

# TAXING FOR SHARED PROSPERITY

Policy options for the Asia-Pacific region

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## ABBREVIATIONS

BEPS	Base Erosion and Profit Shifting
CEDAW	Convention on the Elimination of all forms of Discrimination Against Women
CIT	Corporate Income Tax
GDP	Gross Domestic Product
GNI	Gross National Income
HNWIs	High Net Worth Individuals
MNEs	Multinational Enterprises
MSMEs	Micro, Small and Medium Enterprises
OECD	Organisation for Economic Co-operation and Development
PIT	Personal Income Tax
SDGs	Sustainable Development Goals
SMEs	Small and Medium Enterprises
VAT	Value added Tax

# FOREWORD

The Asia-Pacific region is at a crossroads.

Our report charts a course for the region's economies to be defined by inclusive growth and shared prosperity. The region was a model for 'growing with equity' in the 1970s and 1980s. Rapid economic growth was achieved without major increases in inequality. However an economic take-off and market-oriented reforms in recent years, despite helping hundreds of millions to be lifted from extreme poverty, has been accompanied by growing income and wealth gaps between rich and poor.

This increase in inequality has greatly diminished the ability of economic growth to reduce poverty. The share of the poorest income groups in total consumption has considerably decreased in developing countries in Asia and the Pacific during the high-growth decades since the 1990s. In sharp contrast, the Asia-Pacific's 'super-rich' have increased – even overtaking their peers in North America and Europe in both headcount and total wealth. This poses a significant threat to further economic development and social stability in the region, as income and wealth inequalities also tend to reinforce each other in a downward spiral, if left unchecked.

Governments in the Asia-Pacific region must now advance a comprehensive strategy to reverse rising economic inequality. Public finance – and tax policies in particular – are vital for this purpose. Taxes provide the primary source of financing for public education, healthcare and investment for jobs. These public services equip poor people with better skills and prospects in the job market, and provide better chances to improve their economic status on their own merit. Taxes are also the financial backbone for social security networks and basic welfare, providing essential support to poor people against unexpected risks and preventing them from falling back into poverty during difficult times. Crucially, progressive tax policies are central to fostering a fairer distribution of income and wealth. In OECD countries, for instance, tax and transfers together bring down overall income inequality by more than a third, on average.

This potential of tax policies to close income and wealth gaps remains untapped in the Asia-Pacific's developing countries. Tax revenues in a large group of developing countries in the region remain substantially below the developing country average worldwide, and below the level required for effective delivery of basic public goods and services. Moreover, the overall tax mix in the region's developing countries remains highly skewed towards indirect taxes, which are usually regressive and place a greater burden on the poorest. Direct taxes account for roughly a third of the region's total tax revenue, compared with over half of the total tax revenue in OECD countries.

Personal income tax, in particular, is considerably lower in the developing Asia-Pacific, mobilizing less than a quarter of the level mobilized in OECD countries on average. Finally, property and wealth taxes are largely missing in the region, except in developed country members. Policy weaknesses and a lack of public understanding are the main obstacles preventing these taxes from playing a greater role in the region's development.

We signed up with ambition and hope to the 2030 Agenda for Sustainable Development to leave no one behind. Our common vision is not just to eliminate extreme poverty, but to make sure that the gains of development are shared by everyone.

Developing countries in the Asia-Pacific can meet this ambition by placing greater emphasis on inclusiveness and equality and by learning from countries that have succeeded in closing the inequality gap via proactive public policies. It is encouraging to see more of the region's developing

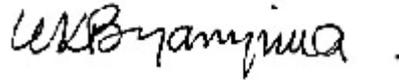
countries making the choices to explore tax and public policy options that address rising inequality. In a few cases the level of inequality has been stabilized.

A broader political shift is now required towards strengthened revenue mobilization, improving tax structures, and better leveraging progressive taxes for shared prosperity.

This publication has been prepared in the hope that it will contribute to efforts in combating inequality in Asia and the Pacific, through the analysis of the income and wealth inequality trends in the region and the discussion of the potential policy measures to address this challenge.



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# SUMMARY

During the last few decades, the Asia-Pacific region as a whole has been the world's model of rapid economic growth and significant poverty reduction at the same time. The early experiences of the 'Asian Tigers' demonstrated the possibility of 'growing with equity' and between 2005 and 2012 alone, the number of people living in extreme poverty in Asia-Pacific was reduced by 1.1 billion, accounting for more than 90% of the total poverty reduction achieved worldwide.

The region's recent achievements, however, are accompanied by a rise in income and wealth inequality, especially in the region's most populous countries. Measured by any metric, evidence suggests a widened gap between the rich and the poor. The population-weighted income Gini coefficient, based on household income estimates, increased from 37 to 48 between 1990 and 2014; an increase of almost 30% in less than three decades.

The rapid concentration of private wealth is of even greater concern. Wealth inequality would normally peak after income inequality peaks, but it has already reached alarming levels in a number of countries in the region, where the richest top 5% control close to 70% of the nation's total private wealth and the top 1% control more than 50%. In recent years, the Asia-Pacific's 'super-rich' have already overtaken their peers in North America and Europe in both headcount and total wealth. The estimated wealth Gini stood at 81.9 in China and 87.6 in India in 2015. This figure for the rest of the Asia-Pacific region was even higher at 90.4, topping any other region in the world.<sup>1</sup>

Excessive inequality in income and wealth undermines social cohesion, hurts long-term growth, and reinforces inequality of opportunities. More importantly, international evidence suggests that income and wealth inequality may have a tendency of self-reinforcement if left unchecked. This raises an important development question on the types of policies that governments in the region can and should adopt in order to ensure shared prosperity for all, especially keeping in view the 2030 Agenda for Sustainable Development.

In particular, tax policies can play an essential role, through two main channels, in an effective pursuit of Sustainable Development Goal 10, which calls for reducing inequality. First, taxes provide the main revenue source for financing essential public programmes for inclusive development, such as healthcare, education, social protection and welfare schemes. Asia-Pacific currently falls far behind on these fronts compared with other regions of the world. Public expenditure on education for example, averages 2.9% of GDP in Asia, compared with 5.3% in advanced economies and 5.5% in Latin America. The situation is similar regarding public expenditure on healthcare and social protection. It is estimated that an additional 2–5.75% GDP in public revenue would be required for low- and lower-middle-income countries to attain the SDGs by 2030. This would be a challenging task for many developing countries of the region.

Second, taxes can become a powerful policy tool for direct redistribution of income and wealth in a society. Progressive direct taxes such as the personal income tax (PIT), property tax and wealth taxes can play a substantial role in restoring economic equity and preventing inter-generational inequality; especially inequalities of opportunities inherited from the earlier generation from the start. In OECD countries, for instance, taxes and transfers together bring down market inequality by more than a third on average.

There is great space for Asia-Pacific developing countries to better leverage progressive direct taxes for both revenue mobilization and redistribution for greater equality. Asia-Pacific as a whole has one of the world's lowest tax-to-GDP levels compared with the developing country average of 20.2% and the developed country average of 25.1%. If the Central Asia and the Pacific sub-regions

are excluded, the average tax-to-GDP ratio in developing countries in the region would be even lower, at 14.2%. Recent estimates suggest that many developing countries in the region only achieve less than or around 50% of their maximum tax potential.

Direct taxes account for only 36.1% of the total tax revenue in the region, while for OECD countries, 55.8% is mobilized from direct taxes. In particular, personal income tax averages only 2% of GDP in Asia-Pacific, less than one-quarter of revenue mobilized by PIT in OECD countries. Revenue generated from property tax is also very small in developing countries of the region, accounting for less than 0.5% of GDP in most cases. Wealth taxes are largely missing, in sharp contrast with the region's level of wealth concentration and wealth inequality. Such underutilization of key progressive direct taxes not only jeopardizes revenue mobilization, but also undermines the effectiveness of these taxes in adjusting income and wealth distribution.

Strengthened revenue mobilization in a more progressive manner could be achieved through five channels. First, the regressive impact of indirect consumption taxes, value added tax (VAT) in particular, could be reduced through targeted measures. These include setting lower VAT rates or provide zero-rating or exemptions on food and necessities, as well as goods or services with positive externalities for the public good – for example, public transportation. It could also take the form of VAT exemptions for small and medium enterprises (SMEs); the major employment provider for the poor in most developing countries. As long as share of direct taxes remains small in developing countries of the region, these measures are likely to remain 'second best' solutions to minimize the regressive VAT burden on the poor.

Second, PIT could be strengthened as the backbone of a progressive tax system. Empirical analysis suggests that PIT does have a positive redistributive effect in Asia-Pacific, and the marginal effect could be higher than in other parts of the world. PIT remains small in the region compared with that in developed countries, and it has the potential to provide not only another revenue pillar in the overall tax mix, but also an effective leverage for the government to reverse rising inequality. At the same time, however, countries should be fully aware that the timing, sequencing and detailed design of PIT policies need to take into account local economic, social and cultural contexts, as well as capacity constraints for both tax administration and compliance. A comprehensive PIT with moderate progressivity in rate structure, that captures capital income and is manageable, accountable and with fewer loopholes that the rich could exploit, would outperform an overambitious design that is only better on paper.

Third, property and wealth taxes could be better explored to reduce wealth inequality. In general, taxes on wealth and inter-generational transfer of wealth are highly progressive, targeting only the richest group in most cases. More importantly, they are essential to prevent excessive concentration of wealth and power in the hands of a few, and to ensure greater equality of opportunity across generations. The obstacles for better use of these tax tools rest in tax administration challenges like asymmetric information and valuation, in addition to social and cultural resistance to these taxes. Wealth and property taxes are often prone to loopholes that the rich could exploit, resulting in the middle class shouldering a large part of the tax burden. Nevertheless, several higher-middle-income developing countries of the region have started to push forward wealth and property tax reforms. Although small, and more like a luxury tax on a narrow base of the top income groups, these experiments are steps in the right direction and would provide good foundations for future reforms.

Fourth, corporate income tax (CIT) is the largest direct tax in most Asia-Pacific developing countries. On average, it mobilized 3.6% of GDP in revenue in these countries in 2015, which is even higher than the average level mobilized in OECD countries. Given such weight of the CIT in the overall tax mix in the region, ensuring that large corporations, especially the multinationals, pay their fair share of tax through enhanced international and regional cooperation would be very

important. The issue of base erosion and profit shifting (BEPS) and the risk of wasteful tax competition are receiving increasing attention worldwide, which has paved the way for international tax cooperation initiatives such as the OECD BEPS agenda. Active developing country participation in these global initiatives would be key for their success. In this process, regional tax cooperation and information sharing would also be indispensable. An effective regional platform for dialogue and coordination could better inform Asia-Pacific developing countries and strengthen their voice in the negotiation of new international taxation norms and practices.

Fifth, the implications of tax policies on gender inequality should also be taken into account. Gender inequality is part of the broader socio-economic inequality that is specifically highlighted in Sustainable Development Goal 5. Tax systems, by virtue of their design, could either alleviate or reinforce gender inequality. In this regard, it is pertinent to recognize that tax structures need not be gender-neutral, and that it is important to investigate how these differentially impact men and women thereby creating varying development outcomes for them.

In light of the above, the following measures are recommended.

### 1. Enhance public resource mobilization through taxes

- **Strengthen tax revenue for progressive public expenditure:** Asia-Pacific developing countries have considerable potential to mobilize additional tax revenue for essential public spending on poverty reduction, education, healthcare, vocational support and housing, which not only generate direct economic benefits for the poor, but also enable the poor to improve their economic status through their own efforts. Appropriate revenue mobilization that takes into account countries' tax capacity should be a first and foremost priority to address the inequality challenge.
- **Enhance regional tax cooperation to address tax evasion, base erosion and harmful tax competition:** Information exchange and collective actions remain key to eliminate tax havens, detect misbehaviour and close loopholes. It is also necessary to avoid excessive and harmful tax competition and create space for new progressive tax vehicles, such as taxes on financial transactions.
- **Support the increased role of the United Nations in international tax cooperation:** This would facilitate international tax cooperation and policy coordination, and most importantly, promote a new generation of international tax reforms that are required for the effective pursuit of inclusive and sustainable development.

### 2. Rationalize tax structure and better leverage progressive tax policies

- **Conduct comprehensive review of key taxes, including consumption and wealth taxes:** In particular, proactive measures to reduce their regressive impact would be critical for developing countries of the region when there is a lack of accountable alternatives. At the same time, improved awareness of the implicit fiscal and social costs of a multiple rate system, zero-rating and exemptions and more prudent cost-benefit analysis would be required to ensure that these policies do serve the common good.
- **Initiate forward-looking reforms aimed at a better balance between direct and indirect taxes to promote a progressive tax system:** This includes the adoption of a well-paced action plan to gradually increase the share of direct taxes and strengthen appropriate types of taxes within the countries' institutional context. The overarching objective is to ensure the fair distribution of tax burdens across different income groups to eliminate extreme inequality, break the spiral of growing income and wealth gaps, and minimize the inheritance of inequality across generations.

- **Improve tax statistics and tax incidence analysis:** Informed policy making depends on statistics, especially in the case of gauging the overall redistributive impact of tax policies. The collection of disaggregated tax revenue and taxpayer information, and regular updates for transparency would greatly benefit the search for more focused and effective tax policies that promote inclusive and sustainable development.

### 3. Reinvigorate the fiscal compact in the region

- **Build a benign tax culture through fair taxes and accountable spending:** The extent of tax compliance depends on a tax system that is considered fair and transparent and the public expenditures that are accountable to the taxpayers and generate concrete results for inclusive and sustainable development. A positive 'tax morale' based on these two anchors could significantly decrease the risks and costs of tax policy implementation and tax administration. In particular, sufficient and effective public spending on people's livelihoods, education and healthcare play a central role in this process.
- **Encourage public participation in tax reforms:** Transparency and public awareness are important measures to overcome the difficulties in revenue mobilization associated with deploying progressive taxes. Engaging in continuous dialogue with citizens and stakeholder groups and conducting research on the cost and benefits of proposed tax reform would help calibrate the conceived policies with public preferences and secure people's understanding of reforms for the common good.
- **Promote gender-sensitive tax policy making:** Gender equality is a component and a reinforcing factor for economic equality. The awareness of the direct or implicit impact of tax policies on gender equality is thus an essential part of the overall effort towards reducing inequality. Broad consultation, especially with women and civil society groups, and related policy evaluation would be required to ensure commitment to achieving gender equality.

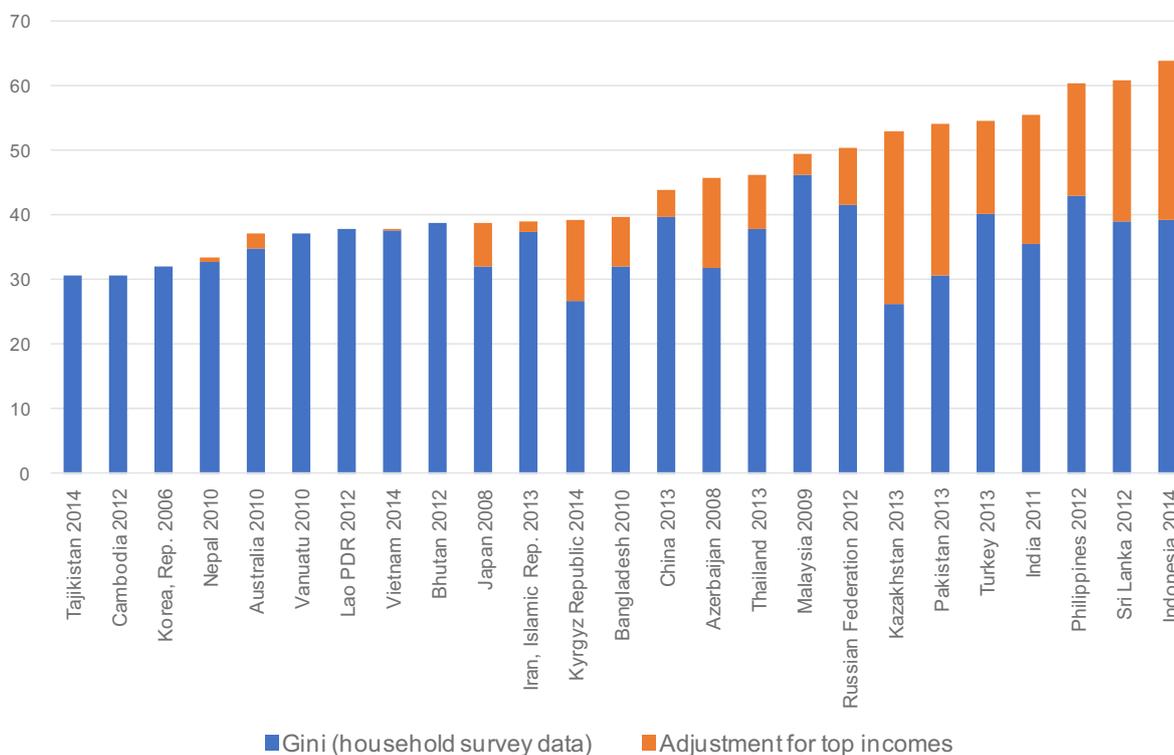
# 1 INEQUALITY ON THE RISE

The Asia-Pacific region<sup>2</sup> as a whole has been a global model for rapid economic growth and significant poverty reduction at the same time. The early experiences of the ‘Asian Tiger’ economies demonstrated the possibility of ‘growing with equity’, and between 2005 and 2012 alone the number of people living in extreme poverty in the region was reduced by 1.1 billion, accounting for more than 90% of the total reduction in poverty achieved worldwide.<sup>3</sup>

However, the region’s recent achievements have become increasingly accompanied by sharp rises in inequality in income and wealth, especially in the most populous countries. Measured by any metric, there is evidence of widening gaps between rich and poor. The population-weighted income Gini coefficient for the region, based on estimates of household income, increased from 37 to 48 between 1990 and 2014,<sup>4</sup> an increase of almost 30% in less than three decades.<sup>5</sup>

This trend has been driven largely by the most populous developing economies in the region. China has gone from being one of the most equitable countries at the beginning of the 1990s to a country of high inequality in the 2000s. According to the latest official estimates, the Gini coefficient for income in China stood at 46.5 in 2016, which is below the peak of 49.1 in 2008 but still relatively high.<sup>6</sup> Basing the estimation on net household income, the Gini coefficient rose from 33 in 1990 to 53 in 2013.<sup>7</sup> India experienced a less dramatic increase in its Gini score for household net income, from around 45 to 51 in the same period – but like China, India has become more unequal than most other countries around the world. Indonesia has also experienced rapidly growing income gaps in recent decades. Its Gini coefficient increased from 31 in 1990 to 40 in 2013, and if adjusted for the top incomes<sup>8</sup> actually stood at 64 in 2013.<sup>9</sup> These three countries, along with others in the region that have experienced growing inequality in the past two decades, account for more than 80% of the total population of the Asia-Pacific region.

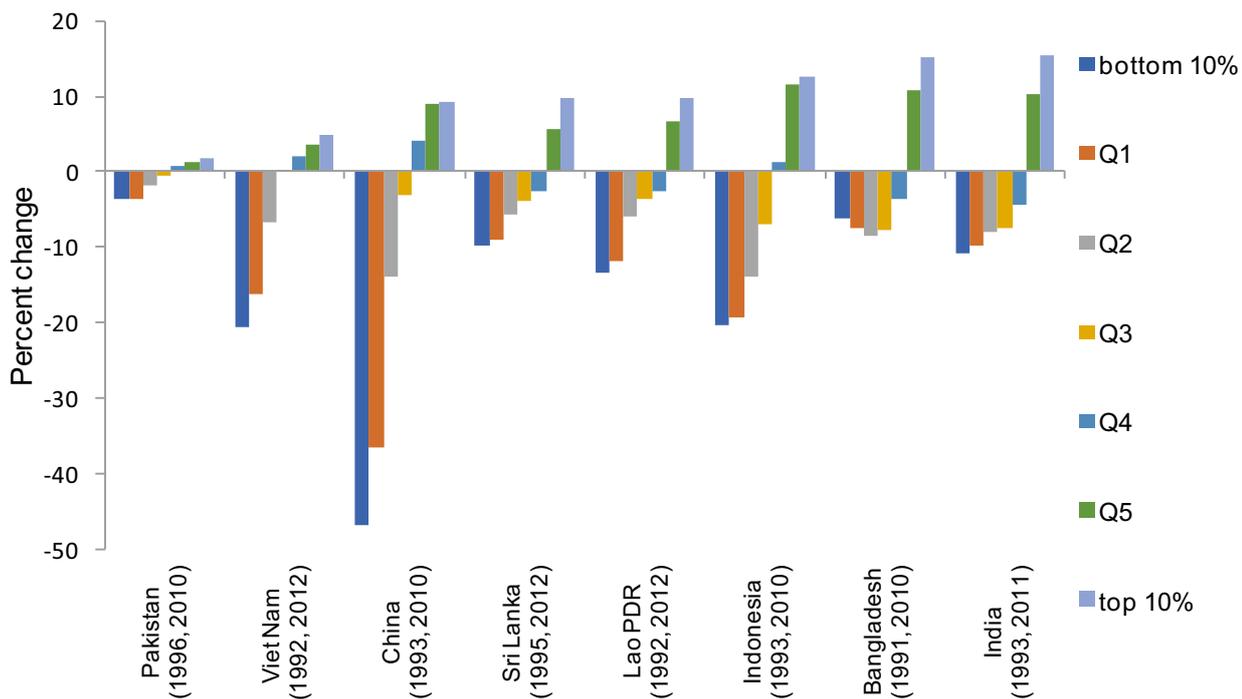
**Figure 1: Gini coefficients for income in Asia-Pacific region**



Source: Chandy and Seidel (2017)

Other indicators of inequality that are more sensitive than the Gini coefficient to changes at the top and bottom of the income spectrum tell a similar story. In Bangladesh, China, India, Indonesia, the Lao People's Democratic Republic, Sri Lanka and Viet Nam, rapid economic growth has almost uniformly benefited the rich, with the top 10% reaping the biggest benefits while the bottom 10% have suffered significant drops in their share of an expanding pie (Figure 2). In India, Bangladesh, the Lao People's Democratic Republic and Sri Lanka, for instance, only those in the top income quintile have increased their share of overall consumption, while all four of the other quintiles have suffered reductions in their share. In China, while growth has succeeded in lifting hundreds of millions of people out of poverty and has created a broad middle class, the bottom 10% have been deeply marginalized in the process, with their share of the overall income pool almost halving from 3.18% in 1993 to just 1.69% in 2010.

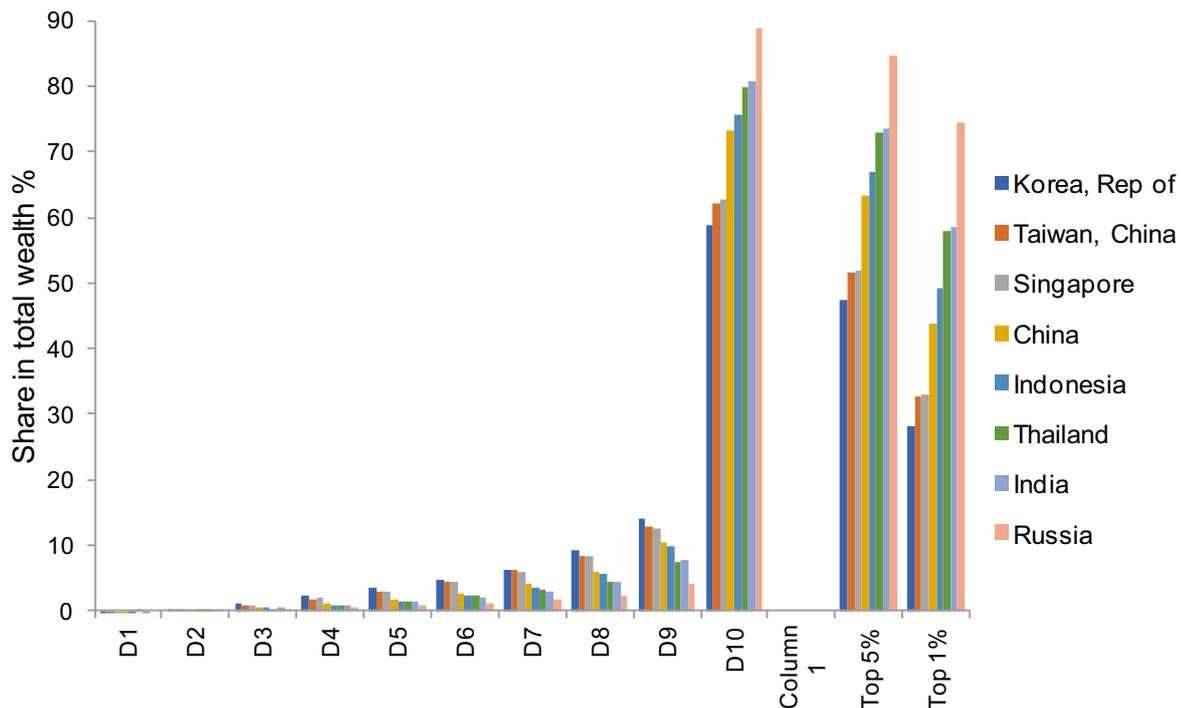
**Figure 2: Changes in consumption for different income quintiles of the population (1990s to 2010s)**



Source: ESCAP, based on World Development Indicators (WDI)

More remarkable than the rise of income inequality is the growth of wealth inequality in Asia and the Pacific. The region's economic success has led to a rapid accumulation of private wealth for a select few. Normally, wealth inequality would build up slowly as income inequality increases and would peak after income inequality peaks. However, wealth inequality is already at very high levels in many countries in the region. In Indonesia, Thailand and India, for instance, the richest 5% of the population now control close to 70% of the total private wealth pool in these countries and the top 1% hold more than 50% (see Figure 3). The estimated wealth Gini in Asia-Pacific stood at 81.9 in China and 87.6 in India in 2015. This figure for the rest of the Asia-Pacific region was even higher at 90.4, topping any other region in the world.<sup>10</sup>

**Figure 3: Wealth distribution in selected countries**



Source: Credit Suisse (2016). *Global Wealth Databook 2016*

This concentration of wealth is also reflected in the growing numbers of super-rich people in the region. According to Capgemini's World Wealth Report,<sup>11</sup> the Asia-Pacific region registered the world's highest growth rate in both the number and the total wealth of high net worth individuals (HNWIs)<sup>12</sup> between 2009 and 2015. The number of HNWIs in the region expanded from three million to five million in these six years, and their total wealth almost doubled, from \$9.6 trillion in 2009 to \$17.4 trillion in 2015. Today the region not only has the largest HNWI population and wealth pool but is also ahead of North America and Europe in Forbes' billionaire list, with China, India and Russia all ranking in the list's top five countries (see Figure 2).<sup>13</sup>

Excessive inequality in income and wealth undermines social cohesion, hurts long-term growth and reinforces inequality of opportunity. More importantly, international evidence suggests that income and wealth inequality may tend to be self-reinforcing if left unchecked by public policies. Historical data suggest that wealth tends to accumulate more rapidly for those who have wealth in the first place, because long-term capital returns normally outpace long-term economic growth and the gap between the rich and the poor tends to widen over time due to this underlying trend.<sup>14</sup> Extreme wealth also correlates with political capture. The disproportionate political influence of the rich over policy making may increase rent seeking and extractive activities at the expense of broader society. On the brighter side, the challenges of inequality have given rise to broad concern and a great deal of social debate in the Asia-Pacific region. Promoting inclusive development and reining in excessive inequality have increasingly become key priorities in countries' national development strategies.<sup>15</sup>

Implementing such strategies, however, might prove to be a challenging task. This is because technological progress, globalization and market-oriented reforms – which tend to favour capital over labour, skilled labour over unskilled labour and urban and coastal areas over rural and inland areas, and thus widen the gap between the rich and the poor – are prominent features of the prevailing economic frameworks in most developing economies. Some adjustments by means of government intervention are therefore inevitably needed to strike a balance between economic growth, equity and social stability.

Adding to the problem are inadequate levels of spending across the region on social protection, health and education, which are most effective policy measures for addressing long-term inequality. The provision of basic public healthcare and health insurance, for example, has been widely recognized as being essential for preventing poverty and inequality caused by catastrophic health expenditure by individuals.<sup>16</sup> Public pensions and unemployment protection are also often the only safety net that poor people can rely on if they lose their main source of income.

Most importantly, public spending on education and healthcare is a direct investment in the human capital of the poor and can significantly enhance their ability to explore economic opportunities, strengthen their position in wage negotiations and improve their economic status through their own efforts. Research suggests that the effect of education on reducing inequality may be greater in Asia and the Pacific than elsewhere in the world: an increase of one percentage point in education expenditure could reduce income inequality in the region by 0.49 percentage points, compared with 0.034 percentage points in the rest of the world.<sup>17</sup>

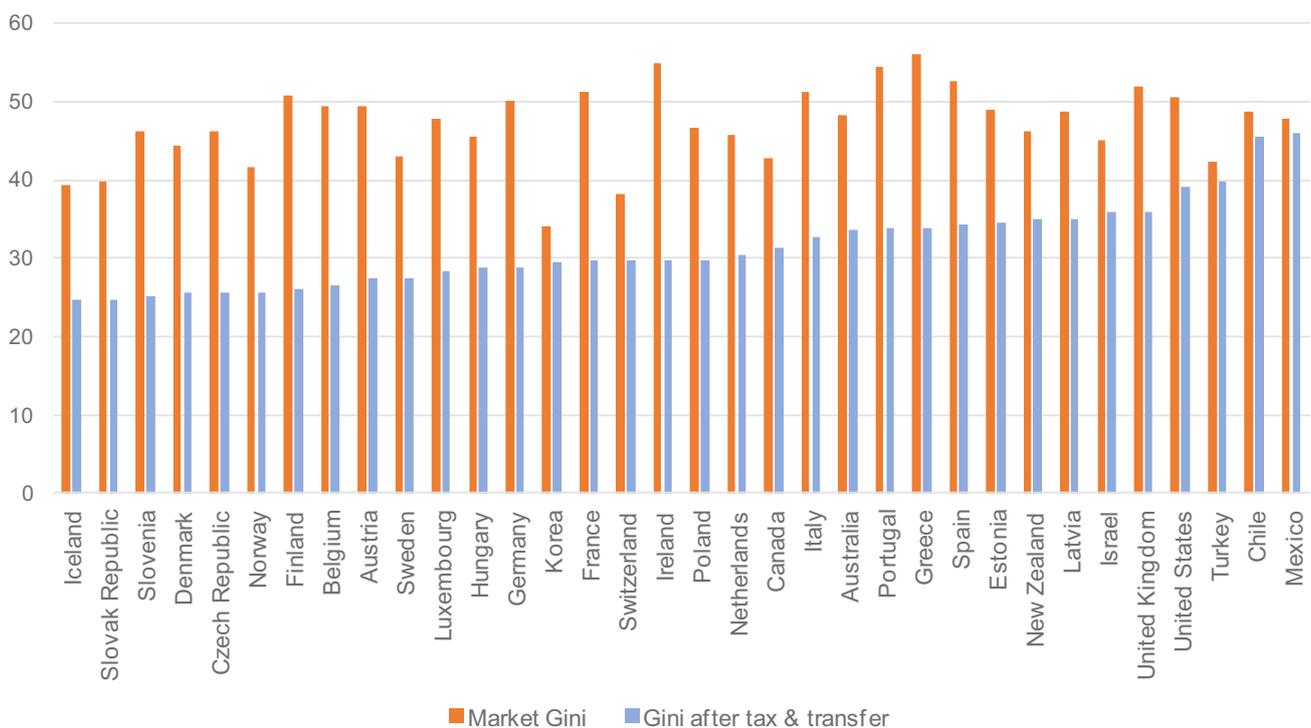
However, Asia-Pacific currently spends far less on these fronts as a proportion of gross domestic product (GDP) than other regions of the world.<sup>18</sup> Public expenditure on education averages only 2.9% of GDP in Asia, while in advanced economies the figure is 5.3% and in Latin America 5.5%. When it comes to public expenditure on healthcare, the gap is even greater. Developing countries in Asia spend only 2.4% of their GDP on public healthcare, compared with 8.1% in advanced economies and 3.9% in Latin America. On social protection, developing countries in Asia spend about 6.2% of their GDP, only half of the 12% spent in Latin America and less than a third of the 20% allocated in advanced economies.<sup>19</sup> Such inadequate public spending in these essential sectors has severely limited the scope and effectiveness of public interventions to reverse the trend of rising inequality and to mitigate the social and long-term impacts of this on the poor.

## 2 CAN TAX POLICIES HELP TO NARROW THE GAP?

The debate about tax policy is often rather a debate about the kind of society we want.<sup>20</sup> Indeed, tax policy plays an important role in creating a more balanced society characterized by less extreme inequalities, greater social mobility and fairer competition between the poor and the rich – and this role is becoming ever more critical in the era of the Sustainable Development Goals (SDGs), which emphasize the importance of ‘leaving no one behind’.<sup>21</sup>

Tax policy contributes to this broad objective through two main channels. First, taxes provide the main source of revenue for financing public investments in healthcare and education and for subsidizing capacity development programmes,<sup>22</sup> as well as funding social protection and welfare schemes such as subsidized basic insurance and public housing. Second, taxes can become a powerful policy tool for the direct redistribution of income and wealth in a society. Progressive direct taxes such as personal income tax (PIT) and taxes on property and wealth can play a significant role in restoring economic equity and preventing inter-generational inequality, especially inequality of opportunity inherited from earlier generations. In OECD countries, for example, taxes and transfers together have consistently reduced the overall levels of income inequality by about a third, from a rather high market Gini<sup>23</sup> of above 45 to a more moderate level of around 30 (see Figure 4).<sup>24 25</sup>

**Figure 4: Gini coefficient before and after taxes and transfers in OECD countries (2014 or latest year available)**



Source: OECD Inequality Update 2016

The experience of Latin American countries since the 2000s provides another example of the potential for progressive direct taxation to enhance tax revenue and reduce inequality at the same time. During this period, tax-to-GDP ratios in the region increased by more than two percentage points and income Gini scores on average declined by around three points. Many factors may have contributed to these changes, including general improvements in economic performance, the

emergence of middle classes and levels of educational spending, but tax policy is also believed to be among them. Increases in tax revenues have been a factor in the decline of inequality even after the effects of education and other redistributive public spending have been taken into account.<sup>26</sup>

This is reflected in the success of recent reforms in countries such as Uruguay, Peru, Chile and Argentina, which have moved towards more progressive tax systems with renewed emphasis on progressive direct taxation. Between 2001 and 2011 in Latin America, the share of revenues raised by taxes on income, profits and capital gains increased on average from 22.8% of the overall revenue pool to 32.6%. In contrast, the average revenue shares of taxes on sales, excises and trade all declined.<sup>27</sup> This offers a clear illustration that progressive tax policies can both mobilize revenue and reduce inequality in developing countries if they are correctly designed and implemented.

## CURRENT TAX REVENUE STRUCTURES IN ASIA-PACIFIC

So where does Asia-Pacific stand today overall in terms of tax collection and mix of taxes? At the risk of over-simplifying, the position across the region can be summarized as follows:

- There are wide variations across countries in collecting sufficient revenue to enable public expenditures to mitigate inequality;
- Direct taxes, in particular PIT, account for a relatively low share of the overall tax mix;
- Social contributions are weak and there is very limited use of wealth and property taxes;
- Tax collection is inefficient, which is due partly to high levels of tax evasion and huge informal sectors.

### **1. Enhancing tax revenues should be a priority for some of the region's poorest countries**

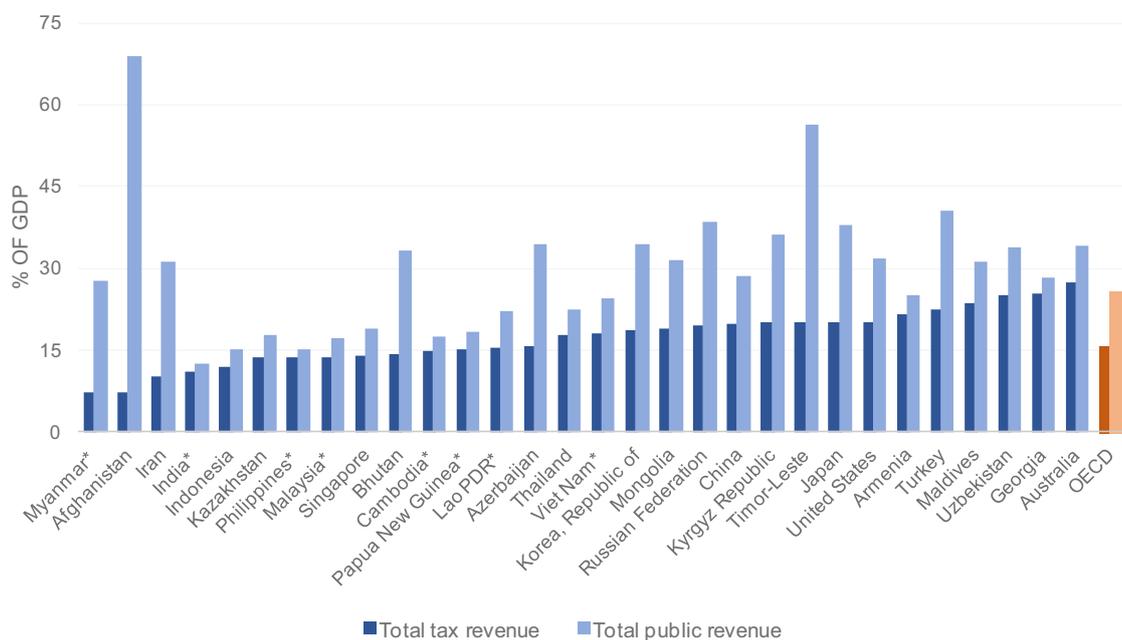
The Asia-Pacific region as a whole has one of the world's lowest tax-to-GDP levels. In 2015<sup>28</sup> total tax revenue averaged 16.4% of GDP across the region, compared with a developing country average of 20.2% and a developed country average of 25.1%. This regional average also masks huge differences between countries. For instance, the average level of tax revenue would fall to only 14.2% of GDP if the Central Asia and Pacific sub-regions were excluded and only developing countries were considered. Afghanistan has the lowest tax-to-GDP ratio in the region at just 7.3%, while for Bangladesh, Myanmar, Iran (Islamic Republic), Pakistan, Sri Lanka and Timor-Leste the figure is no more than around 10% (see Figure 5).

The extremely low levels of tax revenue in some of the region's poorest countries are a particular cause for concern. Given the generally poor state of education, infrastructure, healthcare and social protection in these countries, insufficient public financing is a primary barrier to efforts to lift many millions of people out of extreme poverty and to effectively pursue achievement of the SDGs. The estimates available suggest that the incremental spending needs of low- and lower-middle-income countries to achieve the SDGs may amount to at least \$1.4 trillion per year.<sup>29</sup> This would mean mobilizing public revenue equal to an additional 2–5.75% of GDP<sup>30</sup> for a typical country in this group, even if half of the additional investment needs could be met by the private sector.

However, this revenue gap is not an obstacle that cannot be overcome. In fact, recent analysis suggests that most developing countries in Asia-Pacific appear to be underperforming on their tax potentials. A 2013 study estimated that almost half of the Asia-Pacific countries analysed were achieving less than or just above 50% of their maximum tax potentials, given their levels of economic development and sectoral structures.<sup>31</sup> In contrast, most European countries collect close to their maximum revenue capacity. A later study in 2016 reported similar findings, with developing countries in Asia-Pacific collecting on average less than two-thirds of the tax revenue they could potentially mobilize.<sup>32</sup> While these estimated maximum tax potentials are for general guidance only

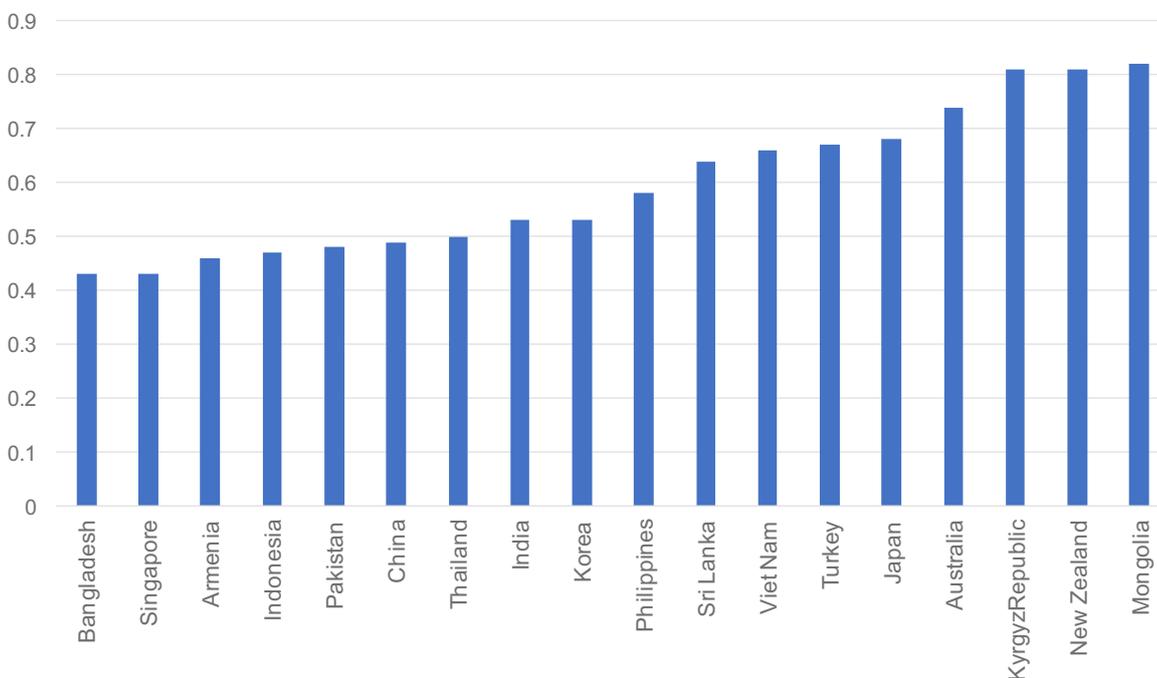
and collection efforts can be highly dependent on policy priorities and individual choices made by countries,<sup>33</sup> these results demonstrate that for many developing nations in the region strengthening the mobilization of tax revenue is not only possible but also a priority (see Figure 6).

**Figure 5: Public revenue and tax revenue in Asia-Pacific countries (2016 or latest available year)**



Sources: IMF GFS. Note: general government data except for countries marked with an asterisk.

**Figure 6: Estimated tax effort of Asia-Pacific countries compared with their potentials**



Sources: DFI/Oxfam Tax Progressivity Database, based on Brun and Diakite (2016) and Fenochietto and Pessimo (2013)

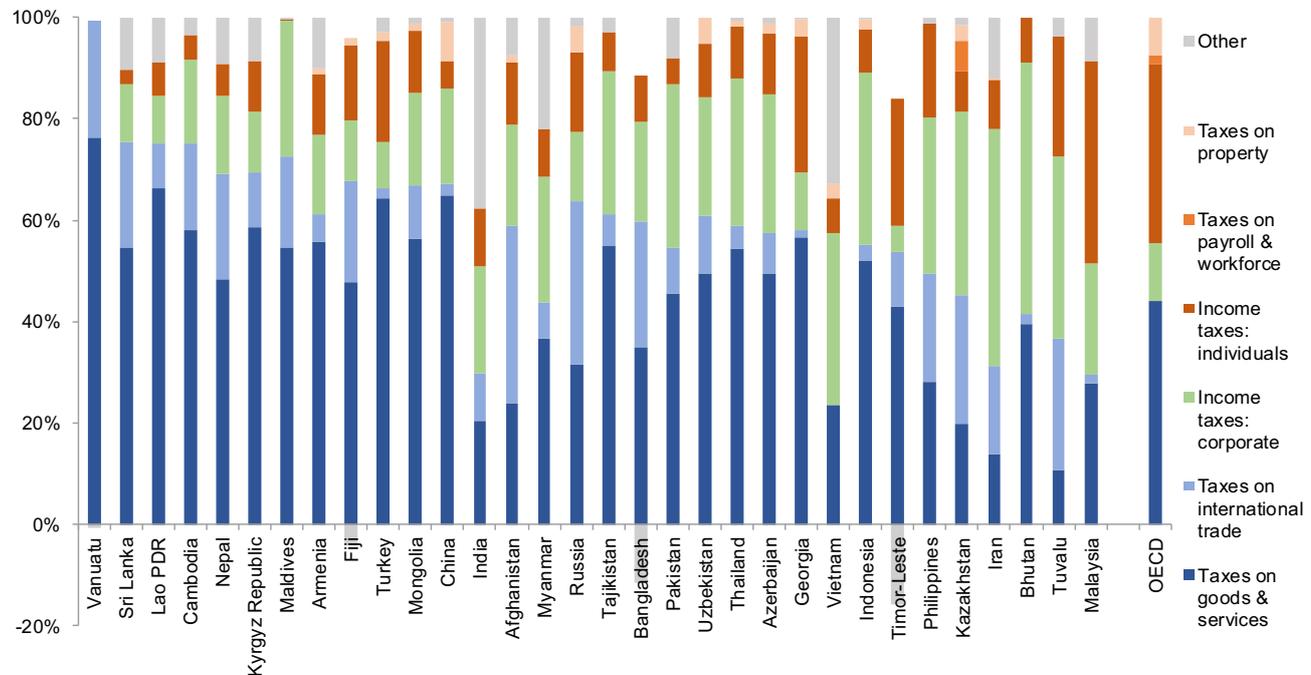
## 2. Direct taxes could play a greater role in overall tax composition

As a whole, compared with developed countries, the tax mix in Asia-Pacific is heavily biased towards indirect taxes. Direct taxes account for only 36.1% of the total tax revenue in the region, while for OECD countries direct taxes account for 55.8% of the total (see Figure 7). This bias towards indirect taxation is not surprising, as taxes such as value added tax (VAT) or excise duties typically pose lesser tax administration and political challenges for developing countries compared with direct taxation. Nevertheless, the outcome is considerably less desirable since indirect taxes tend to be more regressive. Relying on a large share of indirect taxes and a relatively small contribution from direct taxes could further aggravate an already serious problem of inequality in the region, especially when pro-poor public spending and social protection schemes are still far from adequate.<sup>34</sup>

Of direct taxes, countries in Asia-Pacific also rely more on corporate income tax (CIT) than on personal income tax (PIT). On average, developing countries in the region collect 3.6% of their GDP from CIT, which is actually higher than the 2.9% of GDP collected by OECD countries. However, the average revenue from PIT in these countries is just 2% of GDP, while OECD countries collect more than four times this amount, at 8.8% of GDP.<sup>35</sup>

Such a bias is undesirable because Corporate Income Tax (CIT) can often be shifted to labour, especially in an increasingly integrated world where capital has much more mobility.<sup>36</sup> As economic integration deepens in Asia-Pacific and worldwide, the effect of CIT on inequality becomes more debatable. In contrast, PIT is potentially the best tax instrument for redistributive purposes, and by its nature is almost impossible to shift to another party. However, past experience also shows that PIT performs strongly as a redistributive tool only if it is well designed and well administered and has sufficient coverage.<sup>37</sup> Extremely low levels of collection are often a strong indicator of failures of PIT in both revenue mobilization and income redistribution.

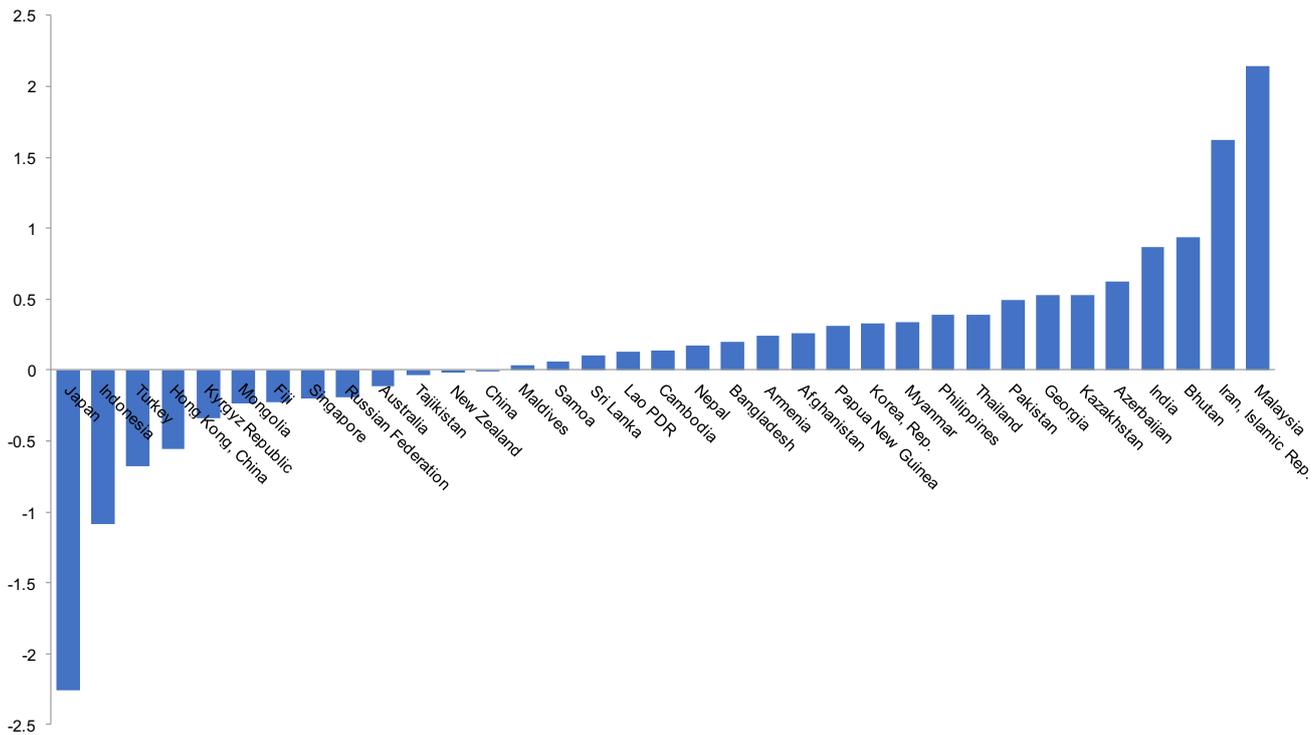
**Figure 7: Structure of the tax mix in Asia-Pacific countries and OECD countries (2014 or latest available year)**



Sources: IMF Government Finance Statistics (GFS), national sources and OECD

Although many countries in the region have made substantial efforts to strengthen the share of direct taxes in their overall tax mix, and have made progress in this regard, these efforts have not been uniformly effective. Indonesia and Turkey, for instance, experienced significant falls in the share of direct taxes in their overall tax mix between 1990 and 2014. In Turkey, direct tax revenue was 1.13 times as much as indirect tax revenue in 1990, but by 2014 this figure had more than halved, to only 0.45 times. Indonesia saw a decline from 2.05 to 0.96 times over the same period. In China, Tajikistan, Russia, Fiji, Mongolia and Kyrgyzstan, the share of direct taxes also fell or largely stagnated (see Figure 8). This indicates that a higher share of direct taxes is not an automatic result over time and that deliberate policy actions are required to promote a more progressive tax system in general.

**Figure 8: Direct to indirect tax ratio, change between 1990 and 2014**



Source: ESCAP calculation based on IMF GFS and CEIC.

The differences between developing countries in the Asia-Pacific region and developed countries are greater when looking at social contributions. OECD countries on average collect 9.1% of GDP through social contributions, and for some this figure is higher than 15%.<sup>38</sup> In Asia-Pacific, by contrast, many countries collect few or no social contributions. Indonesia, for instance, has introduced a mandatory social contribution programme starting only from 2015, with moderate contribution rates of 3% from employees and 6% from employers for pension and health insurance combined.<sup>39</sup> A monthly salary cap of \$540 was also introduced for the calculation of contributions.

Although the notion of mandatory social contributions is relatively new in the region, for countries that have already implemented such a policy revenue collections have been impressive. In Iran and Japan, social contributions are the largest component of the broader tax definition, accounting for more than a third of total broader-concept tax revenue. In Armenia, China, Mongolia, Korea, Russia, Turkey and Uzbekistan, social contributions are second only to taxes on goods and services in mobilizing revenue. However, despite this progress, social protection and welfare coverage remain narrow, and in many cases have biases in favour of public and formal sector employees. Such biases can actually add to inequality rather than reversing it, as some recent studies suggest.<sup>40</sup>

# LEVERAGING PROGRESSIVE TAX POLICIES TO ADDRESS INEQUALITY

## 1. Reduce the regressivity of VAT

Consumption taxes, in particular VAT, are generally considered to be regressive because poor people spend a much larger proportion of their incomes on consumption compared with those who are richer. VAT or other consumption taxes levied on staple foods, public transport, basic education and health services and other necessities can be particularly burdensome for the poor, and to some extent they can also have a distorting effect since public transport, education and healthcare should normally be subsidized given their positive externalities and their contribution to overall economic and social development.

To address these concerns, a number of measures could be introduced into the design of VAT regimes. First, countries could set lower VAT rates on food and other necessities and on economic activities that governments wish to promote or protect. Second, they could apply zero rating to certain products and services, which would see them charge zero VAT but still enable them to claim input credits. This is most common when promoting exports, but can also be applied to basic necessities. In contrast, direct exemptions from VAT remove products or services completely from VAT liabilities in the production and distribution chain; this means that no VAT is charged, but at the same time no input credit can be claimed. In addition, exemptions or lower rates can be applied to small and medium-sized enterprises (SMEs). This can often reduce both the tax burden on SMEs and the compliance burden associated with complex information collection and reporting rules for VAT.

According to KPMG's 2016 Asia Pacific Indirect Tax Guide,<sup>41</sup> all of the 22 Asia-Pacific countries surveyed provide VAT exemptions and only one does not have reduced VAT rates or zero rating. Most of these preferential arrangements are designed to promote public agendas and the common good, and reducing the regressive effect of VAT and its burden on poor citizens is one of their objectives.

There are many examples from countries across the region. In China, agricultural products and contraceptive drugs and devices are exempted from VAT. Education, life and medical insurance, and goods and services donated by non-profit bodies are exempted in Fiji. Various food and agricultural products are exempted in India, which also has multiple VAT rates. Specified agricultural inputs, education and medical services are exempted in Lao PDR. Basic foods, supply of the first 300 units of electricity and the supply of treated water to domestic users are zero rated in Malaysia. Education, medical services, public transport and certain food products have zero rates in Mongolia. Basic foods and medicines, education and public transport are also exempted in Myanmar. Most medical supplies have a zero rate in Papua New Guinea, and education and medical services together with public road transport are also exempted. Basic foods and medicines are exempted in Sri Lanka, while education, healthcare and domestic transport services are exempted in Thailand. In Vietnam, the provision of certain essential goods and services such as clean water, fresh foodstuffs and medical and educational equipment is taxed at half the standard rate.

Despite the widespread practice of reduced rates and exemptions in VAT design in order to make the tax less regressive, most tax experts would argue against excessive use of these measures. On the one hand, VAT is generally designed to mobilize revenues from a relatively broad base that is easy to target. Evidence suggests that the actual distributional effect of reduced VAT rates or exemptions can be limited, and a large proportion of the related benefits may accrue to the rich rather than the poor. For example, just 5% of the benefits of total revenues foregone due to VAT zero rating on food in Mexico go to the poorest 10% of the population, while more than 20% of the benefits actually go to the richest 10%.<sup>42</sup> At the same time, multiple VAT rates, zero rating and

exemptions can be costly in terms of both revenue mobilization and economic efficiency. These measures erode the tax base, break the VAT chain and pose significant challenges for tax compliance and administration. A structure with multiple rates also requires companies to keep separate records for different inputs, which in turn is costly in terms of auditing and VAT self-assessment.

In this regard, it is often suggested that progressivity across the whole fiscal system can be better achieved by means of direct taxes, redistributive transfers to the poor or public subsidies for basic goods and services. Instead, runs this argument, VAT should be left to focus on its main purpose of revenue mobilization and its distributional impact should be analysed in a broader context where both tax and expenditure programmes are taken into account.

However, these arguments may not hold entirely in the face of the realities in developing countries. First, while it is true that a larger proportion of the benefits of VAT exemption may go to the rich, this does not mean that exemption does not improve the position of the poor in overall income distribution. Take Mexico, for instance, where the income share of the bottom 20% of the population was only 5.1% in 2014, even after years of improvement. This means that the bottom 10% receive less than 2.5% of income as a whole. Thus, even if they receive only \$5 out of each \$100 foregone in tax revenue due to the zero rating on food, they are still relatively better off in the overall income distribution. More importantly, the impact of this \$5 benefit may be much greater for those who are in or close to extreme poverty than the \$20 benefit for the richest 10%.

Second, given the fact that personal income and wealth taxes currently make up a very small proportion of total taxes in most developing countries, direct taxes are yet to become a viable alternative for progressive taxation. Redistributive public expenditure is not fully effective either, since in many developing countries there tends to be more pressing needs for spending than for transfers, especially given their low levels of tax revenue. This is not to say that the proportion of direct taxes should not be increased or that the accountability of public expenditure need not be improved. Instead the point is that, in the current situation, these 'first best' options may not be feasible in the near term. Thus, reducing VAT regressivity may be considered as a 'second best' but nonetheless pragmatic solution in developing countries even though it is not the optimal solution.

Exemptions, zero rating and reduced rates to reduce VAT regressivity are likely to remain part of the package of fiscal measures adopted to address inequality in developing countries in Asia-Pacific, and they can play an important role in the transition towards more desirable fiscal systems characterized by progressive direct taxation and public spending. In this process, it is important to be aware of the revenue and economic costs of these measures and to conduct a prudent cost-benefit analysis. In addition, VAT on luxury products and certain economic activities – financial services in particular – can be highly progressive. Opportunities of this nature to mobilize additional revenues in a progressive manner need to be explored further.

## **2. Make personal income tax work better**

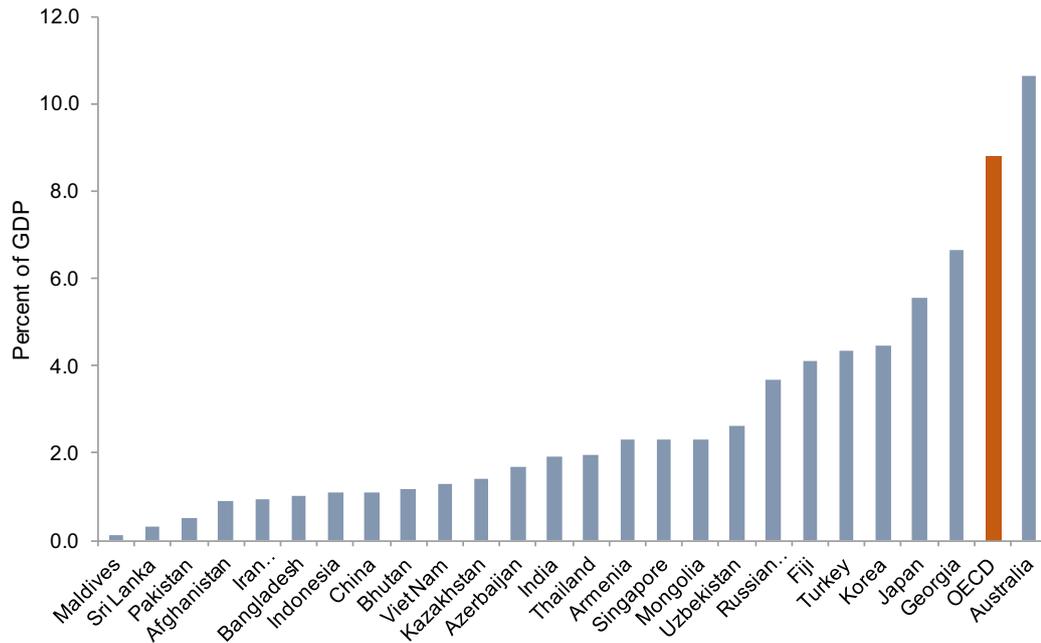
PIT is widely seen as the central component of a progressive tax system. In OECD countries it is not only a major source of public revenues but also contributes significantly to income redistribution for greater equality. The experiences of the developed world formed the basis of early tax policy thinking in the 1950s and 1960s, which advocated for a central role for highly progressive and comprehensive PIT structures.<sup>43</sup>

However, the results of experimentation with this idea in developing countries have been disappointing. PIT revenues have remained largely stagnant at very low levels compared with those in developed countries. Indeed, the small amounts of revenue collected from PIT have significantly restricted the overall redistributive effects in developing countries. Moreover, most of this revenue

has come from taxing labour income, while income from capital and other economic activities has often been neglected. As a result, it is the middle-income working class rather than the really rich who have shouldered the burden. In addition, developing countries in general lack modern tax-related infrastructure (such as accounting, auditing, data collection and reporting) and the capacity for effective administration of PIT. This, coupled with corruption, has led to much higher costs of compliance and collection for progressive PIT in developing countries than in developed countries, and has left many flaws and loopholes that the rich, who have more resources and are better connected, have been able to exploit.

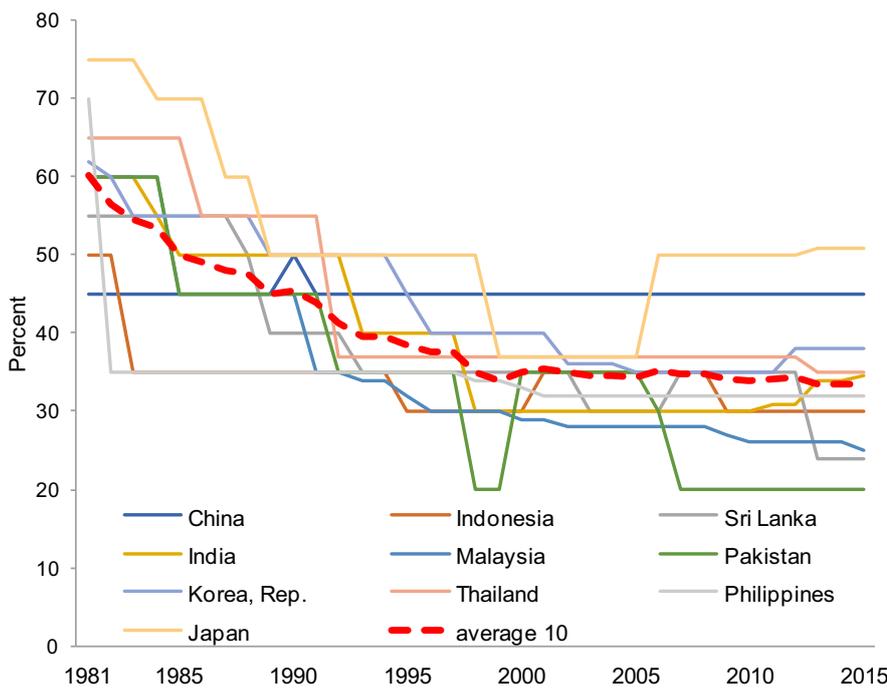
These general limitations have been mirrored in developing countries in the Asia-Pacific region. The average PIT revenues of such countries grew only marginally between 1999–2001 and 2014, from 1.8% of GDP to 2.0%, less than a quarter of the OECD average. At the same time, governments in the region followed the global trend of reducing their top rates of PIT. From 1981 to 2015 in 10 Asia-Pacific countries, the average top rate of PIT was almost halved (see Figure 9b).<sup>44</sup> Such a significant change reflects a revision of the earlier emphasis on progressivity and a transition in the 1980s and the 1990s to a new set of ‘best practice’ tax structures anchored on flatter rates and a broader base, in an attempt to minimize challenges in tax collection and economic distortions.

**Figure 9a: PIT revenue**



Source: ESCAP, based on IMF GFS, KPMG, EY and CEIC

**Figure 9b: PIT top marginal rates 1981–2015**



Source: ESCAP, based on IMF GFS, KPMG, EY and CEIC

The PIT base in Asia-Pacific also remains narrow, partly due to high PIT exemption thresholds compared with gross national income (GNI). The higher PIT thresholds and GNI ratios imply broader PIT exemptions and drains on revenue – as in the case of Pakistan, where the great majority of the population are exempted from paying PIT. Broad PIT exemptions may be advisable for countries with average incomes just above the poverty level and which do not have a vibrant middle class, but gradually broadening the PIT base should be a long-term objective for middle- or upper-middle-income developing countries. In addition, PIT revenue depends on how the tax is designed. India, for example, has much higher PIT thresholds (relative to per capita GNI) than

China, and slightly lower PIT rates (a range of 10–30% compared with 3–45% in China). Yet India collected the equivalent of 1.9% of its GDP from PIT in 2014, while China collected only 1.1% of GDP. One main reason for this difference could be that PIT in India is more comprehensive, in the sense that the country taxes aggregated income of different types, while China taxes different income types separately.

Empirical analysis suggests that PIT does have a positive redistributive effect in Asia-Pacific, and the marginal effect could be higher than in other parts of the world.<sup>45</sup> Two contributing factors to this are high PIT exemption thresholds and the existence of large informal employment sectors in developing countries in the region, which effectively ‘untax’ the majority of poor citizens. However, as the region’s middle classes grow larger and PIT coverage expands and gradually incorporates the informal sector, the marginal effect of PIT in reducing inequality may decrease over time.

Meanwhile, the importance of closing PIT loopholes exploited by the rich should not be overlooked. In Pakistan, for instance, the Federal Board of Revenue discovered in 2012 that more than 1.5 million adult citizens who had travelled abroad at least once a year over a period of many years were not registered with the tax authorities. About half a million people who had multiple bank accounts had also not registered. And of the 341 members of the National Assembly, only 90 had filed tax returns in that year.<sup>46</sup> The damage caused by such weak PIT compliance by the rich and elite is significant, as it casts serious doubts on the accountability and fairness of the system, undermining efforts to create a conducive tax culture within society.

For the future, governments should be fully aware that there is no simple ‘one size fits all’ formula for PIT implementation. The timing, sequencing and detailed design of PIT policies need to take into account the local economic, social and cultural contexts, as well as capacity constraints for both compliance and administration. A moderate but well-designed PIT that is manageable and accountable is likely to perform better than an over-ambitious strategy that only looks good on paper. This is particularly true in terms of long-term strategy where policies are often path-dependent and a bad start could have undesirable consequences.

In general, governments should choose their PIT implementation strategies according to their particular stage of development and their accumulated experience and capacity in PIT administration. A country with a small middle class and a large population of poor citizens could focus more on ‘untaxing’ the poor and introducing an easy-to-manage PIT design that targets mainly top-income individuals. A middle-income developing country could adopt a more balanced approach of gradually broadening the PIT base by including its emerging middle class in its coverage and at the same time strengthen PIT administration to effectively tax capital and other non-wage incomes. A more advanced developing country with stronger governance and administrative capacity could trial a more ‘ideal’ form of PIT design with broad coverage and greater progressivity, and could seek to address new challenges such as expanding sources of income from abroad.

### **3. Leverage wealth taxes more effectively**

Taxes on wealth, including recurrent taxes on wealth and property as well as taxes on inheritance, estates and gifts, are another fiscal tool that potentially can be used to address inequalities in society. In general, taxes on wealth and its inter-generational transfer are relatively more progressive, targeting only the richest group in most cases. Importantly, such taxes are essential to prevent the excessive concentration of wealth and power in the hands of a few<sup>47</sup> and to ensure greater equality of opportunity across generations. The progressivity of property taxes, on the other hand, is less straightforward and depends to a great extent on their specific design.

In OECD countries, wealth taxes are important components of the overall tax system. Combined, they contribute close to 2% of GDP on average, although there are significant variations between countries. In contrast, wealth taxes play only a marginal role in Asia and the Pacific. Of all the region's developing countries, only China, the Russian Federation and Uzbekistan manage to collect more than 1% of GDP from property taxes, and taxes on inheritance, estates and gifts exist in only a handful of countries, such as Iran, the Philippines, Thailand and Vietnam. India has recently abolished inheritance tax and replaced it with an extra 2% income tax surcharge on the super-rich. On the other hand, Japan and South Korea, both OECD members, do raise substantial sums from such taxes. They also have the world's highest inheritance tax rates, at 55% and 50% respectively.

This difference between developing countries in Asia-Pacific and OECD countries partially reflects the administrative challenges involved with wealth taxes, most notably disclosure and valuation. Given weak institutions, capacity constraints and the lack of mature property markets in developing countries, the task of estimating and taxing personal wealth can be extremely challenging. When overall levels of tax compliance are low and more sophisticated groups are likely to exploit loopholes, the efficiency and fairness of wealth taxes can be undermined; the introduction of such taxes therefore needs to be carefully designed to avoid them creating an unnecessary burden for the middle class.

Nevertheless, despite all of these difficulties,<sup>48</sup> a number of higher-middle-income developing countries in the region are pushing ahead with wealth taxes. Thailand, for instance, introduced an inheritance tax for the first time in 2016. Although this initial step was less ambitious than expected,<sup>49</sup> it still marked a positive effort to contain growing inequality in the country. China is also preparing to introduce property and inheritance taxes in the coming years, and its initiatives on this front have two unique features. First, both taxes have been trialled at local levels and legislative proposals have been put forward for further debate, in view of the complexity of the taxes and the importance of fostering public support for them. Second, the design of the property tax has an emphasis on discouraging speculation in the housing market and the ownership of multiple or luxury properties for investment purposes.

#### **4. The need for global action on international taxation**

Asian economies are closely integrated into the global economy, and their tax systems are intimately linked to the globalized world. As such, it is necessary to examine both global and regional trends in taxation. One important global trend has been a move to reduce CIT rates to attract investments from multinational enterprises (MNEs). When multiple countries follow this course of action, the outcome may be a 'race to the bottom' that primarily benefits large corporations.

Another tax issue facing Asia and the wider world is the practice of base erosion and profit shifting (BEPS), whereby MNEs use various means<sup>50</sup> to evade tax.<sup>51</sup> Globally, governments lose as much as an estimated \$240bn a year due to corporate tax dodging.<sup>52</sup> Given that developing countries rely more on CIT for revenue, the impact of BEPS in GDP percentage terms is likely to be greater for them than for developed countries. Such loopholes primarily benefit large corporations, wealthy individuals who hide their wealth offshore and rich tax havens, and tend to put further stress on the already narrow fiscal space of developing countries in the region.

Recognizing the problem of BEPS, in 2013 the G20 countries gave the OECD a mandate to design a solution, and the OECD BEPS Project produced a final package of recommendations in 2015.<sup>53</sup> It may be in the interest of Asia-Pacific countries to work closely with the OECD to implement this package, and also to consider providing inputs on how to improve this solution. Given the evolving nature of the BEPS Action Plan and its implications for developing countries, there may be a need

to strengthen the role of the United Nations in promoting international cooperation on tax matters. It is in the interests of the Asia-Pacific region to continue to work with other governments and organizations to create an intergovernmental tax body at the UN level to protect the rights of developing countries. At the same time, regional cooperation and information sharing are also indispensable. An effective platform for dialogue and coordination could increase the bargaining power of developing countries in Asia-Pacific, especially those that are not G20 members, in negotiating new international taxation norms and practices with large and influential MNEs.

In addition, regional coordination to address harmful tax competition is important in the consideration of new and progressive tax vehicles, including a financial transaction tax. With rapid expansion of the financial sector in the region, taxing financial transactions could provide an alternative source of revenue. Such taxes are also regarded as being quite progressive.<sup>54</sup> However, capital and financial activities also have great mobility. Thus, without effective coordination it may be difficult for any country to pursue this avenue without compromising its own competitiveness. In fact, rather than taxing financial activities, a number of countries in the region are actually providing tax exemptions and other incentives for the financial sector. Changing the course of such policies will require greater consensus among different nations to work together.

## **5. Tax matters in the fight against gender inequality**

In Asia gender inequality persists, notably in the economic realm, where social norms tend to devalue the work done by women. This situation is exacerbated when policies fail to support the economic rights of women. On average, women across Asia earn between 70% and 90% of what men earn, while women also carry out around 2.5 times as much unpaid care work as men.

Well-designed tax systems could be used as a tool to alleviate gender inequality and to advance women's economic empowerment, which is essential to achieve SDG 5: 'Achieve gender equality and empower all women and girls'. The impact of taxation on gender inequality in Asia is a relatively unexplored area of research, and to make progress in this area gender-disaggregated data are urgently required. However, some general lessons can be gleaned from fiscal analyses conducted elsewhere.

Tax systems have a bearing on gender inequality in two important ways. First, they raise revenues that can be deployed to alleviate issues that aggravate gender inequality. A recent UN review of progress on implementing the Beijing Platform for Action, 20 years after it was agreed, identified insufficient resources for targeted investments in gender equality and in sectors such as health, education, social protection and water and sanitation as major challenges to achieving women's rights.<sup>55</sup> Furthermore, in 15 of the 17 countries studied in the Asia-Pacific region, national budget allocations for institutional mechanisms to help the advancement of women amounted to less than 1% of the total.<sup>56</sup> Although many countries have made commitments towards gender equality, an analysis of national action plans to achieve these goals shows that funding deficits are as high as 90%.<sup>57</sup> Progressive tax systems with commitments to steadily increase tax collection and close loopholes are crucial if governments are to raise the revenue needed to invest in gender equality and women's rights. Additionally, this needs to be complemented by the mainstreaming of gender concerns into tax policies and the adoption of gender budgeting as a mechanism to ensure that revenues collected through a gender-sensitive tax system are spent for women's empowerment.

Second, depending on their design, tax systems can either alleviate or reinforce gender inequality. In this regard, it is important to recognize that tax structures need not be gender-neutral and that it is essential to investigate the different impacts and development outcomes they might have for men and women. For instance, in industrialized countries, it has been found that the burden of PIT discourages women from joining the labour force.<sup>58</sup> In developing countries the situation is different, when we consider the proportion of women in formal employment. Women in Asia constitute only

about 33% of the total workforce, and they tend to be employed in sectors characterized by low wages and insecure work, such as agriculture and services. Moreover, women perform 76% of unpaid domestic and care work in the region, leaving them with less time to participate in paid employment.<sup>59</sup> This pattern is consistent with global economic trends. Where women in Asia are doing the same jobs as men, they earn significantly less pay – in some countries, roughly half to two-thirds of men's income. Tax policy is particularly relevant to women entrepreneurs in the region. Globally, women remain more vulnerable to living in poverty than men, due in large part to their over-representation in unpaid and low-paid work. The bulk of women entrepreneurs operate in the informal sector and do not undertake formal registration for fear of having to pay high taxes. Given this understanding, it is important to ensure that tax structures do not aggravate the situation of women who are in economically vulnerable positions.

It is important also to understand how different consumption taxes, such as VAT, affect women's overall expenditure patterns and welfare. VAT without exemptions can hurt low-income groups, including women, the most, as everyone pays the same rate regardless of their income. Women are more likely to be poor in the first place and consequently must spend a larger proportion of their income on necessary consumable goods, which means that they are doubly harmed by indirect taxes like VAT. To quantify the actual impact of VAT on women, it would be useful to consider the bundle of goods and services covered by this type of tax and the differential consumption patterns of men and women. Gender-disaggregated household consumption data need to be generated to support evidence-based policy decisions on VAT and its impact on gender equality.

Public services such as healthcare and education are critical in alleviating the 'time poverty' of women, especially in developing countries, where they do the bulk of unpaid care work. When women bear the double burden of care work and generating income, a lack of public services can push them into a vulnerable position.

Putting more emphasis on progressively designed direct taxation would help to reduce gender inequality, as a graduated tax rate on income and wealth would shift the burden of tax revenue towards the highest income groups, which are usually dominated by men. A progressive tax system where more tax revenue flows from CIT and PIT, combined with gender-responsive budgeting with adequate attention paid to education and healthcare, are enabling factors in achieving sustainable development via gender equality and empowerment. When low-income groups – and women in particular – have greater access to private resources to invest in their children and households, economic inequality is reduced, education levels and health indicators improve and the SDGs in general are more attainable.

The way in which taxes are filed at the household level can also have an impact on gender inequality. When a husband and wife file income taxes jointly as a couple (as, for example, in Indonesia), the secondary income earner is often regarded as being dependent on the primary income earner. Joint filing in a dual-income household usually places the secondary worker, who is typically a woman, at a disadvantage in the pooling of income as they tend to face a relatively higher marginal tax rate.<sup>60</sup> On the other hand, tax reductions are often available for single-income households due to the assumption that income is shared equally between the couple, and such tax systems discourage women from seeking paid work. Ensuring that income taxes can be filed separately can both decrease the rates that women pay on their incomes and improve gender equality. Furthermore, the Convention on the Elimination of All Forms of Discrimination against Women (CEDAW) requires that families are based on 'principles of equity, justice and individual fulfilment for each member'.<sup>61</sup> Considered in conjunction with tax laws, this means that women should be treated on an equal footing with men, i.e. as individual, autonomous beings as opposed to being dependent on men.

Progressive and gender-sensitive tax systems would ensure that the funds needed for investments in gender equality could be raised in a way that is redistributive and without reinforcing gender inequality. Of the measures that would facilitate this, raising revenue through the direct taxation of income, profits, wealth and capital gains, rather than through indirect taxes, is key. Time-bound preferential tax treatment for formally registered micro, small and medium enterprises (MSMEs) owned by women entrepreneurs would also encourage more enterprises to be registered, thereby opening the door for governments to support them.

Despite the great potential of tax policy as a tool for alleviating inequalities between men and women, it remains under-used in the Asia-Pacific region and suffers from major omissions that can unwittingly widen gender gaps. Gender-sensitive tax policies, in tandem with policy commitments to spend tax revenues in areas that contribute the most towards gender equality and empowerment, are pivotal to the achievement of sustainable development in the region. Unfortunately, the tax systems in most Asia-Pacific countries are not yet gender-sensitive and thus lead to fiscal injustices, especially for women. Countries in the region should assess their fiscal policies to ensure that they are designed in a way that best supports gender equality. Gender budgeting should be adopted as an important means to this end. Further research is needed to assess the extent to which tax systems in Asia reinforce gender inequality, and Asian governments should invest in this area, particularly by developing gender-disaggregated data on household consumption and income.

# 3 RECOMMENDATIONS

## 1. Enhance public resource mobilization through taxes

- **Strengthen tax revenue for progressive public expenditure:** Developing countries in the Asia-Pacific region have considerable potential to mobilize additional tax revenues for essential public spending on poverty reduction, education, healthcare, vocational support and housing, all of which not only generate direct economic benefits for poor citizens but also enable them to improve their economic status through their own efforts. Appropriate revenue mobilization that takes into account the individual country's tax capacity should be a top priority to address the challenge of inequality.
- **Enhance regional tax cooperation to address tax evasion, base erosion and harmful tax competition:** Information exchange and collective actions remain key in order to eliminate tax havens, detect wrongdoing and close loopholes. It is also necessary to avoid excessive and harmful tax competition and to create space for new and progressive tax vehicles, such as taxes on financial transactions.
- **Support an increased role for the United Nations in international tax cooperation:** This would facilitate international tax cooperation and policy coordination and, most importantly, would promote a new generation of international tax reforms that are required for the effective pursuit of inclusive and sustainable development.

## 2. Rationalize tax structures, and better leverage progressive tax policies

- **Conduct a comprehensive review of key taxes, including consumption and wealth taxes:** In particular, proactive measures to reduce the regressive impact of consumption taxes such as VAT are critical for developing countries in the region when there is a lack of reliable alternatives. At the same time, an improved understanding of the implicit fiscal and social costs of multiple-rate systems, zero rating and exemptions, together with more prudent cost-benefit analysis, is required to ensure that these policies serve the common good.
- **Initiate forward-looking reforms aimed at achieving a better balance between direct and indirect taxes to promote a progressive tax system:** This includes the adoption of a phased action plan to gradually increase the share of direct taxes in the revenue pool and strengthen appropriate types of tax within the institutional context of the country. The overarching objective is to ensure the fair distribution of tax burdens across different income groups in order to eliminate extreme inequality, break the spiral of widening income and wealth gaps and minimize the inheritance of inequality across generations.
- **Improve tax statistics and tax incidence<sup>62</sup> analysis:** Informed policy making depends on statistics, especially in terms of gauging the overall redistributive impact of tax policies. The collection of disaggregated information on tax revenue and taxpayers, with regular updates for transparency, would greatly benefit the quest for more focused and effective tax policies that promote inclusive and sustainable development.

## 3. Reinvigorate the fiscal compact in the region

- **Build a benign tax culture through fair taxes and accountable spending:** The extent of tax compliance depends on a tax system that is considered fair and transparent and on public expenditure that is accountable to taxpayers and that generates concrete results for inclusive and sustainable development. A positive 'tax morale' based on these two anchors could significantly reduce the risks and costs of tax policy implementation and administration. In particular, sufficient and effective public spending on people's livelihoods, education and

healthcare plays a central role in this process.

- **Encourage public participation in tax reforms:** Transparency and public awareness are important measures to overcome the difficulties of revenue mobilization associated with deploying progressive taxes. Engaging in continuous dialogue with citizens and stakeholder groups and conducting research on the costs and benefits of proposed tax reforms would help governments to calibrate their proposed policies with public preferences and secure people's understanding of reforms for the common good.
- **Promote gender-sensitive tax policy making:** Gender equality is a component and a reinforcing factor for economic equality. Awareness of the direct or implicit impacts of tax policies on gender equality is thus an essential part of the overall effort towards reducing inequality. Broad consultation, especially with women's and civil society groups, and related policy evaluation are required to deliver on commitments to achieving gender equality.

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## NOTES

- 1 This wealth Gini estimate is not an average of national wealth Ginis, but the wealth Gini within the whole population of the countries covered. Thus, it not only accounts for wealth inequality within countries, but also for wealth inequality across countries in the region.
- 2 By default, the Asia-Pacific region refers to the formal member States of United Nations Economic and Social Commission for Asia and the Pacific, while the regional average figures in the paper also depend on data availability.
- 3 Based on \$1.25 per day in 2005 PPP terms. ESCAP (2015). Statistical Year Book for Asia and the Pacific 2015. [http://www.unescap.org/sites/default/files/SYB2015\\_Full\\_Publication.pdf](http://www.unescap.org/sites/default/files/SYB2015_Full_Publication.pdf)
- 4 S. Jain-Chandra et al (2016).
- 5 Even the much more conservative official Gini estimates based on household consumption data, which may significantly underestimate the extent of inequality, recorded an increase of four points, from 33.5 to 37.5, from the early 1990s to 2014. See ESCAP (2015).
- 6 Official figures from the National Bureau of Statistics of China.
- 7 S. Jain-Chandra et al. (2016), based on SWIID (The Standardized World Income Inequality Database) version 5.0.
- 8 Household surveys are often unable to collect accurate income data for the top income groups due to limited access to these groups and under-reporting.
- 9 L. Chandy and B. Seidel (2017).
- 10 Credit Suisse (2016). Global Wealth Databook 2016. <https://www.credit-suisse.com/corporate/en/research/research-institute/global-wealth-report.html>
- 11 Capgemini (2017). World Wealth Report 2017. <https://www.worldwealthreport.com/>
- 12 Those with more than \$1m in net wealth.
- 13 Forbes (2016). <http://www.forbes.com/sites/forbespr/2016/03/01/forbes-30th-annual-worlds-billionaires-issue/#f7c728871a8c>
- 14 T. Piketty (2014).
- 15 For instance, China's 13th five-year plan (2016–20) emphasizes a more balanced, inclusive and sustainable growth model, as do India's 12th five-year plan (2012–17) and the Philippine Development Plan (2011–16).
- 16 ESCAP (2013).
- 17 Claus et al. (2012).
- 18 MF (2014).
- 19 G. Estrada et al. (2014).
- 20 R.M. Bird (2012).
- 21 <https://sustainabledevelopment.un.org/?menu=1300>
- 22 Such as vocational training and technical assistance to farmers, etc.
- 23 That is, Gini before taxes and transfers.
- 24 In 2014, for instance, the average market Gini before taxes and transfers was 47.0, but this fell to 31.5 after taxes and transfers.
- 25 Unweighted average across countries.
- 26 For example, see G.A. Cornia (2012), G.A. Cornia et al. (2014), E. Tsounta and A.I. Qsueke (2014) and J. Clifton et al. (2017).
- 27 J.C. Gómez Sabaíni et al. (2016).
- 28 2015 or the latest year available. Unweighted average of 36 economies in the region for which recent data are available.
- 29 G. Schmidt-Traub (2015).
- 30 Based on the assumption that the private sector will shoulder half of the overall financing need. The figure would be 2% of GDP if estimated based on PPP terms or 5.75% of GDP based on market exchange rate of the local currency.
- 31 R. Fenochietto and C. Pessimo (2013).

- 32 J.F. Brun and M. Diakite (2016).
- 33 For example, Japan, the Republic of Korea and Singapore collect only around 64%, 47% and 28% respectively of their estimated potential tax revenues, far less than other developed countries. However, this difference could be largely due to the different economic policy emphases of these countries, and in any case it has not prevented them from achieving economic success and very high levels of income.
- 34 For example, P. Kohler (2015: 15) shows that public spending in Asia on education, health and social protection ranks as the lowest in the world. The empirical results obtained by I. Claus et al. (2012) suggest that spending on social protection and housing in Asia actually increases inequality, which contradicts international experience.
- 35 2014 or the latest year.
- 36 A.C. Harberger (1962), (1995) and (2006).
- 37 R.M. Bird and E.M. Zolt (2005).
- 38 OECD (2014).
- 39 KPMG (2015). Indonesia – Update on Income Tax and Social Security Developments. <https://home.kpmg.com/xx/en/home/insights/2015/08/flash-alert-2015-104a.html>
- 40 I. Claus et al. (2012).
- 41 Available at <https://assets.kpmg.com/content/dam/kpmg/pdf/2016/05/aspac-indirect-tax-guide-2016.pdf>  
<https://home.kpmg.com/xx/en/home/insights/2016/05/asia-pacific-indirect-tax-guide-2016.html>
- 42 M. Keen (2013).
- 43 in the sense that PIT is based on the aggregate value of all different income sources.
- 44 These countries were China, Indonesia, India, Japan, the Republic of Korea, Malaysia, Pakistan, the Philippines, Sri Lanka and Thailand.
- 45 I. Claus et al (2012).
- 46 NOREF Expert Analysis (2014), citing a statement by the FBR chairman in February 2013.
- 47 T. Piketty (2015).
- 46 Sri Lanka, India, Bangladesh, Pakistan and Indonesia all abolished inheritance/estate/gift taxes.
- 49 The tax is expected to affect fewer than 10,000 individuals and to mobilize between \$28 million and \$56 million each year. Global Legal Monitor (2016). Thailand: First Inheritance Tax in Decades Comes Into Force. <http://www.loc.gov/law/foreign-news/article/thailand-first-inheritance-tax-in-decades-comes-into-force/>
- 50 For example, transfer pricing, employing hybrid mismatch arrangements, avoiding permanent establishment status, etc.
- 51 As well as large corporations, wealthy individuals often take advantage of loopholes to avoid tax.
- 52 OECD (2015). Measuring and Monitoring BEPS, Action 11 – 2015 Final Report. OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. DOI: <http://dx.doi.org/10.1787/9789264241343-en>
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- 56 UNESCAP (2015). Gender Inequality and Women's Empowerment in Asia and the Pacific: Perspectives of Governments on 20 years of the Implementation of the Beijing Declaration and Platform for Action. ST/ESCAP/2726 © UN-ESCAP, Bangkok 2015.
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59 Asian Development Bank (2015). Women in the Workforce: An Unmet Potential in Asia and the Pacific. © 2015 Asian Development Bank, 1550 Metro Manila, Philippines.

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61 General Recommendation 21, paragraph 4.

62 Tax incidence refers to the division of tax burden among different groups. In other words, who bear the tax burden eventually.

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The information in this publication is correct at the time of going to press.

Published by Oxfam GB for ESCAP and Oxfam International under ISBN 978-1-78748-128-2 in December 2017. DOI: 10.21201/2017.1282

Oxfam GB, Oxfam House, John Smith Drive, Cowley, Oxford, OX4 2JY, UK.

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