Heterogeneity income tax ratios
Causes, dimensions and development
of tax discrimination
in the Netherlands

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Introduction

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Vice Dean Faculty Governance & Global Affairs, UL The Hague

Topics
- Distribution tax-benefits social security and pensions
- Tax policy
- Reforming social and tax regulations
- Poverty EU and OECD / Lisbon Agenda / Europe 2020
Environment

- Debate: Tax Reform is going on for a while: Committee Van Weeghel (2010) and Committee Van Dijkhuizen (2012/2013)
- Major Tax Reform 2001 (preparation 1997)
- Mirrlees Review (2011) → current tax system (dis)incentives for labor participation (high marginal rates labor income)
- Parliament called-upon: Kamerbrief Keuzes voor een beter belastingstelsel (2014)
- European Commission and OECD encourage to adjust Dutch tax system
The Political Economy of Tax Reform

In the real world (i.e. not the one inhabited by tax theorists), proposals for tax reform are constrained by politics – not least the unfortunate observation that those who lose from tax reforms tend to be vengeful while those who gain from them tend to be ungrateful. This can lead in tax policy, perhaps more than in other areas of public policy, to a ‘tyranny of the status quo’.

Outline

Intended tax policy - looking ahead

Today: looking back

Assessment framework for income tax policy
  a) Distribution of income tax ratios in the Netherlands
  b) Perspective income (re) distribution
  c) Results 1990-2014

Tax policy: results since 2001

Tax legislator discriminates ... Increasingly - empirics

Final: from the 50th percentile onwards a ‘marginal tax rate’ ≥ 100% since 2001

“The hardest thing to understand in the world is the income tax.”

Albert Einstein
Government's fiscal position. Everybody happy?

Statistics Netherlands: highest tax burden in 20 years = 40%
Intended tax policy: *framing*

- **Budget Memorandum (MN2019):** taxes will be reduced by 6.5 billion compared to *basic path* (and that includes an increase of the burden by 9 billion).

- **Council of State (Raad van State):** government hide tax burden (both for citizens and businesses). Discrepancy of 1.5 billion between MN2019 and MEV (CPB).
  - CPB: increase of 5.3 billion
  - 850 million for citizens
  - 4.4 billion for companies

- **Cabinet:** 3.8 billion tax increase in line with Coalition Agreement (hidden in appendix MN2019).

*Budget Memorandum (MN2019)*
- Lower business taxes (p. 6)
- Both small firms and corporations will profit from lower taxes (p. 49)

*RAISE MY TAXES - LOSE MY VOTE!*
Dutch policy practice

Constitution Article 20: The livelihood of the population and the wealth distribution are objects of government concern.

Socio-economic policy (SER): achieving a ‘fair’ distribution of income.

Many consecutive cabinets:
- existing income distribution *not* questioned
- maintaining existing distribution of income
- rather pragmatically

Exceptions:
- Cabinet Den Uyl (1975)
- Cabinet Rutte-Asscher: income (re) distribution
Assessment Dutch tax policy since 2001

Main goals

☑ Incentives: promoting labor participation and economic growth (CPB, 2018)
☑ Income tax policy: stable income distribution (Caminada et al, 2017)

How? Via instrumentalism - fiscal discrimination ...

• Tax regulation: in many places deviation from ability to pay
• Contradistinction between en within social groups: tenants vs. owners, self-employed vs. employees, single earners vs. dual earners, households with vs. without (young) children, wealthy vs. non-wealthy.
• Tax policy had to adjust annually (increasingly) to present "balanced" income effects of public policy.

Bron: Caminada & Stevens (2017a)
Trade-offs Tax Policy

Equity / income (re) distribution

Efficiency / arbitrage

Tax law (Haig-Simon)

Optimal tax structure depends on:
- Societal aversion inequality
- Elasticity supply labor (tax incentives)
- Density population by income level

Fairness?
Who to tax: households or individuals?

Towards welfare enhancing policy?
Tax Reform?
Urgency is still missing although much room for improvement!
Empirics: Leiden University global research team & data

Assembled Datasets (URL: www.economie.leidenuniv.nl)

- Budget Incidence Fiscal Redistribution Dataset on Income Inequality
- Idem, on Relative Income Poverty Rates
- Social Assistance and Replacement Rates Dataset
- Unemployment Replacement Rates Dataset
- Sectoral Income Inequality Dataset

Luxembourg Income Study
World Wealth & Income Database
ECHP-EU-Silc
Netherlands Income Statistics (CBS)
Nomenclature

Disposable income =

Market income from labor, business and wealth

+/+ social benefits

-/- income taxes, social contributions

- Gross income = market income +/+ social benefits
- Disposable income = gross income -/- income taxes, social contributions

Tax ratio = \( \frac{\text{Gross income} - \text{disposable income}}{\text{Gross income}} \times 100 \)

Equivalence scales: correction for size and composition of households

Statistics Netherlands
- Administrative data
- Integral – micro data
- International conventions
- Top quality

Discover the world at Leiden University
Result: stable income distribution, 1990-2014

Shares income deciles equivalized disposable income

Idem, top shares (1% of 0.1%) remarkably stable: no trend income concentration

Source: Caminada, Goudswaard & Been (2017)
Share Dutch top incomes 1990-2012

Top shares remarkable stable over time → no increasing income concentration

Source: Caminada, Goudswaard & Knoef (2015)
Distribution equivalized market income: deciles, 2001-2014

Marker income more unequal:
- Lower share deciles 1-7
- Higher share deciles 8-10

Cause:
- Wages (panel b)

Not:
- Income from business (panel c)
- Income from wealth (panel d)

Source: Caminada, Goudswaard & Been (2017)
**Summary: Dutch income inequality and redistribution via T/B-system→ decomposition**

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<tbody>
<tr>
<td><strong>Gini primary income</strong></td>
<td>0.514</td>
<td>0.494</td>
<td>0.556</td>
<td>0.062</td>
</tr>
<tr>
<td>reduction via social transfers</td>
<td>0.187</td>
<td>0.166</td>
<td>0.197</td>
<td>0.031</td>
</tr>
<tr>
<td>reduction via income taxes and social contributions</td>
<td>0.022</td>
<td>0.050</td>
<td>0.072</td>
<td>0.022</td>
</tr>
<tr>
<td><strong>Gini disposable income</strong></td>
<td>0.306</td>
<td>0.278</td>
<td>0.286</td>
<td>0.008</td>
</tr>
<tr>
<td><strong>Redistribution T/B-system (Gini PI -/- Gini Dpi)</strong></td>
<td>41%</td>
<td>44%</td>
<td>49%</td>
<td>5%-p</td>
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**Shares (programs)**

- **Public old-age pensions**: 32%, 29%, 33%
- **Supplementary pensions**: 20%, 24%, 25%
- **Income taxes and social contributions**: 8%, 17%, 18%
- **Welfare (safety net)**: 13%, 7%, 5%

Source: Caminada, Goudswaard & Been (2017)
Dutch phenomena? Vast literature on redistribution via income by taxes and transfers in a comparative setting

- Atkinson & Brandolini (2001)
- Brady (2004)
- Brandolini & Smeeding (2007)
- Ervik (1998)
- Kenworthy & Pontusson (2005)
- Kopi & Palme (1998)
- Morillas (2009)
- O’Higinis et al (1990)
- Immervoll & Richardson (2011)
- Research team Reform of Social Legislation, Leiden University

Budget Incidence Analyses
Did T/B- systems became less effective in redistribution since mid-1990s?

Claim OECD: reduced redistribution is a main driver of widening income gaps
### Trend in fiscal redistribution among WA and total population

<table>
<thead>
<tr>
<th></th>
<th>Total population</th>
<th>Working-age population</th>
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<tbody>
<tr>
<td></td>
<td>Gini MI</td>
<td>Gini Dhi</td>
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<tr>
<td>Around 1985</td>
<td>0.431</td>
<td>0.280</td>
</tr>
<tr>
<td>Around 2012</td>
<td>0.479</td>
<td>0.297</td>
</tr>
<tr>
<td>Change 1985-2012</td>
<td>0.048</td>
<td>0.018</td>
</tr>
<tr>
<td>Share rise inequality offset by Fiscal Redistribution</td>
<td>63%</td>
<td>Share rise inequality offset by Fiscal Redistribution</td>
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<td>1985-2012</td>
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- Sizeable increase market income inequality in most LIS countries over the last 25 years.
- Fiscal Redistribution via T/B-system increased too.
- T/B-systems *increasingly effective at reducing inequality over time*.

Study / database Caminada & Wang (2017)
- 47 LIS countries, 1967-2014 (N*T = 291 micro data sets)
- Above: 15 countries, 1983-2014
# Key figures Dutch income (re)distribution and tax policy 2001-2014

## Income inequality

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<tbody>
<tr>
<td>Gini gross equivalent income</td>
<td>0.33</td>
<td>0.34</td>
<td>0.35</td>
<td>0.36</td>
<td>0.03</td>
</tr>
<tr>
<td>-/- redistribution via income taxes + ssc</td>
<td>0.05</td>
<td>0.06</td>
<td>0.07</td>
<td>0.07</td>
<td>0.02</td>
</tr>
<tr>
<td>Gini equivalent disposable income</td>
<td>0.28</td>
<td>0.28</td>
<td>0.28</td>
<td>0.29</td>
<td>0.01</td>
</tr>
<tr>
<td>Redistribution, %</td>
<td>15%</td>
<td>18%</td>
<td>19%</td>
<td>20%</td>
<td>5%-p</td>
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## Income taxes + social security contributions

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<tr>
<td>Taxes, total as % gross income</td>
<td>38.8%</td>
<td>41.0%</td>
<td>40.8%</td>
<td>41.3%</td>
<td>2.5%-p</td>
</tr>
<tr>
<td>- Social security contributions</td>
<td>20.0%</td>
<td>18.5%</td>
<td></td>
<td></td>
<td>-1.5%-p</td>
</tr>
<tr>
<td>- Contributions health care</td>
<td>9.1%</td>
<td>11.7%</td>
<td></td>
<td></td>
<td>2.6%-p</td>
</tr>
<tr>
<td>- Income taxes + taxes on wealth</td>
<td>9.5%</td>
<td>11.0%</td>
<td></td>
<td></td>
<td>1.4%-p</td>
</tr>
</tbody>
</table>

## Mean (real) disposable household income

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<tr>
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<th>€35,000</th>
<th>€34,400</th>
<th>€36,000</th>
<th>€35,000</th>
<th>€0</th>
</tr>
</thead>
</table>

Source: Caminada & Stevens (2017)
Heterogeneity tax ratios 2001-2014

\[ \text{Tax ratio} = \frac{\text{Gross income} - \text{disposable income}}{\text{Gross income}} \times 100 \]

Mean tax ratio 2014 considerably higher than in 2001. What about heterogeneity?

Difference gross and disposable income (including employer's contribution)

- Taxes on income and wealth
- Social insurance premiums for employees (including pensions)
- Health insurance premiums (nominal + income-related contribution - healthcare allowance)

Fiscal redistribution *machine* was running at full speed to maintain existing income distribution.
Heterogeneity tax ratios (1) - open to debate

Level 2001 and 2014

Change 2001-2014

Source: Caminada & Stevens (2017)
Change Dhi (mean, %) per socio-economic group 2001-2014

Source: Caminada & Stevens (2017)
Tax Law may or may not discriminate? Unexpected difference in tax ratios

Differences in tax ratios *hardly* depend on income levels, but:

- Household composition (alone / cohabitants / kids)
- Division of income between partners
- Preference raising kids (kindergarten)
- Preference home ownership (mortgage interest)
- Labor market status
- Age (65- versus 65+)
- Patterns of labor (sole earner, two earner couples, self-employed)
- Interest debts deductible; income from saving taxed
Heterogeneity tax ratios (2) = results fiscal discrimination

\[
\text{Tax ratio} = \frac{\text{Gross income} - \text{disposable income}}{\text{Gross income}} \times 100
\]

Policy: To what extent will society take differences in income and other factors into account by determining tax ratios?

€ 33,551 \rightarrow P10=22\%

€ 38,865 \rightarrow P10=39\%

P50=39\%

P90= 50\%

P50=52\%

P90= 56\%

Source: Caminada, Goudswaard & Knoef (2018)
How? Income related tax credits + allowances!

‘Als links het voor het zeggen krijgt, hebben we straks inkomensafhankelijke krentenbollen.’

Mark Rutte
VVD partijcongres 2010

‘Nivelleren is een feest’
Hans Spekman, 3 nov 2012
Illustration 1: income loss when a lone parent with modal income will cohabitate with ...

Credit lone parents
Allowance kids
Contribution kinderkarten
Allowance healt care
IACK
Allowance tennants

Source: Caminada & Den Boogert (2014)
Illustration 2: sole earner couple under pressure

✓ promote labor participation + economic independency of partners

• Lower taxes two earner couples via higher tax credits (AK, IACK)
• Higher taxes one earner couple: phasing out credits (AHK, aanrechtsubsidie)
• Income related schemes, credits, et cetera

Result: divergence difference tax ratio one and dual earners couples

International comparison:
• Netherlands at the forefront of the difference in tax burden between one and dual earner households (with an equal gross household income).
• Tax ratio difference is far above other countries
Causes differences tax ratio sole earner – dual earner couple (50%-50%), euro’s 2018

2018

2008

Source: Caminada (2018)
Changes gross income 2001-2014 unequally distributed

Source: Caminada, Goudswaard & Knoef (2018)

Percentiles equivalized gross income 2014 (corrected for CPI)

P50 = € 33.551

P95 = € 88.865
Changes income taxes + ssc 2001-2014 unequally distributed

Source: Caminada, Goudswaard & Knoef (2018)
Increasing redistribution ... (changes 2001-2014, euro)

From the 50th percentile onwards: ‘marginal tax rate’ ≥ 100%

Source: Caminada, Goudswaard & Knoef (2018)
... but in the end not that much changed in the distribution of disposable income (changes 2001-2014, euro)

Source: Caminada, Goudswaard & Knoef (2018)
Concluding remarks

Policy commitment since 2001
✓ Stable income distribution (implicit)
✓ Promoting labor participation and economic independency

How? Via higher taxes + tax incentives + an increase in fiscal redistribution.
  o The tax system, credits and allowances became complex.
  o Tax policy increasingly had to adjust to redress changes in gross incomes in such a way that a "balanced" income pattern remained.
  o To that end, the tax legislator discriminates ... fully and increasingly.
  o Increases of gross incomes have been fully or almost fully taxed away since 2001.
  o Purchasing power of many Dutch households is equal or lower in 2014 than in 2001. From the 50th percentile onwards: ‘marginal tax rate’ ≥ 100%.

Towards welfare enhancing policy? Urgency is still missing although much room for improvement!
Further reading – downloads via www.economie.leidenuniv.nl


