International Growth Centre

Authors

Nora Lustig

Professor of Latin American Economics at Tulane University

Center for Global Development

Published on: 23 Jun 2015

Countries: Africa, Asia, International

Research themes: Inclusive Growth, Public Sector and Tax, State

A missing target in the SDGs: Tax systems should not reduce the income of the poor

Achieving the new Sustainable Development Goals will depend in part on the ability of Governments to improve their tax collection and enforcement systems. However, demand for investments into infrastructure and public services must be balanced against the competing need to protect low-income households that may otherwise be made worse off from misaligned tax and transfer policies.

Once adopted by the UN General Assembly in September of this year, the Sustainable Development Goals (SDGs) will commit countries to attain poverty and hunger eradication, healthy lives, quality education, gender equality and sustainable development. Countries will also commit to promoting full-employment growth, decent work, peaceful societies and accountable institutions as well as to reducing inequality and strengthening global partnerships for sustainable development.

One key factor to achieving the SDGs will be the availability of fiscal resources to deliver the floors in social protection, social services and infrastructure embedded in the SDGs. A significant portion of these resources is expected to come from the countries' own fiscal systems, complemented by transfers from the countries that are better off. The conference on Financing for Development in July this year will set the framework for where the resources to achieve the SDGs and other commitments endorsed in the numerous global and regional compacts will need to come from. The current draft states that "… For all countries, the mobilization and effective use of *domestic resources* [emphasis added] is at the crux of our common pursuit of sustainable development and achieving the SDGs… ."[2] Moreover, countries will be expected to set spending targets to deliver social protection and essential public services for all and set nationally defined domestic revenue targets.

As is typical with these exercises designed to identify priorities and commitments which the great majority of countries will need to endorse, the proposals shy away from acknowledging that goals have trade-offs. In particular, that raising additional revenues domestically for infrastructure, protecting the environment or social services may leave a significant portion of the poor with less cash to buy food and other essential goods. It is not uncommon that the net effect of all governments taxing and spending is to leave the poor worse off. The Commitment to Equity Project found that in, for example, Armenia, Bolivia, Brazil, El Salvador, Ethiopia and Guatemala, the number of

Brazil, El Salvador, Ethiopia and Guatemala, the number of poor people who are made poorer through the taxing and spending activities of governments exceeds the number who actually benefit from those activities (Lustig, 2015). This perverse outcome is the consequence of primarily consumption taxes—e.g., value added or excise taxes—. For example, the Brazilian tax system results in heavy taxes on such basic staples as rice and beans. For many households, transfers from Bolsa Familia are not there or are not large enough to compensate what they pay in consumption taxes (Higgins and Lustig, 2015). This is not the result of a "diabolical" plan: it is the outcome of targeting schemes which select households on their characteristics (poor with school-age children), a very complex cascading tax system and consumption patterns of the poor. In the case of Ethiopia, it is mainly the result of taxes on agriculture, even small-holder agriculture. The big risk in setting an ambitious domestic resource mobilization agenda is that in the process governments will impoverish poor people even further.

As it stands, the SDGs list of targets would not alert us of such a perverse outcome. Under Goal One on poverty reduction, there should be a Target 1.6: **"By 2020 to ensure that the tax system does not reduce the income of the poor."**