

Fiscal welfare, poverty and inequality

Særnummer: Velfærdsstatens udfordringer, forandringer og konsekvenser

Tax reliefs result in substantial losses of revenue in many countries. Their largely hidden effects tend to benefit the better-off so they can reinforce, if not increase, inequalities and undermine public spending objectives to help those in greatest need. In this article the very limited evidence on their scale and cost in taxes forgone, even less on their distributive impact, is reviewed comparatively before major effects across society of these little analysed subsidies are discussed. Indications of fiscal policies that could contribute to tackling the trends that contribute to higher poverty and inequality are briefly outlined.

Introduction

Tackling poverty and inequality have long been major concerns in policy-making. Yet, despite the ways that tax reliefs can reinforce if not increase inequalities and undermine public spending objectives, government policies carried out through them as opposed to direct spending continue to receive little attention.

Fiscal welfare and *tax expenditure* are overlapping terms to describe policies through taxes rather than spending programmes. Tax reliefs such as allowances, exemptions, reduced rates or tax credits can encourage and support a wide range of activities such as saving for retirement, bringing up children or buying a home. Fiscal welfare was first used by Richard Titmuss to denote one of the three areas of the social division of welfare in contrast to public or social welfare and occupational welfare, the latter often much subsidised by fiscal welfare (Titmuss 1958; Alcock 2001; Sinfield 2023).

Working in the US government in the late 1960s, tax lawyer Stanley Surrey introduced tax expenditure in direct contrast to public expenditure. Social tax expenditure (STE) is often used to indicate fiscal welfare as opposed to the many other areas in which tax expenditures are used. Tax expenditure budgets were eventually enacted in 1974 (Surrey 1973; Surrey and McDaniel, 1985). Recognition of the term slowly expanded to many countries but its integration into policymaking is still very limited. Despite the substantial impact on budgets, it can remain 'hidden' or even 'subterranean' (Greve 1994; Ervik and Kuhnle 1996; Howard 1997; Hacker 2002).



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The expanding but still very limited evidence on the scale and costs of tax expenditures is reviewed in the article before the even fewer data on their distributional impact. The significance of the persisting focus on income tax reliefs to the virtual exclusion of analysis of other tax expenditures and the persisting reluctance to provide comparison of fiscal alongside public spending are considered. Brief indications of fiscal policies that could contribute to tackling the trends in higher poverty and inequality are outlined before the conclusion.

Accounting for tax expenditures

Most governments have been slow to accept accounting for tax expenditures and publishing the costs of revenue forgone as a basic routine responsibility (but see Canada 2022). Tax professionals are concerned with advising clients on 'fiscally exciting ways' to mitigate 'the burden of tax' by taking full advantage of tax reliefs. Social policy has tended to focus on orthodox welfare state benefits and services, neglecting the 'tax welfare state' despite Titmuss's example (Titmuss 1958 and 1962). Thus the considerable effects of fiscal welfare on individuals, families, communities, the wider society and economy have been allowed to continue and develop beneath the radar.

The OECD includes *tax breaks for social purposes* (TBSPs) in accounting for not only public spending but also social tax expenditures and private welfare spending (Adema et al 2014). This shows the considerable fiscal resources going into social policy in the United States. In 2019 it was the biggest spender after France (OECD 2023, figure 5) while only twenty-third in public spending alone. Over the decades in the United States private welfare was stimulated by tax subsidies by both parties: the Republicans were not so much anti-welfare but anti-state welfare (Howard 1997 and 2007; Hacker 2002).

The Global Tax Expenditure Database (GTED <https://gted.net/>) now provides data from over 100 countries on a simple-to-use website with access to financial data released by governments. Calculations of total estimated costs, main categories of use and percentages of GDP or of tax revenue can be quickly displayed. It allows systematic comparison of different countries' use of tax expenditures. In richer countries revenue forgone through these reliefs averages 4.7 per cent of GDP against 2.3 per cent in poorer countries (Haldenwang et al 2021a, 9). Among EU and OECD countries five of twenty examined were well above the richer-country average: Netherlands 15 per cent, Finland 11.7 per cent, UK 8.13 per cent, Australia 7.59 per cent. By contrast Germany at 0.86 per cent, New Zealand 1.34 per cent, Hungary 2.27 per cent, Denmark 2.46 per cent and Spain 3.17 per cent were well below that average (GTED 2023).

The total number of tax expenditures and the proportion of these with estimated costs do not explain the differences. The Netherlands, with the highest costs, has 101 items and costs all but four of them. The next highest, Finland with 194, only costs 119; and Ireland, the next with 258, only costs 47. Among

the lowest Spain has costed all of its 113 items while New Zealand with 70 only costs 14 (GTED, 2022, country files). The UK, fourth highest at 8.13 per cent of GDP, has revenue forgone more than three times that of Denmark, one of the lowest at 2.46 per cent. The UK recognises more than twice as many tax expenditures as Denmark, 338 against 158 but only estimates costs for 45 per cent of them against 55 per cent in Denmark. In the 1990s Denmark removed many tax reliefs including for social security benefits which were increased in compensation; it now collects more direct tax from benefits than any other country, over twice the average (OECD 2023, Figure 2; Kvist and Sinfield 1997, 257-8).

GTED inclusion of all tax expenditures makes it more useful for analysis than OECD TBSPs which exclude items without direct parallel with public social welfare. But GTED only includes what individual governments identify as tax expenditures so variations in national definitions become important.

While most countries identify tax expenditures in relation to their benchmark tax system, how they do it can still differ (Evans et al 2017, 77). In Germany, for example, the long-established practice allowing spouses to split total earned income for tax is treated as part of the tax benchmark system, not a tax expenditure, because the German constitution allocates particular significance to marriage. Its cost, reported once a decade ago (BT-Drs. 17/13044, s.2), was almost as much as the tax forgone for child tax credit which was counted as a tax expenditure. Child tax credit helps lower income families more while tax-splitting has the opposite effect, especially benefiting higher-paid couples, particularly those with only one earner. Reporting the cost of one but not the other relief distorts the view of how government affects the distribution and redistribution of resources, and the opportunities for change.

The UK rejects the use of the benchmark system and also only classifies much less than one third of all tax reliefs as tax expenditures, costing few of the remainder. It is not known how much other countries exclude tax reliefs from this count nor the costs of these.

The redistributive impact of tax expenditures

Who benefits from fiscal welfare and by how much receives very little official attention (Morel et al 2018). A major question for public spending has long been who gets what and how, so early analysts of fiscal welfare also sought answers particularly relevant to government interventions that affect poverty and inequality. Surrey described many reliefs as 'upside-down' benefits because regressive larger gains go to those on higher incomes (Surrey 1973, 37). In income and some other taxes, they pay higher marginal rates of tax: a relief at those rates provides more to the better-off, and generally even more to the best-off. A relief of 500 euros is worth 250 euros on a marginal tax rate of 50 per cent but just 150 or 100 euros to those paying tax only at 30 or 20 per cent rates. Tax credits are an exception: they benefit all income taxpayers to

the same amount if their tax liability is as large as the credit. 'Refundable' or 'wastable' tax credits pay any excess of the credit to those with an income so low that they pay little or no income tax.

The dual distinction between universal and selective, means-tested benefits is long established in public spending. Taking account of the tax welfare state as well requires a third category. Income tax and many other reliefs are *means-enhancing* while many more social security benefits for those of working age are becoming means-tested. Tax reliefs reinforce, even expand, the security of better-off beneficiaries, particularly if they would otherwise pay higher rates of tax. The cost of their upside-down benefits reduces tax revenue that could be used in public spending. Much fiscal welfare goes into the private benefit market, financing competition with the public sector. Far from providing alternative means of delivery within the welfare state, fiscal welfare may serve to undermine or sabotage it, reducing its resources so that public services and benefits become poorer and of lower status. Those with resources to buy privately are even more encouraged to do so while those on lower incomes become more deprived by public cutbacks.

It is surprising that more government attention is not routinely paid to the reverse targeting of regressive tax reliefs, particularly when it is vigorously argued that public benefits for those of working age at least should be means-tested and confined to those on very low incomes. Tax reliefs are not, as many seem to think, part of the tax gap where taxes are not paid although they are required to be. They are part of the tax policy gap, provided by government and not illegal although some exploit them improperly. In the UK, select committees in the Houses of Commons and Lords have begun to demand more information on the redistributive impact of tax reliefs. The Treasury Committee (2018) revealed that the richest tenth of taxpayers received half the income tax reliefs on pension contributions but the poorer half only one-tenth.

Significantly income and some other tax reliefs provide little, if any, benefit to those not paying much tax. This is now even more important in the UK given personal tax allowance thresholds were lifted for many years while benefits were held down by the austerity imposed on public spending after 2010. In 2019-20 the saving from freezing benefits affecting mainly the poorer virtually paid for lifting tax thresholds, including at the higher rates for the better-off (Lymer and Oats 2020, 126). However, after the dramatic unsettling of the UK economy by the first September budget of 2022, the Conservative government froze the main tax allowances for some years ahead, even reducing thresholds for some others reducing the impact of tax reliefs to an extent.

The extent to which tax expenditures benefit others as well as or rather than direct beneficiaries and the effects of this have received even less analysis. UK employers, for example, gain by more than three times as much as employees from pension contribution tax reliefs. Benefits to the pension and insurance industry from the total relief of 2.2 per cent of UK GDP are unknown but

probably considerable (HMRC 2023). These fiscal subsidies aiding employers and the pensions and insurance industries are probably the greatest example of wider impact in most countries. *The Cold War on Welfare* sees them as a form of 'privatisation [which] is about reducing the role of the state and expanding the role of stock markets ... altogether a different proposition' to providing better pensions (Minns 2001, xv, italics in original).

Tax expenditures can also have impacts beyond a country's own borders. From the start of donor aid, richer countries have generally forced poorer recipient ones to exempt from many taxes some or all forms of donor support. This can make local sub-contractors on aid projects, not only resident expatriates, more privileged by higher net incomes or tax-free access to services and goods. So tax policies of donors can influence not only attitudes but also behaviour, undermining general willingness to pay taxes (Steel, 2021; von Haldenwang et al 2021b, 45). Recent UN guidelines on taxing aid have yet to make much progress although an OECD hub launched in 2022 may generate more momentum (OECD 2022).

The limited analysis of tax expenditures

Analysis of tax expenditures is generally limited, if not blinkered, in two important respects. First, reliefs in other taxes than income tax receive very little attention. This includes social security contributions which can also provide costly reliefs. In the UK taxes on wealth provide a spectacular example. Over the last half century these taxes have continued to raise only 2 per cent of GDP while 'private wealth more than doubled from around 250 per cent to over 600 per cent of GDP' (Summers 2019, 115). The cost of the reliefs forgone are greater than the tax raised. The UK is not alone in neglecting the often enormous amounts of reliefs. Interest in taxing wealth more effectively is increasing but not within many governments (Advani and Summers 2022; Rowlingson 2023). The vested interests in taxation of the wealth defence industry are little scrutinised, let alone pursued (for example, the growth in tax-protecting 'family offices' below the fiscal radar in many countries, Collins 2021).

Second, the cost of tax expenditures is rarely compared to public spending, reflecting a general lack of governmental interest in, if not resistance to, more open debate on the workings of taxes. In the UK it was not evident that the estimated cost of the six largest tax expenditures rose by 18 per cent in 2020-21 (HMRC 2023, para 4.1) while restraint on public benefits continued and increased poverty. Closer comparison of public and tax spending in countries such as the United States and Canada often revealed a larger than expected contribution from tax reliefs. However, changes of government usually ended such comparisons although budgetary bodies continue to recommend it. International agencies have however become increasingly critical of the neglect: it 'violates' vertical and horizontal equity (World Bank 2003, 2). 'Out-of-sight

out-of-mind attitudes ... insulate inefficiencies from scrutiny' (OECD 2010, 29; Brys et al 2016, 51; EC 2014; IMF 2019).

The views of recipients of both tax welfare and public social security have thrown light on differences in perception in the United States (Ellis and Faricy 2021). Beneficiaries of tax reliefs generally regarded them more favourably, seen as an entitlement earned by paying tax, in contrast to public welfare often felt as stigmatising.

The need for greater debate of taxes as instruments of social and other policies

Tax expenditures, 'the hidden side of the fiscal contract' (von Haldenwang et al 2021b, 128), show how taxation works as an instrument of social and other policies. But governments also run policies through taxes in other ways (Farnsworth 2023). 'Taxation is part of the overall socio-cultural-economic system which constitutes the social world' (Byrne and Ruane 2017, 117; Ruane et al 2020). Taxes, individual and corporate, direct and indirect, shape and influence people's lives and the wider society, polity and economy. Leaving examination of taxes within a fiscal bubble of tax professionals and experts allows the undermining of publicly professed policies to tackle poverty and inequality (Bradshaw 2019).

Fiscal opportunities to tackle stubbornly high poverty and inequality could be made by better integration of taxes with priority policy concerns. Two such examples are the climate crisis and the better achievement of human rights.

Countries are coming under greater pressure, nationally and internationally, to tackle the growing climate crisis more robustly. But many standard UK fiscal responses to the climate change, particularly through indirect taxes, regressively maintain or increase inequalities (Bridgen and Buchs 2023). Tax incentives provide more for fossil fuel industries than for renewables, demonstrating how tax policies beyond personal ones affect societal welfare (*The Guardian* 9 March 2023). One major UK tax that has been little discussed in relation to tackling the climate crisis is the main consumption tax, value-added tax (VAT). Its relief supports the building industry and its suppliers in constructing and selling new buildings but not in maintaining, repairing and renovating existing ones with the immediate benefit of saving considerable embodied emissions at once by not demolishing them. That tax relief for new-build in 2021-22 cost £16.1bn, but increasing sustainability needs more repair and restoration, especially as government funds little home insulation. With many older buildings, most with poor energy efficiency, fiscal incentives for more repair and better insulation could reduce fuel poverty and cold homes among older and disabled people and families with young children as well as limiting energy usage and waste.

The second example relates to strengthening human rights for all (Lister 2021, ch 6). The UN International Covenant on Economic, Social and Cultural Rights requires nations to use 'maximum available resources' (MAR) to achieve 'full realization' of rights. But revenue forgone through tax reliefs is not treated as part of MAR and so not recognised as a resource to fund policies to reduce inequality, prevent poverty and so realise rights more fully. Meanwhile tax reliefs with generally regressive, upside-down benefits continue their hidden means-enhancing effects.

Conclusion

The presentation here may be too dominated by UK experience where tax policy and practice continue to be fenced off from other government action. With no ministry of taxation, much is locked within the Treasury and HMRC that is routinely published and discussed in other policy areas. The annual Budget drama can result in hasty and limited parliamentary appraisal and less opportunity for public scrutiny. Evidence of consequential changes in gender, class, ethnic, age, regional and other inequalities is scarce.

At present concern with establishing better arrangements '*within the tax system*' tends to block out making 'the tax system work to create greater equality *in society*' (Himmelweit 2023, 185, italics in original). Broad, structural analysis of social policy interventions is handicapped if regressive patterns of fiscal welfare and other reliefs are ignored. Recent co-editing and contributing to a book on how taxes operate as instruments of social policy have brought this home to me, revealing the limited changes in accountability, accessibility and transparency over the four decades since a similar book (Sandford, Pond and Walker 1980; Lymer, May and Sinfield 2023).

Pressures to change the different arrangements for tax and public spending have been increasing. There is clearly a need to establish international rules for the reporting of tax expenditures just as there have long been for public spending (McDaniel and Surrey 1985). Much more evidence needs to be provided at national and regional level to increase understanding of the way that taxes can be made to work with other policies to improve the quality and quantity of life for all.

It is not only in the UK that resistance to changes in the tax system has long been endemic, especially in significantly reducing inequalities (Glennerster 2012). The hidden fiscal wiring is 'power at its most effective when least observable' (Lukes 2005, 1). Greater openness and better integration with other policies offers opportunities for major fiscal changes that benefit the common good by reducing the increased inequalities of income and the even greater ones of wealth.

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