

Creating political space for fiscal compromises: How to build consensus around progressive taxation and spending

POLICY REPORT CONTRIBUTING TO THE CHALLENGE PAPER ON INEQUALITY AND EXCLUSION

PAUL VON CHAMIER | JUNE 2019



A progressive fiscal system is one that either through tax graduation, progressive spending, or both, hedges the natural drift of a free market economy toward ever deeper inequalities.¹ Such progressive fiscal systems have a documented track record of stabilizing and often reversing economic inequalities.² There is ample research on why economic and social inequalities are currently on the rise and how they are a drag on development and the well-being of societies.³ There is also an ongoing debate on the side effects of progressive and/or high taxation in terms of GDP growth as well as incentivizing entrepreneurship and risk-taking. While not delving into those conversations, this policy paper aims to elucidate the process whereby political stakeholders actually decide to pursue a progressive tax system.

Summary

The dynamics of socio-economic inequality and technical solutions geared toward addressing it have been well identified. The inability of many societies to deploy those solutions nonetheless is of a political nature. The focus of the debate should therefore be to understand the political dynamics around the subject and to learn to navigate the interests of key stakeholders. Throughout modern history, countries would transition back and forth between progressive, income-neutral, and sometimes even regressive fiscal systems. In doing so, they responded to shifting global and domestic contexts. This policy paper demonstrates that the decision on the progressivity of a tax system and fiscal spending is at its core a political rather than an economic or a technical one.⁴ When there is enough political momentum to address economic inequality, appropriate policies are usually found.

Classical arguments of political economy do not properly capture the essence of inequality dynamics.

When confronted with evidence, many standard assumptions around what political developments exacerbate or curb inequality do not hold water. Counterintuitively, democracy does not seamlessly translate to less inequality. Moreover, even when a democratic society is free of elite capture and has a left-leaning government at its helm, it might still be not enough to achieve sizeable and lasting changes in socio-economic distribution. Assumptions about the inevitability of inequality under certain circumstances are also often wrong. Globalization, while driving countries to enter the race to the bottom in terms of corporate taxes, does not create pressure to slash personal income taxes.

Forward-looking political arguments for progressive fiscal spending can be based on three different foundations: fairness, fear of instability, and external-internal interactions. Evidence from a diverse pool of developing and developed countries shows that rationale that compels decision makers to actually enact fiscal progressivity can be grouped into three main categories. Demand for economic fairness is a strong driver of human behavior. People will enact to erase what is seen as unearned privilege, especially when a situation arises that serves as a lightning rod for their frustration. Another strong catalyst for fiscal progression is fear of instability. When inequalities threaten a state's survival, appropriate policies are likely to be enacted. Finally, interactions with external actors such as the World Bank or the International Monetary Fund (IMF) might reinforce local reformist voices, leading to more progressivity.

Many occurrences can prevent progressive taxation and spending, even when the right amount of social support and sound arguments are in place. These arguments need to be further refined by being framed in a way that navigates fraught social interactions around sharing resources, especially in culturally diverse societies. They need to tap into the psychological dynamics underpinning people's perception of inequalities. If successful, such arguments can serve as a lightning rod for people's frustrations, successfully attracting a broad coalition of political partners at the intersection of various social challenges.

I. Progressive fiscal reforms – classical arguments of political economy

There is much confusion about what it actually takes for a society to institute a progressive fiscal structure. Many older arguments could not have been properly vetted when first conceived. As a result, fossilized misconceptions are now persistent, obscuring the picture and inhibiting the ability to come up with solutions that work. As a first step, we should take a look at some of the most popular arguments that do not withstand contemporary evidence or are inapplicable in the modern context:

Ineffective political arguments

Democracy hypothesis

Democracy on its own is not enough for a society to tax the rich. The most popular hypothesis on why universal suffrage would consequently lead to higher taxes on the rich is based on voting power dynamics. It states that in unequal societies poor people outnumber the rich, giving the former more voting power and a strong incentive to push for tax progression. However, evidence from 184 countries analyzed by Daron Acemoglu of the Massachusetts Institute of Technology (MIT) finds no such pattern.⁵ There are many forces in a democratic polity that could prevent progressivity. He notes: "Elites in newly

democratized countries may hold on to power in other ways, the liberalization of occupational choice may increase inequality among previously excluded groups, and the [newly empowered] middle class may redistribute income away from the poor and the rich alike.”⁶ Data from twenty Organisation for Economic Co-operation and Development (OECD) countries analyzed by David Stasavage and Kenneth Scheve show only a marginal impact of introducing universal male suffrage on the top rate of income tax.⁷ The average was just below 20 percent before the first year of universal male suffrage and remained at about 20 percent for years afterwards. In the US, expanding voting rights and turnout did not coincide with more progressive taxes. In fact, the latest round of voting rights expansion, in 1965, was followed by a long-term fall in tax progressivity both at the federal and state level; the states most affected by suffrage expansion were the ones to curb progressivity most. This happened despite the fact that African-Americans, who were the beneficiaries of the reform, were at the bottom of the income ladder. It turned out that the issues of identity and the psychological dynamics of repugnance toward sharing with “others” proved stronger than class interests.⁸ There is also no consistency in how democracies react to deepening inequalities. Some apply more progressivity in the wake of growing imparities (e.g. Scandinavia), while other pursue unchanged fiscal policies (e.g. the US and the UK).⁹

While not a decisive force on its own, democracy can serve as a compounding factor. As we will see below, some of the most compelling arguments in favor of tax progressivity refer to compensation. At the height of World War One, when mass mobilization was first deployed, democratic countries responded much more robustly and faster to compensatory claims by the poor. While taxes for the rich grew in both democratic and non-democratic countries which mobilized their population, the progressivity effect was much stronger in the former.¹⁰

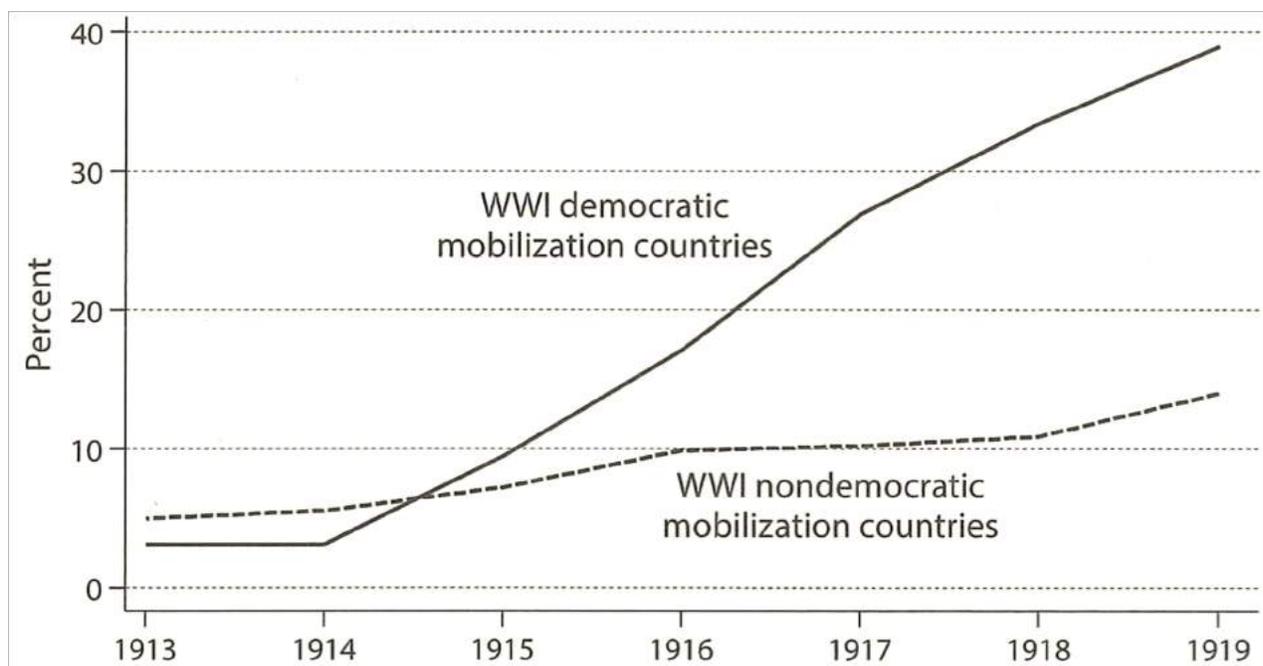


Figure 1. Democratic countries introduced much greater tax progression as part of war mobilization. Source: *Taxing the Rich: A History of Fiscal Fairness in the United States and Europe - Top income tax rate in 20 OECD countries*

Elite capture hypothesis

Elite capture does not explain why inequality does not always translate to tax progression. The “capture hypothesis” suggests that democracy could result in more tax progressivity, provided its institutions are not captured by the wealthy.¹¹ Indeed, members of the US Congress tend to vote in alignment with the interests of their high-income constituents as opposed to the general electorate, especially since the controversial *Citizens United* decision from 2010 removing donation caps.¹² Nevertheless, evidence from other countries is inconsistent. It suggests that lack of “capturedness” by the wealthy, while helpful, is not enough to enforce progressive taxes.¹³ The US has never abolished the progressive inheritance tax. Canada and Sweden, two countries where campaign financing by private donors is much more limited, did so in 1971 and 2004 respectively. New Zealand, a country with robustly representative institutions, is among the top ten most unequal OECD countries in regard to income.¹⁴

Ideological hypothesis

The limited impact of democracy on its own is also visible when measuring the effect of left-wing parties coming to power. In their book *Taxing the Rich*, David Stasavage and Kenneth Scheve examined the influence of coming to power by left-leaning parties on progressivity of the tax system in twenty mostly Western countries. Over the past century, such an event led to the top income tax rate rising temporarily by three percentage points four years after the election before reverting to the original value.¹⁵ As soon as a non-socialist party comes to power, progressivity comes down to its long-term average.

Technical argument against progressive taxation without much impact

Globalization

Globalization has limited states’ capacity to apply high corporate and capital taxes but not personal income taxes. Corporate taxes have fallen as capital has become more mobile internationally.¹⁶ This is due to competition between countries for the tax domicile of companies. Especially small countries with a small domestic economy have a large incentive to become tax havens and poach international firms.¹⁷ Since corporate taxes have a much greater incidence on the wealthy, this race clearly reduces fiscal progressivity.¹⁸ However, this trend seems not to apply to personal taxes on income or inheritance. Countries are found to adjust those tax rates in synchrony, but Princeton University research suggests that the strength of that interdependence has been the same over the past seventy years.¹⁹ Smaller countries do not have lower personal income taxes, which would make sense if there was a possibility to woo rich people this way.²⁰ Individuals, even wealthy ones, are much likelier to relocate their liquid capital than themselves.²¹ The reaction to the recent tax reform in the US is consistent with that finding. Moody’s Investors Service reported it had found “no discernible signs yet” that the changes triggered any migration even though many rich people ended up paying higher state taxes.²² This might be due to the “embedded elite” effect when personal, professional, and cultural ties keep the rich glued to a place, in spite of creeping tax rates.²³

An ethical argument that has a strong impact but is inapplicable in the modern context

Wartime compensatory arguments

David Stasavage and Kenneth Scheve compellingly argue in their book *Taxing the Rich* that over the past century, the most powerful compensatory arguments involved mass military conscription. The world wars' policies privileged the rich. First, the labor force was conscripted to fight while the capital was not. The working class were forced to sacrifice their sole source of sustenance. This was not the case for the wealthy, who continued to enjoy their capital. Second, owners of capital could profit from war contracts and heightened demand. War turned out to be a profitable business for those who could invest in it. Third, the wedge was further reinforced by the fact that the poor were more numerous among the young, conscription-eligible people. Rich people were older on average, allowing many of them to avoid going into the army. They also had fewer conscription-age sons on average. Finally, the wealthy had resources enabling them to get an exemption. Poor people became a unified interest group, raising demands for the government to compensate them for the unfair advantage that the rich were getting.²⁴ The result was steep tax progression that was applied throughout the Western world and the colonies, as shown by country cases.²⁵ A key factor was mass involuntary conscription, which was impossible before the development of the railway system. The period after that development and before the shift to professional army marked the peak of progressive taxation. As the graphs below reveal, tax progression was strongest during the world wars, especially in countries that mobilized their societies.²⁶

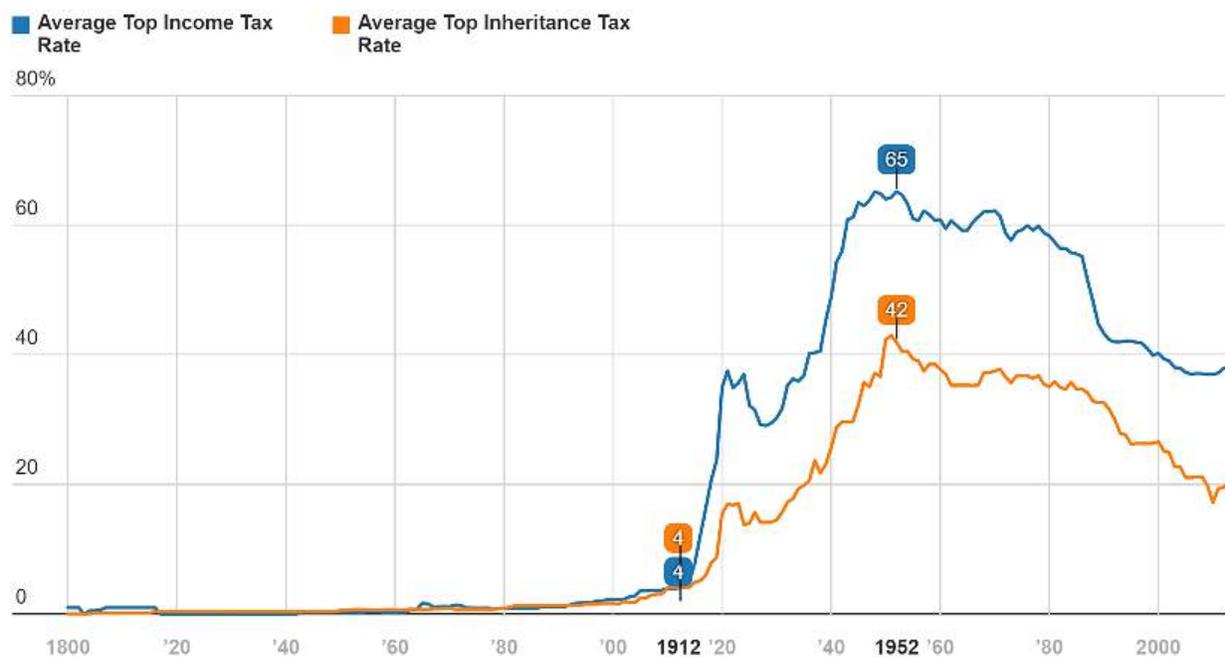


Figure 2. Tax progression rose aggressively during the world wars. Source: Data - *Taxing the Rich: A History of Fiscal Fairness in the United States and Europe*, Visualization – *Theconversation.com*

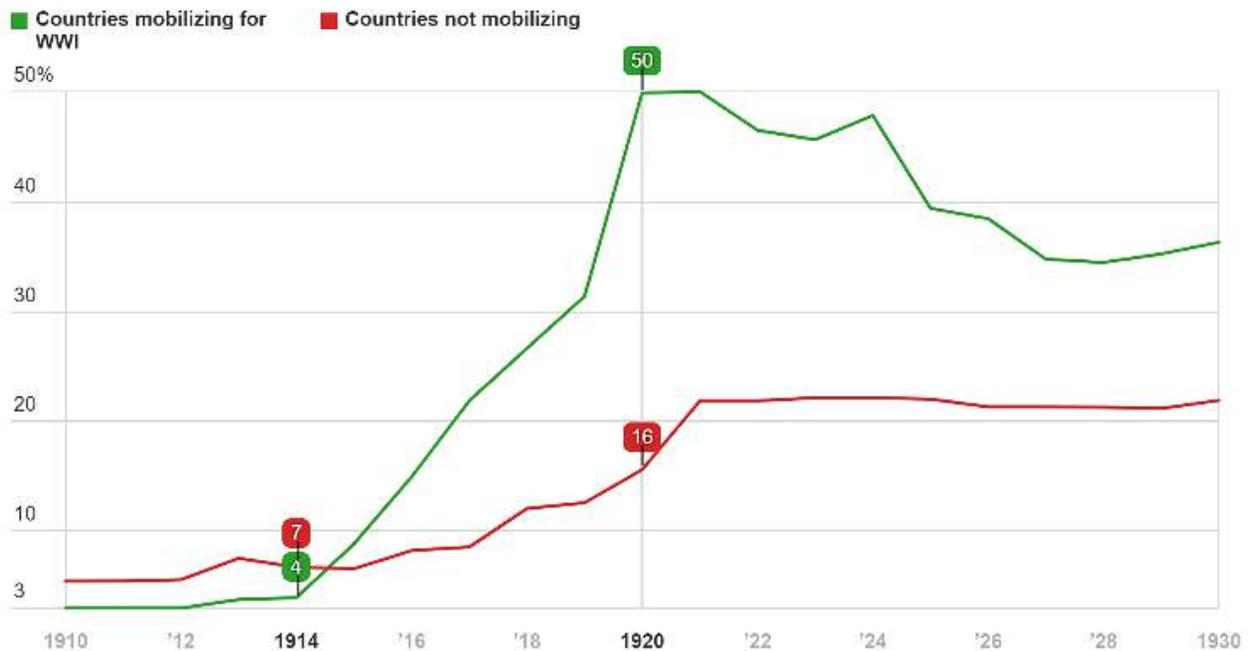


Figure 3. Mobilization countries had much greater tax progression. Source: Average top income tax rates, Data - Taxing the Rich: A History of Fiscal Fairness in the United States and Europe, Visualization – Theconversation.com

Case in point – Canada

Compensatory wartime arguments

Canada received self-government from the UK in 1867. At the time, the provinces established consistent criteria for voting rights: one had to be a male British subject who was at least 21 years old, and who met property qualifications.²⁷ While those laws considerably skewed the system toward the elites, it is still noteworthy that tax progression or in fact any income tax at all was not a topic of any election campaign until 1915 – one year into World War One.²⁸

At the time, the government introduced higher corporate taxes and luxury goods taxes to pay for the war effort. The Liberal Party, in opposition, started arguing for income taxes that year but the government was still able to block such initiatives. At the same time, the government started recruiting volunteers for the army. Provision costs soon shot up and war profit taxes were introduced to tax the rich for what was described as “unmerited benefit” from the heightened demand on the market.²⁹

Since the number of volunteers was not nearly enough, the government decided to announce popular conscription in May 1917. Just a few months afterwards, in July 1917, the same government found itself forced to introduce progressive income tax under pressure from conscripts’ families. The tax had to be raised a number of times over the following three years. Thus, because of the First World War, Canada went from 0 percent tax rate for the rich in 1917 to 70 percent in 1920.³⁰

Case in point—South Africa

Compensatory peacetime arguments

In 1994, as the Republic of South Africa was transitioning away from apartheid and toward representative democracy, the government was poised to introduce progressive tax reforms. The African National Congress (ANC), the ruling party and a member of the Socialist International, represented the black majority, which was awaiting compensation after decades of abuse. The idea of a wealth tax, aimed at the beneficiaries of the racist system, was discussed.³¹

At the same time, South Africa was in need of international support. Its foreign reserves were shrinking and the country needed a loan from the IMF. Part of the package was an agreement to lower taxes and broaden the tax base. Besides, part of the agreement with the last white president - Frederik de Klerk - was to avoid punitive action against the white minority after power was handed over. The ANC decided against risking being seen in breach of the agreement, partially for which Nelson Mandela, the new president had received a Nobel Prize a few months earlier.³²

Still, there was a consensus that some fiscal compensation must take place. The government delayed implementation of the lower corporate taxes agreed with the IMF. Since virtually all the big companies were owned by white people, this was seen as an act of minimal racial tax justice. The dominant view was that corporate taxation was equated with taxation of white people and VAT with taxation of black people.³³

II. Forward-looking arguments

The policymaking community is in need of arguments that are strong enough to propel movement toward progressive taxation and spending. Classical arguments listed in the previous section are either uncertain or inapplicable in the modern context. Below is a summarized review of some themes that could have a tangible impact in current political debates:

1. Fairness

While not as effective as during the mass mobilization period, peacetime fairness arguments might still have impact in the modern context. Those arguments can draw on the logic of:

- a. Compensation for unearned systemic privileges or for disproportionate suffering
- b. Equal treatment
- c. The ability to pay

2. Fear of instability

When the survival of a government and/or the whole constitutional system depends on it, governments are prone to enact egalitarian taxation and spending. Two types of legitimacy-related factors might be delineated here:

- a. Fear of political instability or social unrest
- b. Risk of an armed conflict

3. External-internal interaction

The interaction between the external actors (e.g. multilateral organizations, donors, investors) and internal policymakers might strengthen local reformists and help introduce fiscal reforms.

Fairness

The perception of fairness is a powerful driver shaping tax systems. Many economic theories rest upon the assumption that people are concerned with maximizing their income. The evidence reveals that this is the case, but only up to a point. A study from 2014 of a representative sample of 500 Americans revealed that when asked a series of questions about their preferred tax system, only 53 percent made a choice optimizing their income. The majority of the remaining 47 percent reported fairness as the motivation for the choice to hurt their self-interest.³⁴ This is consistent with other studies, proving that people are ready, to an extent, to sacrifice their material self-interest for fairness.³⁵ This is the case in developed and developing countries alike. A recent Afrobarometer survey reported that Africans say taxes are necessary for social development (63 percent), paying taxes is a civic duty (72 percent), and not paying taxes is wrong (87 percent).³⁶ A famous study from 2004 measured people's behavior during "ultimatum games experiments", in which one of the two participants is asked to make an offer to split a monetary reward with the other. If the second participant rejects the offer, both get nothing. Where the second participant accepts it, they receive their agreed shares. From a purely materialistic point of view, second participants should always accept any kind of offer, even if it is tiny fraction of the reward. However, 16 percent of the offers were rejected by second participants. First participants were offering 40 percent of the reward on average for fear that the second participants would reject a lower offer due to unfairness.³⁷ In a follow-up experiment, where participants were asked to either accept or reject a share of the reward randomly chosen by a computer, they had no problem accepting even extremely low offers.³⁸

Peacetime fairness arguments can garner popular support but are not nearly as powerful as claims advanced in wartime. Broadly speaking, any systemic privilege for the rich might give rise to a fairness argument ("It's not fair!"). Access to better education and therefore life opportunities can be framed as such a privilege. The same might apply to any unearned windfall gains, such as appreciation of urban real estate. Many of the modern fairness arguments have been debated for as long as half a millennium, as documented by records from Renaissance Florence.³⁹ The indirect taxes then, as today, were by nature regressive, claiming a bigger share of the income of the poor than the rich. This established the grounds for an argument for compensation of the poor. For example, in 1907, French minister of finance Joseph Caillaux noted that in a rapidly transforming society, a slew of new categories of untaxed windfall income were emerging. Since this created a recurring unearned privilege for the owners of capital, those new categories of income should be taxed or alternatively the general income tax should be made more progressive.⁴⁰

Compensatory arguments compel people to seek redress. They make sense when the government is obliged to take an unequal systemic action favoring the rich. The key element is that the society perceives the favor as an "unearned privilege".⁴¹ When simply removing that privilege is impossible, society raises a demand for compensatory action. The urge to correct the inequality is the strongest when it has been recently created. Compensatory arguments are also most likely to be raised in a democracy because the underlying premise of the system is that citizens should be treated as equals. If this balance is overtly disturbed, countermeasures are expected.⁴² Such arguments, while valid, have not yet led to nearly as steep progressivity as the wartime compensatory arguments did. Obamacare (ACA), barely overcoming fierce congressional opposition, imposed two taxes on the well-to-do to help pay for the expansion of health coverage to millions of low-income Americans with no access to employment benefits: a 3.8

percent tax on investment income and a 0.9 percent Medicare payroll tax on annual incomes over \$200,000. The resulting \$40 billion of extra tax revenue per year amounts to just 0.23 percent of GDP.⁴³

Case in point – UK

Compensatory peacetime arguments

Compensatory wartime arguments

In 1909, Prime Minister David Lloyd George introduced the “Super Tax” as part of his “People’s budget”. It increased the top income tax rate from 5 to 8.3 percent - a measly figure by today’s standards. The Labour Party manifesto from the same year stated that the most important principle regarding taxation is that it “should be in proportion to the ability to pay”.⁴⁴ The Conservative Party would oppose this claim by invoking nominally equal treatment of citizens (i.e. the same income tax rate) as the fairest approach. Those parliamentary debates can be quantified by tracking the proportions of the arguments made in the records of the House of Commons (Figure 4.).

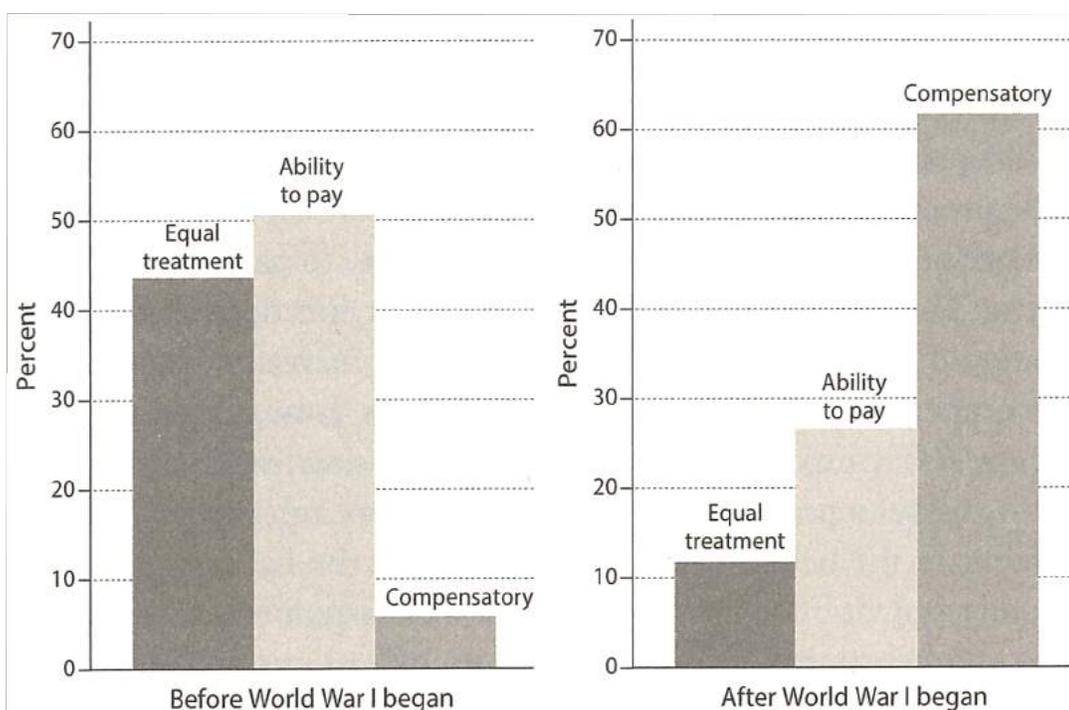


Figure 4. Changing rationale around taxes in the UK. Source: *Taxing the Rich: A History of Fiscal Fairness in the United States and Europe*

The balance of arguments changed drastically after 1914. Wartime compensatory arguments dominated the discussion and their impact was immediately visible. By 1920, the top income rate rose to 60 percent.⁴⁵ The mismatch between that number and the pre-war “Super tax” that meant the top rate of just 8.3 percent highlights the difference between the marginal impact of the ability to pay and peacetime compensatory arguments compared with the overriding nature of the wartime compensatory arguments.

Case in point – Germany

Solidarity tax after the reunification

Every October 3, Germany marks Reunification Day, which commemorates the absorption of the German Democratic Republic by the Federal Republic of Germany in 1990. The newly reunited nation recognized vast economic disparities between the two parts of the country and saw them as a form of historical injustice. To make amends, the government embarked on a multifaceted investment program in the East, financed by the so-called “Solidarity surcharge” established in 1991. The additional 5.5 percent tax is added to both personal and corporate income taxes. Only income above an annually updated threshold is subject to the “Soli”. The great majority of the payers reside in the more developed West.

After almost 30 years and more than €350 billion in post-reunification assistance, the six Eastern federal states' GDP is at 72 percent of that in the West.⁴⁶ The special tax was supposed to expire in 2021. However, since the economic disparities are persisting, the government is now planning to extend the “phasing-out” period until late into 2020s.⁴⁷ German solidarity tax reveals the limits of compensatory fiscal progression. While the attachment of East Germans to the reunified state improved thanks to the investment program, the tax stirs controversies in the West. Solidarity fatigue is now visible in surveys. Phasing-out of the program might be as much of a challenge as its introduction.⁴⁸

Fiscal compensation might also be a redress for disproportionate suffering sustained by a part of the society.

The reunification of Germany in 1990 gave way to fiscal progression aimed at healing a divided nation. At the time, East Germany was underdeveloped after decades running a centrally planned economy. The country had been governed by a single party dependent on the Soviet Union’s political support, which limited scope for economic liberalization. The division into East and West Germany was the result of the aftermath of World War Two and seen as an unfair imposition by external political powers. Following the fall of the Berlin Wall and the absorption of the German Democratic Republic by the Federal Republic of Germany in 1990, the newly reunited nation introduced “solidarity” taxes for high earners to raise funds for development projects in former East Germany. Compensatory logic also drove the decision to delay lowering corporate taxes in South Africa in the 1990s, as described in the case on page 5. More recently, similar proposals of fiscal redistribution driven by national solidarity were offered by the Nobel Prize-winning Tunisian National Dialogue Quartet. The initiative, which helped navigate the nation through the difficult years following the Arab Spring, conducted extensive social consultations. Poor Tunisians pointed to a sense of fiscal injustice being behind much of the frustration.⁴⁹

Alternative peacetime fairness arguments might rest on the notion of equality. Taxes in many countries can be seen as regressive (e.g. payroll taxes or capital gain taxes in the US). As a result, more progressivity would not even have to involve establishing tax progression. Achieving effective flat rates across income brackets of a society would already be more progressive. This raises the possibility of using the argument of simple equality. Historically, such arguments were used in the context of the extreme inequalities in industrializing nations in the 19th century. They might again become applicable. Billionaire Warren Buffet famously said in 2013 that he is paying a lower effective tax rate on his income than his office secretary. He followed by proposing the so-called “Buffet rule” aimed at achieving at least an effective flat rate between the two. The idea was a minimum income tax – “a floor” expressed in monetary terms rather

than percentages, for the highest earners like himself.⁵⁰ It received much support from President Obama but ran into vociferous opposition in Congress.⁵¹

The ability-to-pay argument rests on the idea that people should be inconvenienced to the same degree by taxes. John Stuart Mill described it as “equality of sacrifice.”⁵² Many societies used the idea to tax luxury goods and high income. In Medieval Florence, such tax was called *decima salata*.⁵³ Arthur Pigou, one of the founders of modern welfare economics, interpreted this approach as maximizing social utility by equalizing “marginal sacrifice” between the poor and rich.⁵⁴ According to this idea, the rich should be paying more tax until their contribution is as burdensome as that of the poor people. However, it is impossible to objectively define a person’s ability to pay or implement such taxes without appearing to be penalizing success and entrepreneurship. Various European countries over the past three decades tried to implement taxes based on higher ability to pay of the rich. In the case of almost all of them, those were taxes on wealth rather than income. Wealth, it was argued, is a better measurement of a person’s fiscal comfort. Taxing income could penalize entrepreneurs who took on a lot of debt and risk developing their companies. Such an approach could lower investment appetite and be, well, unfair. In 1990, twelve countries in Europe had a wealth tax. Today, there are only three: Norway, Spain, and Switzerland.⁵⁵ As confirmed by the OECD analysis⁵⁶ and other research,⁵⁷ all such projects ran into similar problems: they were expensive to implement, they disrupted lives of people with family assets but no regular income, lowered investment rate, and led to mass squirreling of money in tax havens.⁵⁸ As a result, disappointingly, they did not raise much money at all. However, there is one category of assets that escaped that logic – real estate. Rich people found it difficult to conceal the market value of houses and apartment. This finding drove President Emmanuel Macron in 2017 to exempt real estate from a bill, scrapping the controversial wealth levy established by his socialist predecessor, Francois Hollande.⁵⁹

Fear of instability

When existing inequalities threaten a state’s or government’s survival, appropriate policies are likely to be enacted despite economic or technical limitations.⁶⁰ Often, states introduce egalitarian fiscal policies during crises involving social unrest that threatens their legitimacy. This fiscal flexibility during legitimacy crises was recognized in the historic World Bank Report from 1993 on East Asia.⁶¹ The institution concluded that “crises of legitimacy” are the moments when governments need the popular support of the poor the most. The price is clear – more fiscal progressivity. In a follow-up publication, the World Bank listed some types of policies introduced to appease the working class: land reforms in Korea and Taiwan, rice subsidies in Malaysia, public housing programs in Hong Kong and Singapore, and many others.⁶² In all those cases, the efforts to preserve the state drove the fiscal policy toward progression.

The crises might be of diverse natures, ranging from a threat of war, through guerrilla insurgencies, to ideological strife. After the Korean War, the South Korean government conducted land reform, giving titles to the farmers. The North Korean military threat made the struggle of the poor more salient.⁶³ In the process, the government subsidized consolidation and investment in improving farm productivity. Newly enriched farmers eagerly participated in the program, resulting in rapid development of the agricultural sector. Threat of an uprising was constantly present in Malaysia’s Borneo island from the early 1960s until the end of the Cold War. Malaysia’s strategy included steep fiscal progression, not only in terms of taxes but also spending. Despite modest resources, it reduced the absolute poverty rate from almost 40 percent to less than 5 percent between 1960-1990.⁶⁴ After the threat to legitimacy caused by the Asian financial crisis of 1998, Indonesia started a careful shift away from fuel subsidies. Even though reducing fuel subsidies

is almost always unpopular, the subsidies are in fact captured by the wealthy for the most part. Since 2005, consecutive Indonesian governments carefully lowered the subsidy, always making sure to replace it with progressive spending so that the state's legitimacy was not undermined. Public transit infrastructure and the new universal insurance schemes were funded with resources freed by the subsidy cuts.⁶⁵

Case in point – Singapore

Fear of instability

Since the 1959 elections, the People's Action Party (PAP) has dominated the political landscape of Singapore. At that key moment, the city state was overwhelmed by squatter settlements and the party pledged to provide low-cost housing, should it win. In 1964 the government launched the *Home Ownership for the People Scheme* to encourage a property-owning democracy in Singapore.⁶⁶ At the same time, PAP led negotiations with neighboring Malaysia to join it as an autonomous region. One of the main drivers was the fear of an uprising by impoverished slum dwellers. After the merger failed in 1965, PAP became all the more convinced that fixing the housing inequality constituted an existential challenge. The government embarked on a long-term strategy to provide good quality housing. In 1968 the government established the Central Provident Fund (CPF) to allow Singaporeans to use their public saving accounts to pay monthly mortgage.⁶⁷ Since the start of the program, supply has been provided by government-owned realtors. As of 2015, 82 percent of the population live in such publicly sourced apartments.⁶⁸

Case in point – Jordan

Fear of instability

In January 2018, the government, as part of collaboration with the IMF, announced a draft tax bill that would encompass lowering of personal tax exemption thresholds, reduction of the bread subsidy, and higher taxes on gasoline, tobacco, and work.⁶⁹ The country, which had managed to avoid political turmoil during the Arab Spring, was swept by a wave of protests that led to resignation of the Prime Minister. In September 2018, the government announced that the bread subsidy would be replaced by a cash transfer program and that the reform would tax only 12 percent of the richest citizens. When that did not stop the outcry, the Prime Minister announced the exemption rate would be actually raised as part of the reform. Parliament finally passed the bill in November.⁷⁰

Analogously, countries gearing up for a war or reeling from a lost one are also more willing to accommodate the plight of the poor. The necessity to shore up popular support compels governments to pursue progressive fiscal policy; for example, Japan, whose establishment was humiliated by the defeat in World War Two. The post-war reconstruction included rebalancing of power relations between the poor and the rich, to the benefit of the former.⁷¹ The second German Reich introduced a number of progressive social insurance schemes in the late 19th and early 20th centuries as its capacity to project force abroad grew. The historic healthcare reform enacted by Otto von Bismarck in 1883 was designed to win over the support of the working class, the main source of manpower and a target group of communist and socialist ideologues. Richard Titmuss, a leading researcher of the welfare state claimed: "If this cooperation [of the poor] is thought to be essential [to the war effort], then inequalities must be reduced and the pyramid of

social stratification must be flattened.”⁷² The legitimacy argument is similar to the one laid out for the compensatory argument. Nonetheless, they rest on two different rationales. The first one relates to bargaining on fair recompense while the second is based on a risk of a revolution, should the poor people reject the premise of the system.

The perceived threat of communism for Western governments in Europe can be seen as a legitimacy-related stimulus for progressive taxation. World War Two led to a long-term increase in taxes on the rich that only wore off in the late 1970s as the threat of a communist revolution ebbed away.⁷³ This “ratchet effect” in taxation was observable as long as the need for more legitimacy in the eyes of the working class persisted. The persistence of high fiscal progression long after the war might have been also reinforced by the “flypaper effect,” where governments’ expenditures grow easily when new tax revenues are available but resist any downscaling.⁷⁴ The drop in workers’ union membership, coinciding with growing inequalities in the 1980s and 1990s, is also a possible factor. However, many scholars argue now that falling union membership was a result of political and economic trends rather than a driving force behind them.⁷⁵

Case in point – Indonesia

Fear of instability

The Asian financial crisis of 1997 put Indonesia in an extremely difficult situation. Investors started aggressively selling the rupiah in August of that year. Skyrocketing inflation and troubles with paying back dollar denominated loans convinced Moody’s to label Indonesia’s long-term debt as “junk”.⁷⁶ The IMF came forward with a rescue package worth \$23 billion but the situation kept spiraling out of control. Amidst violent riots in May 1998, President Suharto stepped down after 31 years at the post. This was followed by a successful bid by Timor-Leste to claim independence in a UN-sponsored process. The inability to stabilize the situation and political flux lowered the legitimacy of the state in the eyes of common people, hurting from unemployment and high prices. Malaysia, with a population five times smaller, had a \$90 billion social security fund at the time. Indonesia had only \$2 billion worth of funds at their disposal.⁷⁷

All the political parties were concerned with the stability of the system. Together they agreed to channel popular frustration and the need for change into a debate about changing the constitution. This helped transform the tension into a national conversation. It also ended up strengthening the legitimacy of the constitution as the unifying political platform. The Post-Suharto era thus started with four constitutional amendments, one of them (in 2002) introducing “social security for all.” In 2004, laws establishing national social security and universal healthcare were passed and the system became fully operational in the early 2010s.⁷⁸ Indonesia became a leader among the developing countries in terms of providing progressive universal insurance schemes. The difficult experience of the late 1990s was turned into an opportunity for social and institutional development.

External-internal interaction

Interaction between external and internal actors can lead to reinforcing reformist voices in policymaking circles. Leading international organizations in the field such as the World Bank and the IMF hold consultations about the fiscal context with governments as part of any development aid package. Those conversations are an opportunity for progressive, reformist voices in a country’s political circles to more forcefully resonate.⁷⁹ After many decades of imposing austerity without considering the social cost,

the World Bank now has a track record of supporting balanced reforms that help regain fiscal stability while staying cognizant of the social cost of introducing them.⁸⁰

External motivation to introduce progressive taxation might also stem from an institutional cooperation framework and multilateral collaboration. Ever since the London Summit of 2009, the OECD has worked on an initiative called “Base Erosion and Profit Shifting.”⁸¹ The G20 group is making an effort to address the subject of tax havens and the race to the bottom on corporate tax. Recently this conversation among world leaders shifted toward an international minimum corporate tax rate arrangement.⁸² Nobel Prize winning economist Joseph Stiglitz suggested tighter connection in trade deals between access to markets and addressing issues of tax dumping and evasion.⁸³ The G20 Summit in Buenos Aires in December 2018 called on countries to enforce a minimum corporate tax rate.⁸⁴ The UN SDG Agenda set a target of “improving domestic capacity to tax” (Target 17.1), which encompasses more effective taxation of the wealthy.⁸⁵

A number of recent World Bank programs have combined funds with governments’ commitments to a progressive tax reform. Colombia’s tax reform in 2012 was introduced in collaboration with the World Bank. At the time, Colombia had the second highest inequality level among upper-middle income countries and the highest unemployment in the region. In 2010, progressive “Party of the U” swept to power, winning the presidential and parliamentary election. The reform was geared towards improving tax collection and raising the overall tax burden of the top 0.6 percent while lowering it for the remaining 99.4 percent of society. A year after the reform, the Gini index was estimated to have fallen by around 1 percentage point.⁸⁶ The São Tomé and Príncipe program was implemented from 2005 and included funds for tax collection capacity building and a progressive income tax reform. The program was a result of the collaboration of the World Bank with the national unity government that encompassed all three parties in the parliament. This unique situation allowed the reformists to implement a non-partisan tax reform. As a result, the tax-to-GDP ratio grew by 3 percentage points between 2005 and 2012.⁸⁷ A recent World Bank program in Poland offered developmental funds for projects in five less developed regions of the country. The initiative was aimed at closing internal gaps in development between regions.⁸⁸

Case in point—Colombia

Risk of an armed conflict

In 2003, Colombian President Álvaro Uribe unveiled his signature policy titled “Democratic Security”. It was a multilayered effort to fight the illegal militia and the drug trade. Guerrillas such as FARC, ELN, and AUC had been terrorizing civilians for decades. To fund the program, the same year Uribe’s administration introduced a one-off 1.2 percent wealth tax on held cash on higher-income Colombians and corporations. More than \$650 million was collected, surpassing original expectations.⁸⁹ The parliament kept extending the democratic security tax until 2014.

Case in point–Mozambique

External incentives

In the context of a resources-rich developing country, progressive taxation often means levying charges on international actors, such as oil and gas firms, whose profits are an equivalent of windfall rents usually targeted by the tax systems in developed countries.

In 2006, Mozambique was granted access to developmental funds as part of a reform program with the World Bank. At the same time, the country was enjoying support from USAID.⁹⁰ The agreed reforms included removing the government’s ability to grant tax rebates to mining companies. The move was supported by reformists in the parliament, who argued for less discretionary leniency in that respect.⁹¹ The new law was enacted in 2006 as part of a wider reform that also included raising rates of the inheritance and gift taxes, and changes in VAT. The reforms unlocked access to funds for an IT system that improved and streamlined tax collection.⁹² Tax/GDP ratio reached 17.8 percent in 2009 against a target of 16.8 percent and compared with a 15.6 percent baseline in 2006.⁹³

III. Building political momentum

In most developed countries, when asked about progressive taxation, the majority of people express their support.⁹⁴ In the US, this support is now higher than at any time over the past few decades.⁹⁵ Similar trends are visible among developing countries.⁹⁶ South Africans, for example, are strongly convinced that more fiscal redistribution is necessary, yet deep inequalities persist.⁹⁷ There are many occurrences that can prevent progressive taxation and spending from being introduced even with the right amount of social support and sound arguments in place. Building sufficient political momentum requires addressing additional aspects, some of which are:

1. Negative agenda power
2. Information gap
3. Framing of a tax reform
4. Intersectionality
5. Timing of the reform

Negative agenda power

Building political momentum requires drawing attention to the subject. However, recent studies found that the topics of income inequality and progressive taxation are being crowded out in societies with higher Gini index. Instead, topics such as social order or the impact of immigration replace them. The shift away from the subject of progressive taxation and spending is consistent with the views of the wealthy, at least in developed countries. Americans in the top fifth of income distribution prefer lower taxes more than the general population.⁹⁸ Negative agenda power is a way to channel social frustrations that steers them away from potentially hurting the interests of the people wielding that power. Frustration about ailing public services might be steered toward a conversation about social order instead of tax evasion and regressive taxes. Annoyance with falling real wages can be transformed into a debate about immigrants instead of one about workers’ status in the gig economy or changing rules on collective

bargaining. This not to say that the latter conversations are not valid. The point of the negative agenda power is that some valid topics are drowned out by other important ones, whose theme is close enough. Success of a progressive fiscal reform requires overcoming the forces drawing public attention away from the conversation on economic inequalities. Interestingly, data from some developing countries (e.g. Brazil and South Africa) revealed more heterogeneous fiscal preferences on the part of economic elites.⁹⁹ A UN survey analyzing views of business, political, and bureaucratic elites in those two countries showed that business elites were consistently supportive of low taxes and light-touch regulatory regimes. However, the political elites were much more in favor of redistribution. The bureaucratic elites were aligned with the business sector in Brazil and with the political elites in South Africa. This heterogeneity might affect the impact of negative agenda power.

Negative agenda power exercise has its *hard* and *soft* version. The hard version is shaping what gets discussed in parliament by influencing political parties' policies and legislative priorities.¹⁰⁰ The soft version pertains to broader efforts of stimulating the national debate through professional, social, and media activity. A study analyzing the bills brought before parliaments of nine European countries between 1941 and 2014 confirm this impact of "negative agenda power."¹⁰¹ Each additional point of the Gini index corresponded with a shift away from a diverse agenda of inequality-related topics and toward a few themes in the parliament such as social order, crime, national security, and immigration.

Information gap

People have historically underestimated economic inequality.¹⁰² Citizens in most analyzed countries, both developed and developing, agree that inequalities are too large while at the same time undershooting how large they actually are.¹⁰³ This is the case for both poor and rich people.¹⁰⁴ A paper published by Harvard Business School attributed this effect to the "local environment bias," which stipulates that people unwittingly assume that the whole society is comparable to their immediate community.¹⁰⁵ People also operate under the "status quo bias." Addressing those biases would mean making people aware of current inequalities, so that they to see them as an active political choice with many others available.¹⁰⁶ The conclusion is that it is not primarily the scale of inequalities that makes people upset about them but rather society's level of awareness and resulting sensitivity about them.¹⁰⁷ As outlined in the section on framing below, the powerful mechanisms that make people sensitive and vocal about the inequalities are largely psychological.¹⁰⁸ An intuitive response to the information gap would be to simply close it with education, however this proves notoriously hard. The negative agenda power coupled with social inertia solidify the information gap. People's anger erupts when there is a situation that can serve as a lightning rod for their frustration. Corruption, a significant contributor to economic inequalities,¹⁰⁹ can be such lightning rod: all except one of the examples in Civicus' State of Civil Society Report 2018 of successful broad-based political mobilization relate to corruption, and recent country cases show a similar pattern.¹¹⁰

Closing this information gap is a key to building a political momentum for progressive taxes since it overlaps with yet another gap—a voting one. The rich are more likely to vote, reach out to their political representatives, and donate to campaigns.¹¹¹ The turnout gap between the affluent and the poor can be as high as 23 percentage points. The wedge is also present for other types of political action. Millionaires and billionaires are spending a great deal of money on campaign donations that might influence the political platforms and the elections.¹¹² The richest one ten thousandth of Americans (the richest one

percent among the richest one percent) were responsible for 25 percent of all the official campaign donations and for more than 80 percent of the money raised by political parties.¹¹³ To achieve more progressivity, people who support it must be mobilized to vote in numbers large enough to counteract that impact. A recent study of eighteen Latin-American countries by the United Nations showed a strong correlation between the intensity of social awareness action and protests regarding economic issues, as well as between the share of members of parliament supporting fiscal progression. Both of those metrics were also related to higher CCT transfers, more universal pension scheme coverage, and lower out-of-pocket healthcare copayments.¹¹⁴

Case in point – Advocacy coalition in Chile

Overcoming negative agenda power

Chile is among the most unequal countries on earth with a business elite classified as particularly influential.¹¹⁵ It is also a country very rich in natural resources, mainly copper. Despite rising international demand for copper, the society felt that the non-wealthy were not getting their fair share of the windfalls. Then a series of corruption scandals rocked the country in 2013. It turned out that both main political parties were complicit in syphoning off public money. President Michelle Bachelet formed the so-called Engel-Commission to investigate. The public pressure led to implementation of 62 percent of its recommendations, significantly improving Chile's anti-corruption regime.

Reclaimed resources could be used for more pro-poor spending. Interestingly, similar corruption cases had been revealed in the past but only this one led to an actual change. The United Nations Research Institute for Social Development pointed to three reasons: 1) in order to join the OECD in 2010, Chile had to establish the Council for Transparency, which served as a resonance chamber later on, drawing constant attention to the scandals; 2) President expressed his support for the protesters, which lent strength to the social anger over revealed graft; and 3) active involvement of the diverse civic society sector, which coalesced around the demand to implement the Commission's recommendations.¹¹⁶

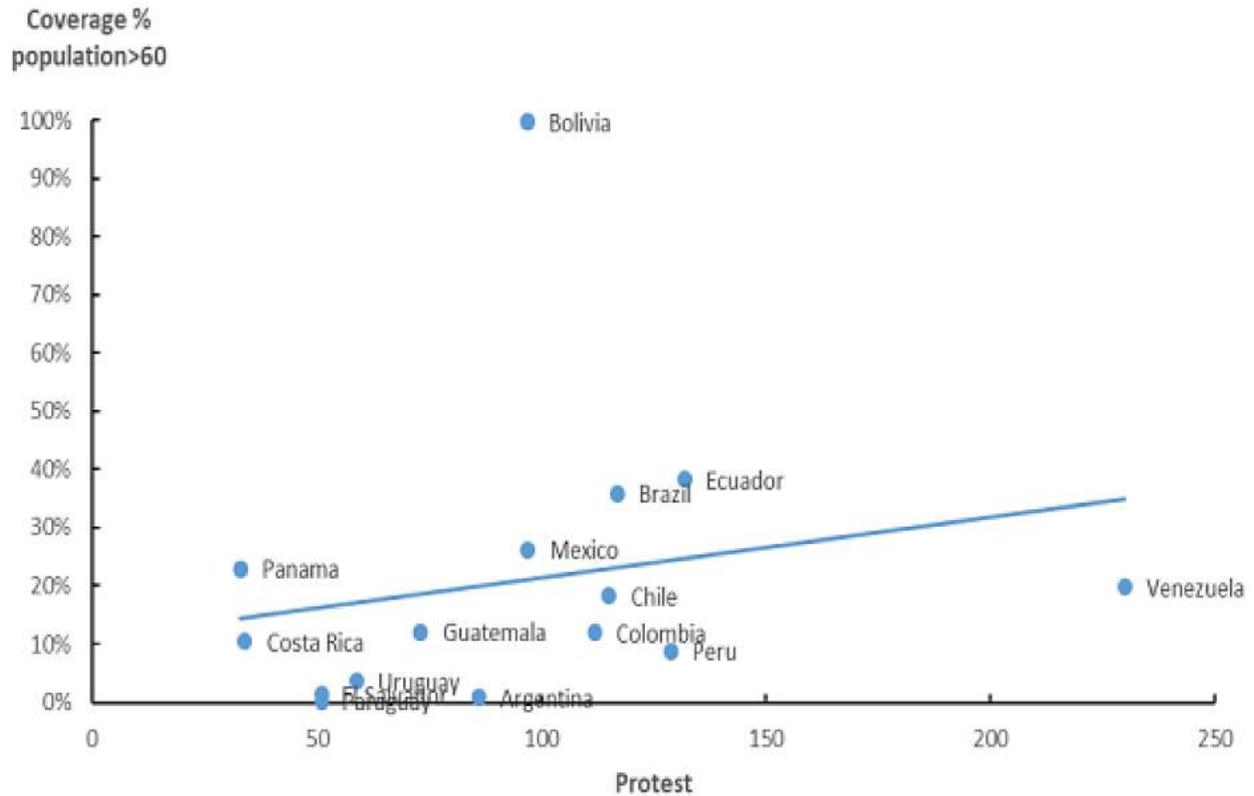


Figure 5. Social mobilization on economic progressivity bears results. Source: UNRISD, *The Dynamics of Redistributive Social Policy in Latin America - Social action and universal pension scheme coverage*

Framing of a tax reform

Support for progressive taxation depends on how the proposal is framed. There are many psychological dynamics surrounding people’s perception on sharing resources in a society. Below are the findings on what tax reforms and framing of their impact are most likely to gain political support.

The first behavioral finding is called “the metric effect.” It means that people’s preferences on fiscal progression are unstable and shift depending on how the question is presented.

People prefer progressivity when it’s presented in relative terms – percentages and shares, rather than absolute numbers.¹¹⁷ A poll of more than a thousand Danes showed that the metric effect gets stronger when discussing higher income. The wedge was small for minimal income (~ 2 percentage points) and kept getting bigger, reaching roughly 8 percentage points for the top income tax rate.¹¹⁸ Similar experiments in the US showed a comparable effect.¹¹⁹ This effect could be explained by the vivid imagery of parting with money stimulated by talking in monetary terms. It stems from the anchoring of perception. Poorer people tend to be impressed by the amount of taxes paid by the rich when stated in absolute terms because they perceive them through their own limited budgets. One study found that people see a flat percentage tax as progressive when stated in dollars.¹²⁰

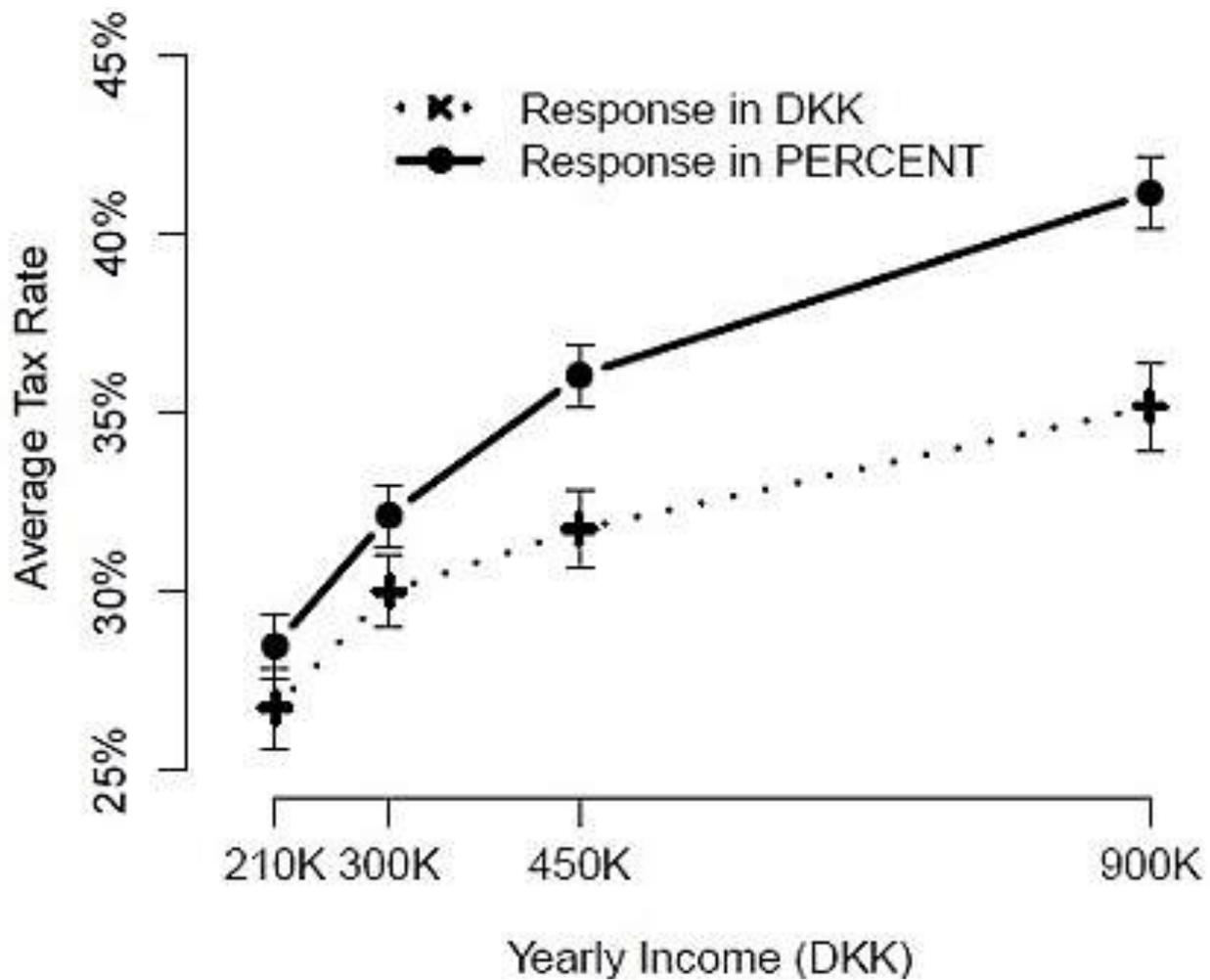


Figure 6. The metric effect – progressivity preferences change when taxes are stated in relative terms. Source: *Taxes are Money: A Metric Salience Effect on Citizens' Tax Preferences.*

There is more nuance to the metric effect. When the progressive levy has to be presented in absolute numbers, people are likelier to support it if it is phrased in terms of retained post-tax money rather than what has to be paid.¹²¹ There is also one case when presenting the policy in absolute number makes people support more progression. A study published by Cambridge University revealed that stating the minimum tax rate in monetary terms as the “minimum post-tax income” induced subjects to support more progression on the lower end of the tax graduation curve.¹²² The minimum income frame pushes people’s limited attention toward the issues of minimal sustenance needs and triggers the need for fairness. While there is no tax system in the world that formally sets the tax rates to achieve a “minimum income,” the metric effect can be used to gain political support for other forms of progressive taxes and spending.

The second finding is called “the isolation effect.” People are much more bothered by taxes when they are salient. If a person has to stop whatever he or she is doing and pay their tax (e.g. annual income tax filing), they will be much more frustrated and resistant than when the same amount of money is

seamlessly deducted from their bank account. A study published by the National Bureau of Economic Research suggested that people might be ready to pay as much as 20 – 40 percent more if the salience of paying the tax is reduced.¹²³ Other lab experiments confirmed that effect.¹²⁴ This suggests that universal insurance schemes (social security, healthcare, accident) or general consumption taxes could trigger much less resistance than direct ones. Moreover, reducing the salience of the direct levies, e.g. property taxes, through setting up a system of monthly payments rather than an annual lump sum could create more space for fiscal progression. The experiments on willingness to pay are consistent with this finding: healthcare, social security, and alternative energy sources were the expenditures people were most likely to pay for, even if it would mean they would be charged above-average rates.¹²⁵

The third finding is “the identifiability effect”. It relates to the impact of labeling the reform and the credibility of the government delivering added value in return. The word “tax” implies a burden and people are much less willing to support something when it is called as such. A study suggested that calling something a payment or contribution and linking it directly to a service provided in return made people 50 percent more likely to support a new program, even if it would imply paying above-average rates.¹²⁶ This strategy is already used for “ecological” and infrastructure taxes.¹²⁷ The effect applies to both taxes as well as pro-poor spending. A study found that identifying needy families that would be supported by a charity program made people ready to spend 25 percent more money.¹²⁸

Case in point – E-ZPass

Progressive taxes - the isolation effect

Starting in 1987, electronic toll collection has been progressively introduced for publicly owned roads, bridges, and tunnels in the US. By 2005, 60 percent of toll payments were made seamlessly through transponders. Amy Finkelstein from the National Bureau of Economic Research used the launch of the E-ZPass system, well known to car drivers in the US, in 123 locations as a natural experiment on the isolation effect. By tracking drivers’ behavior before and after the launch, she found that those who switched to E-ZPass ended up spending between 20 to 40 percent more despite the discount for electronic payments. Traffic would also fall much less in reaction to price hikes on objects covered by E-ZPass, showing less sensitivity to price changes on the part of the drivers.¹²⁹ Follow-up surveys confirmed that drivers who pay electronically are much less aware of how much they spend.¹³⁰

Case in point – Habitat for Humanity Program

Progressive taxes – identifiability

George Loewenstein and Deborah Small of Carnegie Mellon University ran a field experiment to show that people are more sympathetic to “identifiable victims” than they are to “statistical victims.” They sent subjects an appeal to contribute to Habitat for Humanity to help build a house for a needy family. Two types of letter were sent, differing by just three words. One said the needy family “has been selected”. The other said the family “will be selected.” People who received the first letter gave 25 percent more than those receiving the other.¹³¹

Case in point – A study on carpooling reciprocity

Impact of the sense of indebtedness

A sample of 300 study participants were shown the prompt:

Imagine that you started a new job at a company just one month ago. One day last week, you worked so late that you missed the last bus home. Your home is 10 miles away from where you work, which takes around 20 minutes to drive. Your colleague Catherine from the same department happened to work late that day too. She offered to drive you home.

Then the participants were randomly assigned to four groups. The scenario specified for each of them whether the colleague lived in the same direction, so the favor was not a big deal for her (low cost) or in the opposite direction, so she had to take a 40-minute detour (high cost) and whether the situation was urgent because without a ride the receiver would miss their partner's birthday (high benefit). In the low-benefit condition, there was no particular urgency to get a ride home. Participants' feelings were then recorded as: *obligated to reciprocate, thankful, grateful, and indebted*.

The incurred (high) cost to Catherine predicted whether participants were feeling indebted (on top of just feeling grateful). The impression of being indebted strongly predicted the feeling of being obligated to reciprocate.

Low cost incurred by Catherine exuded a feeling of gratitude in participants but no sense of indebtedness. That gratitude did not translate to an urge to compensate Catherine in any way.¹³²

The fourth finding is that perception of indebtedness makes people strongly in favor of a reciprocal action. This argument refers to the compensatory arguments from the first section of the paper. If progressive taxes are framed as a reciprocal action for all the systemic benefits of being at the top of the social hierarchy, people are much likelier to support them compared to when they are profiled as an expression of gratitude, charity, or even solidarity.¹³³ The power of feeling indebted in compelling people to pay compensatory taxes has psychological underpinnings. Recompense driven by the feeling of indebtedness is associated with a feeling of pain while a recompense driven by gratitude, mercy or solidarity translates to pleasure.¹³⁴ Yet, somewhat counterintuitively, it is the indebtedness that pushes people to actually reciprocate while the impact of other impressions is paltry.¹³⁵ Studies found that gratitude has the *symbolic effect* of seeking gain in relational value toward the benefactor as to enhance the social bond. Meanwhile, the *material effect* of indebtedness drives efforts to remove the pain of having created inequity through reception of unearned favors.¹³⁶ A diverse sample of 150 people revealed that around 60 percent of people feel strongly obliged to reciprocate when under an impression of being indebted. A feeling of gratitude had no significant impact whatsoever.¹³⁷ Those results are consistent with a famous finding posited by Daniel Kahneman and Amos Tversky called the "Prospect Theory." It states that people experience much more pain from a loss than happiness from a gain of a symmetrical proportion.¹³⁸ Thus, the urge to minimize the pain created by equity loss dwarfs the prospect of potential relational gain for an extra effort.

A feeling of indebtedness emerges when four conditions are met.¹³⁹ First, there is a tangible and mutually acknowledged net benefit of the benefactor's action.¹⁴⁰ Second, the effort on the part of the benefactor must be intentionally aimed at achieving a positive impact.¹⁴¹ Third, the recipient must feel they were in need of the support provided by the benefactor. Fourth, the community of the benefactor and recipient expresses its awareness of the transfer of benefits. While the first three conditions play out between the recipient and the benefactor, the last one serves as a "social trigger" that creates pressure to restore the equity loss created by the situation. A study found that 53 percent of people would still feel rather indebted if they sufficiently reciprocated for the received favors but in a way that neither the benefactor, nor the community would notice it.¹⁴² Mass conscription of the poor during the world wars checks all these boxes. Their sacrifice was widely seen as benevolent and vital. Popular culture reinforced that notion through an array of channels including press, books, and radio. A natural follow-up was to seek ways to compensate them and thus restore the equity between those who were in service and those who were not.

The fifth and final framing argument relates to channeling of people's emotions regarding their social status. People have an innate tendency to abhor diminishing social status. Since income inequality reflects society's political hierarchy, it should come as no surprise that it is tightly correlated with a sense of diminishing social status and a sense of inferiority on the part of the poor.¹⁴³ Research shows that socio-economic status is actually the strongest driver of the feeling of superiority or inferiority in a community.¹⁴⁴ Moreover, increased inequality is proven to make societies even more attentive and sensitive to those dynamics.¹⁴⁵ Nobel Prize-winning economist Amartya Sen suggested that shame is the "irreducible absolutist core" of the experience of relative poverty and inequality.¹⁴⁶ Thus, the effects of inequality cannot be fully grasped without anticipating people's aversion to the shame of low social status and their readiness to oppose changes that lead to loss of status.¹⁴⁷

Loss of status leads to either agitation or denial. Both can be destructive for the individuals affected and the society.¹⁴⁸ Agitation might fuel political escalation and denial might lead to social problems such as addictions and health problems. In the worst-case scenario, both can lead to the "bicycling reaction," where people affected by the loss of status accept their inferiority toward those above them but "compensate" by venting their frustration on those lower in the hierarchy, e.g. minorities and immigrants.¹⁴⁹ The right framing of tax reform proposal can tap into those emotions in a constructive way, defusing their combustible potential. A positive message about the dignity boost as well as rightly earned recognition of effort and struggle can help build political momentum around proposed changes.¹⁵⁰

Acknowledgment of effort rather than solidarity or charity is important for yet another reason – overcoming of the so-called "fundamental attribution error" in which humans tend to explain other people's predicament as a result of their inherent flaws rather than the circumstance.¹⁵¹ A study published by Oxford University Press found that people display a strong fundamental attribution error bias when thinking about taxes and fiscal spending.¹⁵² People might have diverse opinions on redistribution but studies show a strong consensus for "equality of opportunities" (up to 90 percent of respondents are in favor).¹⁵³ Removing the fundamental attribution error allows the tax reform to be framed in those terms.

Case in point – Death of Despair in the USA

Bicycling reaction - emotions around social status and progressive spending

In 2015, a Nobel Prize winner Angus Deaton, along with Anne Case, discovered that death rates had been rising dramatically among working and lower-middle class white Americans.¹⁵⁴ Overall, the US mortality rate has been falling at a steady pace of about 2 percent a year since the 1970s. Yet among blue-collar middle-aged white Americans, the rate shot up by 9 percent between 1999 and 2013.¹⁵⁵ A slew of problems underlie this trend, including distress, addictions, rising divorce rate, falling labor force participation, and more. Together they lead to more health issues and suicide. Deaton confirmed that those issues are linked to a sense of falling social status in a transforming economy and society.

A recent study published by Oxford University Press also found that white people in the US, especially those experiencing a worsening economic situation, are more prone to support cuts in welfare on racial grounds.¹⁵⁶ A representative group of 151 people were asked the same question: *Would you change social welfare spending size and if so how?* Before that they were randomly split into two groups. The first one was shown a graph presenting demographic trends in the US until 2020 with a stable white majority. The second one was shown the trends until 2060 with the share of white people plummeting until they become a minority. White people in both groups supported cuts in welfare but the ones in the second group argued for cuts that were roughly twice as deep. In addition, whites in the *Salient* group reported significantly greater opposition to welfare in general and higher levels of racial resentment.¹⁵⁷

Case in point – Nonprofit Stabilization Fund for Communities of Color

Intersectionality – social integration and progressive spending

In 2014, the Hispanic Federation, the Coalition for Asian American Children and Families, the New York Urban League, and the Asian American Federation formed an alliance to provide capacity-building support to black, Latino, and Asian-led communities throughout New York City.¹⁵⁸ The coalition serves as a platform around which diverse social initiatives could coalesce to compel the City to invest more resources in the communities that need them most.

In 2015, thanks to the coalition's effort, the New York City Council established the *Communities of Color Nonprofit Stabilization Fund*.¹⁵⁹ By 2019, its budget had expanded from an initial \$2.5 million to almost \$3.8 million. The Fund supports a range of activities in communities of color that enable their members to strengthen social connectivity and improve life prospects.

Intersectionality

Gaining enduring, widespread public understanding is a tall order in a diverse society. Recent experience reveals that for a political idea to get traction and stick in the public debate, it must be supported by a network of various communities. NGOs, trade unions, political parties, churches, and university campus groups are some of the most sought-after allies. The project needs to be pursued by

various political pressure groups and designed in a way that is consistent with their values. It must also relate to other issues such as teenage pregnancy, discrimination against the Lesbian, Gay, Bisexual, Transgender, Queer, and Intersex (LGBTQI+) community, poor education services in minority neighborhoods, overcrowded prisons, mental health, or anything else that can be made relevant.¹⁶⁰

Timing of the reform

Progressive taxes and similar measures (e.g. universal insurance schemes) are usually introduced either at the height of economic prosperity or during economic crises. The first case is more intuitive. A growing economy provides ample fiscal space and allows policymakers to “predistribute” new resources for the reforms rather than redistributing existing ones away from social groups.¹⁶¹ Economic crises often drive redistributive reforms but the driving forces are different. While there is more fiscal capacity to implement progressive measures during a time of prosperity, the political pressure around the subject is stronger during periods of economic crises.¹⁶² The urge for economic redress and the readiness to act on it are strongest when the problem has arisen very recently.¹⁶³ This is usually the case when impoverished sectors of a society are hit by the effects of an economic crisis: unemployment and inflation in the cost of staples. Historical examples might be social security reforms by Franklin Delano Roosevelt in the US in the 1930s and healthcare reform in Indonesia after the Asian financial crisis in 1997.

IV. Discussion

The research strongly suggests that the decision to pursue progressive taxation is driven by political rather than technical or economic considerations. A successful fiscal reform should be based on compelling arguments, which appeal to the circumstance of the moment and human emotional dynamics around the subject as well as generate enough political momentum to break into the center of the public debate. This means that different rationales might be needed for developed and developing countries. The discussion among the former might have a more internal character, with the rich being domestic actors. In many developing countries, the debate might take on a more international hue, with many of the biggest beneficiaries of the tax code being external entities.

The focus of progressive taxation should follow the spirit of the time. The 20th century saw the rise and decline of progressive income tax. The approach should be different in this century. Capital gains, real estate, and financial market investments are now the main channels through which economic benefits are flowing to the rich. As the current economic cycle is maturing and inevitably drawing to its end, the conversation about taxing them might soon gain renewed salience. What is important for sustainability of potential tax reforms is that they are designed and framed in a way that is not retributive but rather emphasizes tangible benefits for all the involved parties.

Next steps should involve identifying the arguments that elicit the strongest reaction in societies affected by deep inequalities and road-testing various framings that compound their strength. Those arguments should involve the compensatory component as people react most strongly to it. In order not to be seen as an attempt to take advantage of the majority of society, the arguments need to accommodate the perspective of the key stakeholders that could potentially block the progress of the reform.

Finally, there are certain new classes of arguments that might give rise to progressive fiscal decisions but have not yet gained enough recognition. One of them is related to climate change and other environmental effects of human activity that result in natural disasters. More dramatic events such as tsunamis, rising sea levels flooding cities, and shortage of potable water might displace communities and create pockets of severe poverty. In the future, those who live in environmentally safe regions might be asked to contribute more on the ground of compensation for an unearned privilege and higher ability to pay. Victims of natural disasters can now enjoy tax rebates in the US and Japan.¹⁶⁴ The Kyoto Protocol established the system of cap-and-trade for industrial CO2 polluters. The system was further developed by the European Union.¹⁶⁵ This might be the “embryotic” stage of that emerging type of fiscal redistribution.

The Pathfinders for Peaceful, Just and Inclusive Societies is a group of UN member states, international organizations, global partnerships, civil society, and the private sector. We work to accelerate the delivery of the SDG targets for peace, justice and inclusion (SDG16+). Pathfinders is hosted by the NYU Center on International Cooperation.

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Endnotes

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