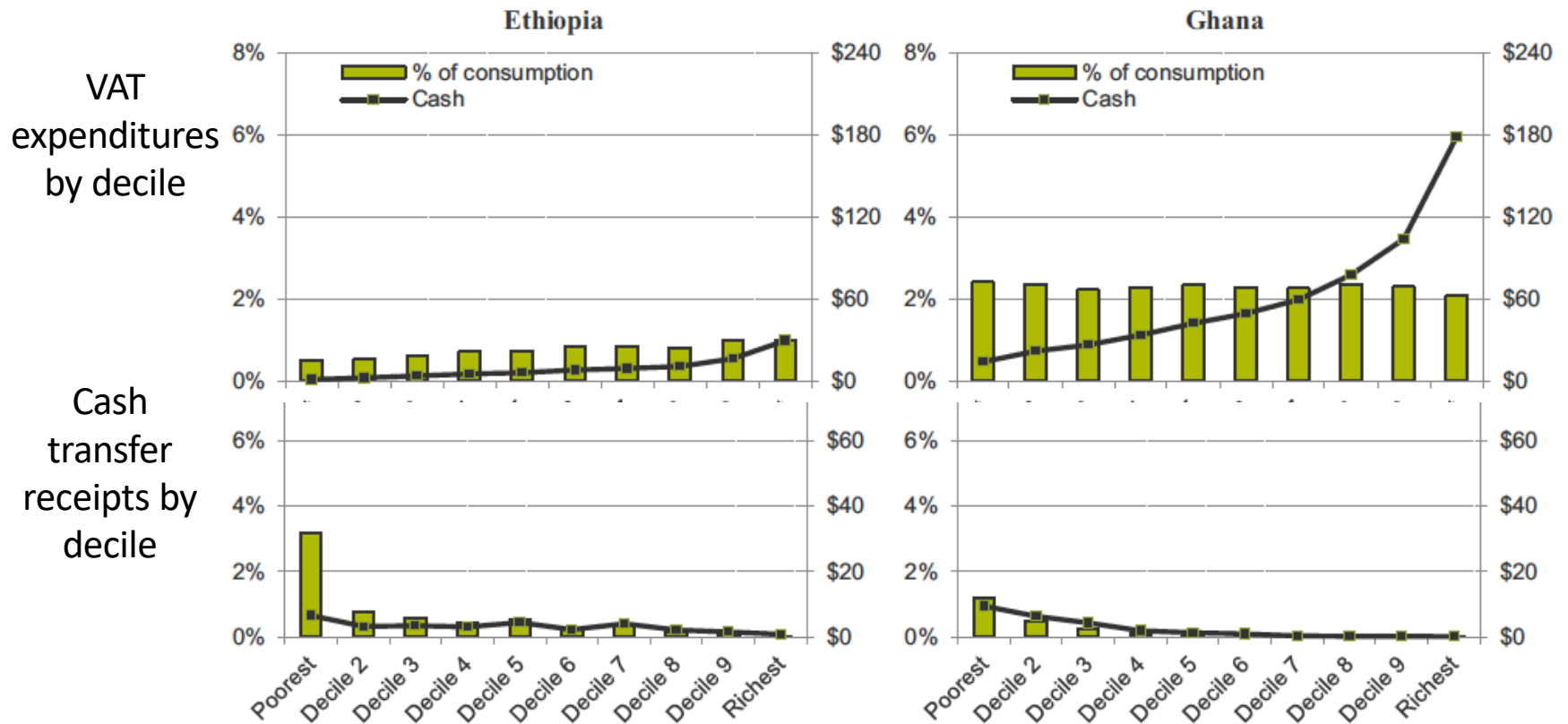
- Indirect Taxes apply directly or indirectly to consumption transactions
- In a cross-section, the marginal propensity to consume (out of income) falls as income rises \Rightarrow consumption as a share of income is higher for those with less income.
- Uniformly effective (ie, no exemptions, special rates, and no informality) indirect taxes are neutral with respect to consumption expenditures and therefore regressive with respect to income.

Indirect Taxes in application sometimes do reduce inequality (via exemptions, preferential rates, and informality)

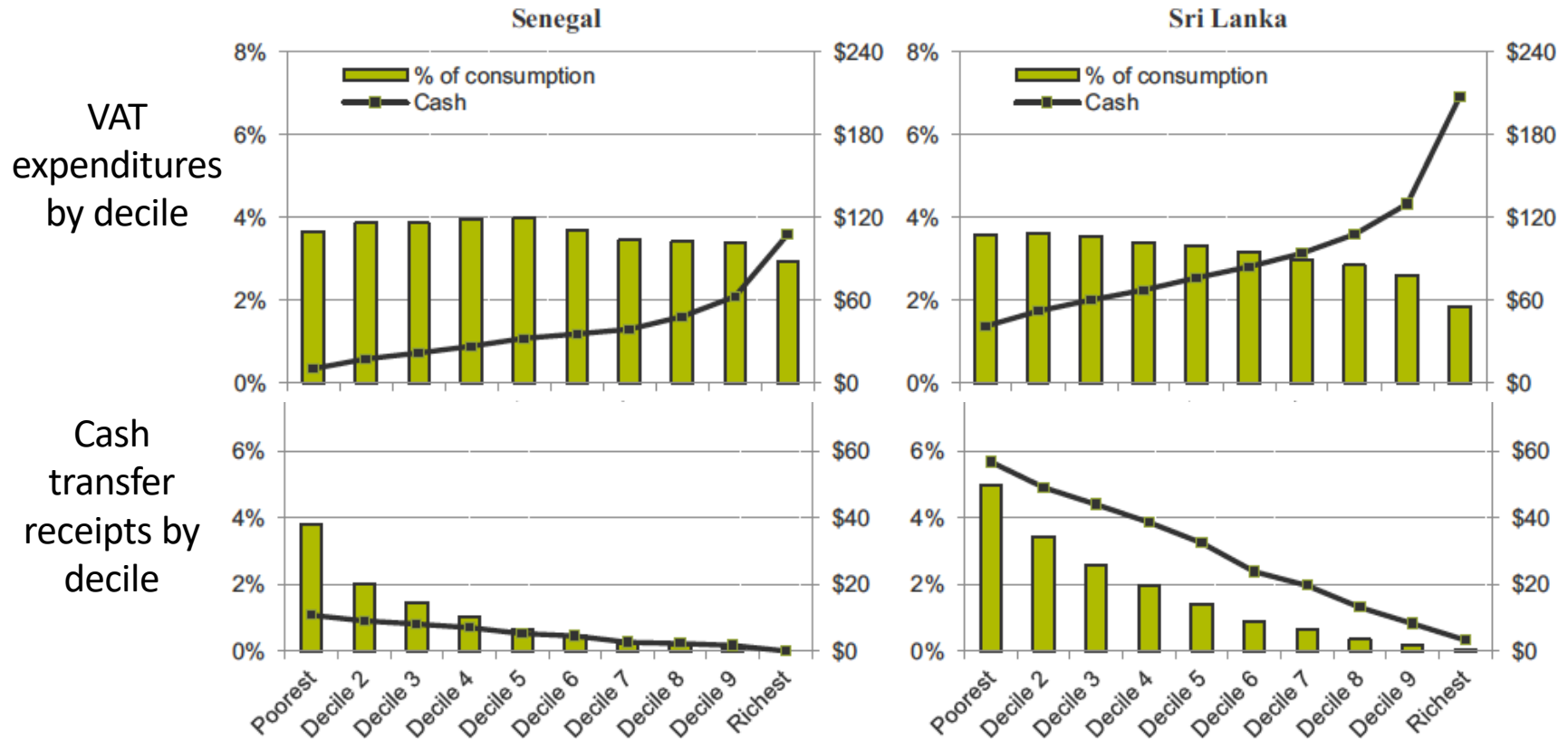
VAT incidence (% of pre-fiscal income) by decile



Exemptions and special rates are inefficient for leaving more consumable income in the hands of poor and vulnerable individuals

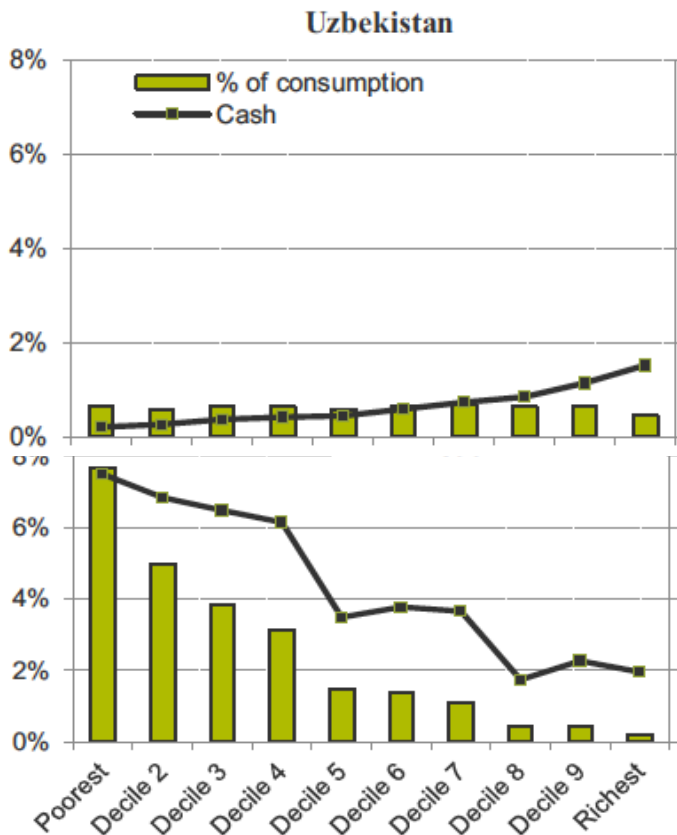


Exemptions and special rates are inefficient for leaving more consumable income in the hands of poor and vulnerable individuals

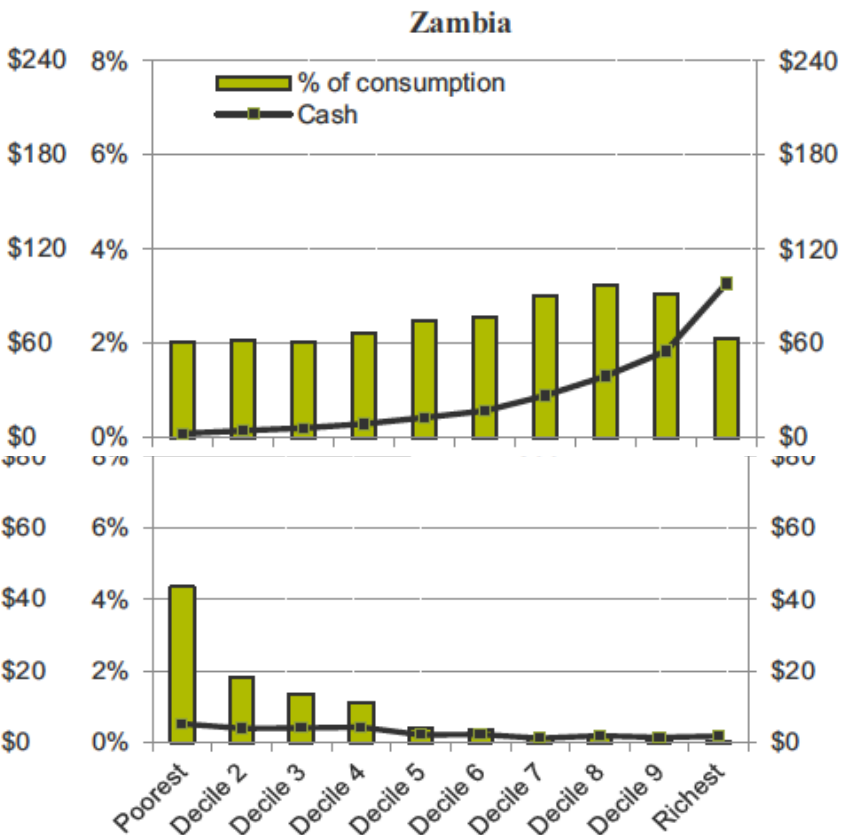


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VAT expenditures by decile



Cash transfer receipts by decile



Exemptions and special rates are inefficient for leaving more consumable income in the hands of poor and vulnerable individuals

Taken from:



The redistributive power of cash transfers vs VAT exemptions:
A multi-country study



Ross Warwick^{a,*}, Tom Harris^a, David Phillips^a, Maya Goldman^b, Jon Jellema^b, Gabriela Inchauste^c,
Karolina Goraus-Tańska^d

When indirect taxes target behaviors with high costs (either private or social) the longer-term distributional impacts may look better

Empirical findings suggest potential for **progressive and welfare-improving** effects of increasing taxes on tobacco, SSBs and alcohol

An Extended Cost Benefit Analysis (ECBA):

Incorporate price-responses to evaluate distributional impact

Incorporate effects of reducing tobacco-related:

(a) Medical expenses + (b) Years of working life lost

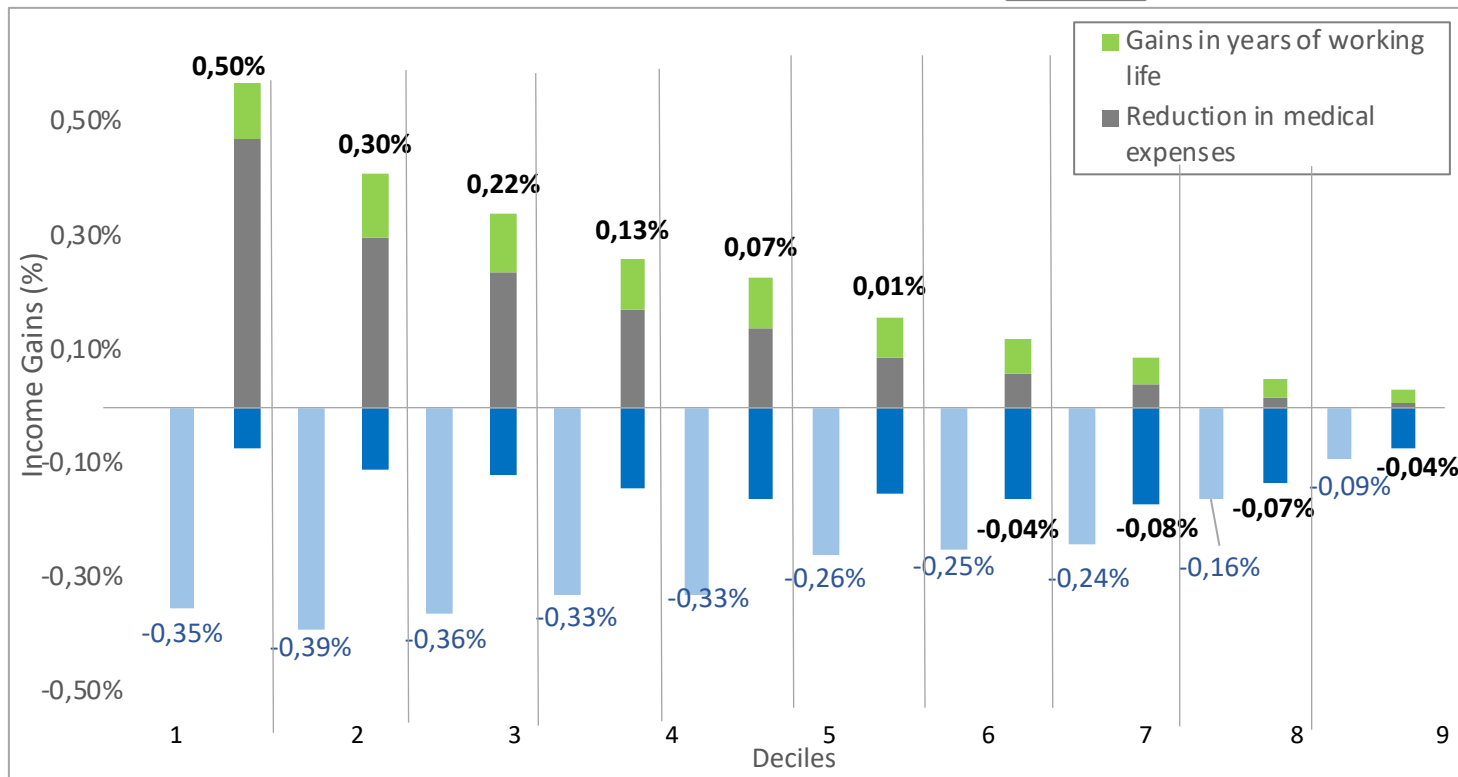
Poor households allocate larger budget shares for tobacco and SSBs

Taxation may seem **regressive** in the short-run

However, taxes and high prices **discourage tobacco, alcohol and SSBs use** (price elasticity), offsetting adverse effects that burden households

RESULTS: CHILE

Total Net effect = Increase in Tobacco Expenditure (A) + Lower Medical Expenses (B) + Rise in Labor Income (C)





Links:

- <https://pubmed.ncbi.nlm.nih.gov/33734366/>
- <https://documents1.worldbank.org/curated/en/358341554831537700/pdf/Distributional-Effects-of-Tobacco-Taxation-A-Comparative-Analysis.pdf>
- <https://openknowledge.worldbank.org/handle/10986/26238?show=full>
- <https://openknowledge.worldbank.org/handle/10986/32062>
- <https://openknowledge.worldbank.org/handle/10986/31249?show=full&locale-attribute=es>
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- https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3116474
- <https://openknowledge.worldbank.org/handle/10986/33970>

Empirical Regularities suggest:

- Indirect Taxes are popular and a significant source of revenues...
- Much like subsidy expenditure, redistributing resources via Indirect Tax expenditures is inefficient and/or involves significant opportunity cost; reducing poverty via indirect taxes is a non-starter
- Longer-term improvements in human capital and incomes (via behavioral change) are expected when indirect taxes are thoughtfully applied to activities with high private and/or social costs.