

## Dealing With Tax Populism

by Jeffrey Owens and Marta Olowska



Jeffrey Owens



Marta Olowska

Jeffrey Owens is the head of and Marta Olowska is a research and teaching associate with the Global Tax Policy Center at the Institute for Austrian and International Tax Law at the Vienna University of Economics and Business (WU).

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This article synthesizes the discussion that took place between Owens and Sergei Guriev during a September 18, 2019, fireside chat event by the WU Global Tax Policy Center. Guriev is a professor and scientific director of the master and PhD programs in economics, a research fellow at the Center for Economic Policy Research, and a member of the executive committee of the International Economic Association.

In this article, the authors discuss the rise of populism in recent years and its potential implications for taxation.

The year 2020 could mark yet another important milestone in the history of populism, with the presidential elections in countries such as the United States and Poland, final decisions

regarding Brexit, planned constitutional changes in Russia, and, of course, the economic, political, and social fallout from the COVID-19 pandemic.

The success of populist parties has been remarkable over the past 30 years. However, what is peculiar about the current situation, and which has not been the case historically, is that populism is spreading and sometimes becoming dominant among countries that are well-established democracies.<sup>1</sup> At a time when political scientists thought that democracy in places such as France and the United States was set in stone and would change little in the years to come, populism has become an unexpected part of the future.

During waves of the 19th and 20th centuries, populism either played a marginal role or became dominant in weak democracies, for example in Latin America.<sup>2</sup> The recent populist upsurge in the emerging democracies of Eastern Europe and in established democracies like the United States has exposed the political vulnerability of the rule of law as a cornerstone of liberal democracy. Citizens have grown restless, angry, and even disdainful of the state.

There can no longer be any doubt that we are going through a populist moment. President Trump's election to the White House has been the most striking manifestation of democracy's crisis. In Poland and Hungary, populist leaders are using those same strategies to hinder freedom of the press, to undermine independent institutions and courts, and to fight the opposition. A populist wave has swept across the democratic world, and it is interesting to consider what lies behind it, particularly the spread of tax populism. How has the trend affected political democracy in Europe

<sup>1</sup>For more, see Tito Boeri et al., "Populism and Civil Society," IMF Working Paper WP/18/245 (Nov. 2018).

<sup>2</sup>Rudiger Dornbusch and Sebastian Edwards, *The Macroeconomics of Populism in Latin America* (1991).

and elsewhere? Will it continue? If so, what are the implications for taxation?

### Populism and Tax Populism

The definition of populism in the field of political science follows Cas Mudde, who writes that “populism is an ideology that considers society ultimately separated into two homogenous and antagonist groups, ‘the pure people’ and the ‘corrupt elite.’”<sup>3</sup> Moreover, in the populists’ Manichaeian view, there is no intermediate space between these two groups. To present “the pure people” as a monolithic and homogenous group, not torn apart by conflict, populists tend to exclude (explicitly or implicitly) some groups from their definition of the term. The exclusion often refers to concepts of “elites” or “establishment.” Interestingly, the *Oxford English Dictionary* defines the term “populist” as “aiming to appeal to ordinary people.”<sup>4</sup> Therefore, populism should be an inherent part of democracy. However, the concept of “the people” is often directly connected to the nation, excluding groups like immigrants or ethnic minorities. It also denies class differences. The populist’s core claim also implies that whoever does not support the populist party might not be part of the pure people to begin with.<sup>5</sup>

What is emerging is the dichotomy between the ordinary pure people and the so-called corrupt elites. This construct automatically leads to successive radicalizations. Because it is often used to express a critique of political decisions in representative democracies, the adjective “populist” is often used to discredit the opponent or attack their contradicting ideas.<sup>6</sup> The core claim of populism is thus a moralized form of anti-pluralism, clearly opposed to the concept of liberal democracy.

<sup>3</sup> Mudde, “Government and Opposition,” 39(4) *The Populist Zeitgeist* 541-563 (Autumn 2004).

<sup>4</sup> The word “populism” goes back to the Latin term “*populous*,” which means “people” in a collective sense.

<sup>5</sup> See J. W. Müller, *What Is Populism?* 20 (2017).

<sup>6</sup> Daniele Albertazzi and Duncan McDonnell define populism as “an ideology which pits a virtuous and homogeneous people against a set of elites and dangerous ‘others’ who are together depicted as depriving (or attempting to deprive) the sovereign people of their rights, values, prosperity, identity and voice.” See Albertazzi and McDonnell, “Introduction: The Sceptre and the Spectre,” in *Twenty-First Century Populism: The Spectre of Western European Democracy* 3 (2008).

In general, the emergence of new political parties and their rise in power should be an indicator of democratic vitality and prosperity rather than an indication of crisis. Political systems are based on a competition between ideas and views and the gradual changes of those in power. The rise of new parties should be beneficial for society and the well-being of democracy. In particular, it should encourage greater participation in the democratic process, especially among younger members of society.

However, populists tend to look to the past instead of looking forward, often espousing a slogan of “making the country great again.” Their visions and ideas are often shortsighted. Their macroeconomic policy is expansionary, emphasizing the benefits of more public spending or lower taxes while playing down the adverse consequences of growing public debt or inflation. Latin American countries serve as a good example of this. Populist Latin American governments engage in expansionary fiscal and monetary policies, frequently with disastrous economic consequences.

This raises the question of why such an approach receives any political support in the first place. This is the background against which tax policymakers must analyze the rise of tax populism.

### Factors Increasing Interest in Tax Populism

Populist discontent has not bypassed taxation. It arises out of the manipulation of the tax law system by “vested interests” so that the rich are getting away without suffering any punishment, while common people bear the whole tax burden.<sup>7</sup> As U.S. Supreme Court Justice Oliver Wendell Holmes Jr. said, “Taxes are what we pay for civilized society.”

There are reasons for the emergence of tax populism. Some of these were discussed in detail by Jeffrey Owens and his guest Sergei Guriev during the 25th fireside chat at the Vienna University for Business and Economics on September 18, 2019. In addition to his career in academia, Guriev is the former chief economist of

<sup>7</sup> Irving Kristol, “Of Populism and Taxes,” 43 *Nat’l Aff.* 4 (Winter 2020).

the European Bank for Reconstruction and Development.

First, there is a widespread view that the effects of globalization — including international trade, capital mobility, and notably migration — along with the perception that the middle class is losing out, are key populist movement drivers. Dani Rodrik<sup>8</sup> argues that populism is a rational response to the shocks caused by globalization. Polarization of the job market, an increase in the outsourcing of major functions, and a change in the balance of power between firms and employees (combined with new technologies) have all contributed to growing inequalities.

The result is twofold: High-net-wealth individuals take an increasing share of national wealth,<sup>9</sup> and multinationals grow in strength. The latter has sparked a debate on whether multinationals pay their fair share of taxes (an idea that motivated the OECD base erosion and profit-shifting project). A 2014 study by Piketty, Saez, and Stantcheva concluded that income inequality has been worsened by a significant reduction in marginal tax rates on top incomes and that tax policy that seeks to reverse this must first broaden the base and close tax avoidance opportunities before increasing the top tax rate.<sup>10</sup>

Secondly, among the economic factors that trigger populism,<sup>11</sup> economic crises figure prominently. Because crises can lead to high levels of debt, unemployment, and stagnating incomes, they are considered another relevant factor in fostering tax populism. The 2008 financial crisis, the subsequent worldwide recession, and the outbreak of the debt crisis in the eurozone had harsh consequences for people who became unemployed or those who experienced a decline in their pensions or other forms of support — for example, as happened in Sweden and the United

Kingdom. Moreover, economists such as Guiso et al., Algan et al., Dustmann et al., or the EEAG report<sup>12</sup> argue that crises and the attendant economic insecurity undermine trust in institutions, in particular European institutions. Therefore, crises can inevitably lead to a debate about the failure of the ruling elites and the fact that the costs of the crisis are not borne by those deemed responsible for it.

However, as Guriev points out, some studies indicate that populism is generally not correlated with economic crises.<sup>13</sup> This claim is supported by case studies of Ireland and Iceland, which did not experience populism despite deep economic crises. Poland, however — which has not been affected by crises — has seen populists rise to power. It may therefore be argued that populist support may also have noneconomic roots, and the importance of economic versus sociocultural factors must be taken into account.<sup>14</sup>

Tax populism may be the response of a society losing its “collective consciousness.” It may be related to more fundamental views and values like a low tolerance of foreigners and different cultures and religions; simple lack of education; or a questioning of why the well-off should pay taxes to finance services for the less well-off. Democracy involves respect for minorities, rule of law, separation of powers, and social solidarity between different income groups. Robert D. Putnam argues that social capital, which was key in building U.S. society, has been declining since the 1960s. According to him, the decline in social capital has increased unhappiness and led to political apathy.

Trust in the system is of crucial importance. Whether people believe that the system is fair, and

<sup>8</sup>Rodrik, “Populism and the Economics of Globalization,” 1 *J. Int'l Bus. Pol'y* 12 (2018).

<sup>9</sup>For more, see Alicja Majdanska, Clement Migai, and Marta Olowka, “High-Net-Worth Individuals: The Challenge for Tax Administrations, Financial Intelligence Units and Law Enforcement Agencies,” 72(10) *Bull. for Int'l Tax'n* 595-606 (Oct. 2018).

<sup>10</sup>Thomas Piketty, Emmanuel Saez, and Stefanie Stantcheva, “Optimal Taxation of Top Labor Incomes: A Tale of Three Elasticities,” 6(1) *Am. Econ. J.: Econ. Pol'y* 230-271 (2014).

<sup>11</sup>For more, see Guriev and Elias Papaioannou, “The Political Economy of Populism,” Centre for Economic Policy Research Discussion Paper DP14433 (Feb. 22, 2020).

<sup>12</sup>Luigi Guiso, Helios Herrera, Massimo Morelli, and Tommaso Sonno, “Demand and Supply of Populism,” Einaudi Institute for Economics and Finance Working Paper No. 1703 (Oct. 1, 2017); Yann Algan, Sergei Guriev, Elias Papaioannou, and Evgenia Passari, “The European Trust Crisis and the Rise of Populism,” *Brookings Papers on Economic Activity* 309 (Jan. 2017); Christian Dustmann, Uta Schönberg, and Jan Stuhler, “Labor Supply Shocks, Native Wages, and the Adjustment of Local Employment,” 132(1) *Q.J. Econ.* 435 (Feb. 2017); and European Economic Advisory Group and CESifo, “The EEAG Report on the European Economy,” No. 16 (2017).

<sup>13</sup>Hanspeter Kriesi and Takis S. Pappas, eds., *European Populism in the Shadow of the Great Recession* (2015).

<sup>14</sup>For discussion, see Ronald Inglehart and Pippa Norris, “Trump, Brexit and the Rise of Populism: Economic Have-Nots and Cultural Backlash,” Harvard Kennedy School Research Working Paper RWP16-026 (Aug. 2016).

that government is delivering what citizens want and need in an efficient way are the factors of success. It is widely recognized that low levels of social capital directly influence confidence in government, decreasing voter turnout and the number of citizens active in politics;<sup>15</sup> high levels of social cohesion are likely to lead to better voluntary tax compliance.

Equally important is the rise of charismatic populist leaders, with more than a third of the population voting in recent elections for anti-establishment parties. A great part of this success can be attributed to the charismatic leaders these parties have selected. As Guriev stressed, only charismatic leaders make it to the center of attention. The reason populists and political newcomers are so willing to challenge basic democratic norms is in part tactical: Whenever populists break those norms, they attract the unequivocal condemnation of the political establishment. This of course proves that the populists really do represent a clean break from the status quo. There is therefore something performative about populists' tendencies to break democratic norms: While their most provocative statements are often considered politically incorrect, their very willingness to make such statements is a big part of their appeal.<sup>16</sup>

### Effect on Tax in Europe and Elsewhere

As Ralf Dahrendorf, former member of the European Commission, noted:

To stay competitive in a growing world economy [the OECD countries] are obliged to adopt measures which may inflict irreparable damage on the cohesion of the respective civil societies. If they are unprepared to take these measures, they must recur to restriction of civil liberties and of political participation bearing all the hallmarks of a new authoritarianism. . . . The task for the first world in the next decade is to square the circle between

growth, social cohesion and political freedom.<sup>17</sup>

After Brexit, the election of Trump in 2016, and a string of populist-candidate election victories in 2017 in Austria, Brazil, the Czech Republic, France, Germany, and the Netherlands, many observers predicted doomsday for democracy in the Western world. Reality has been less dramatic, but there is a sense of transformation inside and outside Europe. More voters support parties that challenge the status quo.

The Panama Papers, the Paradise Papers, and other scandals showed how the rich had been evading taxes. This is changing as the G-20 has pushed the tax transparency revolution forward. Today, high-net-wealth individuals cannot hide their assets offshore and corrupt politicians are less able to use opaque vehicles like trusts and holding companies to siphon off the resources of their countries. The BEPS initiative means that companies pay their fair share of taxes and do not locate profits offshore. But an unforeseen side effect of the G-20 actions has been the growth of tax populism, as discussed by Owens and Guriev. But taxes are also a tool in the fight against populism, and some of the success stories are indicated in the G-20 agenda.

For all these reasons, the impact of populism on tax policy is clearly visible. In France, President Macron has put a strong focus on environmental taxation. Italy and Spain have increased the progressivity of their tax systems. Nevertheless, most populist governments have changed their tax systems to become less progressive. This is demonstrated in moves away from highly progressive personal income taxes, inheritance taxes, and net wealth taxes. When this happens, tax systems become less effective in reducing inequality. As pointed out during the fireside chat, focusing on one particular tax to see whether it is progressive may not be the best approach. Rather, the analysis should take a holistic approach to the tax system. In fact, the correct approach is to ask what the overall impact is of government actions (taxes, regulations,

<sup>15</sup> For discussion, see Putnam, *Making Democracy Work: Civic Traditions in Modern Italy* (1993); or Putnam, *Bowling Alone: The Collapse and Revival of American Community* (2000).

<sup>16</sup> Yascha Mounk, *The People vs. Democracy: Why Our Freedom Is in Danger and How to Save It* 115 (2018).

<sup>17</sup> Ralf Dahrendorf, "Economic Opportunity, Civil Society and Political Liberty," United Nations Research Institute for Social Development Discussion Paper 58 (Mar. 1995).

expenditures) and how they influence the distribution of income and wealth.

The Nordic countries' experience indicates that introduction of a holistic approach is more sustainable. The radical transparency introduced there helps to dispel many myths, reflecting the openness of these societies and different attitudes toward confidentiality and privacy.

At the same time, new technologies offer approaches to taxing capital and wealth. The entire mechanism of paying taxes and compliance processes could be transformed, with compliance depending on peer pressure from civil society rather than enforcement from tax administrations. The goal would be gaining citizens' trust through increased transparency and government accountability.

### Can Governments Counter Tax Populism?

Populists tend to attract the electorate with the promise of tax cuts. They pay for the cuts by increasing prices of some consumer goods, often via some additional levy on delivery, import, or other transaction in the supply chain. Another strategy is to further reduce public spending. No matter which they choose to conduct first, the offer of reducing the tax burden is initially attractive but does not pay off in the long run. Rather, it ends up creating unsustainable public deficits, which in turn can lead to macroeconomic instability.

A better approach is to reform capital and wealth taxation and to reexamine excise taxes on luxury products. What is also crucial is to facilitate better tax compliance for both individuals and companies, and to ensure that public expenditure programs are effective and progressive.

As indicated in the OECD secretary-general's recent tax report to the G-20, the main goal is to allow tax administrations to better track income generated through the use of digital platforms, foster compliance by those active on the platforms, and avoid unnecessary compliance costs stemming from the proliferation of different unilateral reporting rules.<sup>18</sup>

The goal is to show that everyone is paying their fair share of taxes and to address the growing public concern over tax avoidance by multinationals.<sup>19</sup> Furthermore, this debate is not limited to corporate taxes, however, but also applies to consumption taxes. In summary, governments should stop supporting the strategy described by Russell B. Long as, "Don't tax you, don't tax me. Tax that fellow behind the tree."

Regarding tackling the expenditure side of the government budget, public spending must reflect the real needs of citizens and deliver programs efficiently. This can help counter tax populism because it leaves less space for a populist agenda.

Greater accountability could be achieved by a decentralization of expenditures and resources to lower levels of governments. As criticism of the EU suggests, it can be easier and more effective to have more power at the local level.

There remains, however, the question of how tax populism can be channeled into improving democracy. Fighting tax evasion, recognizing the need to introduce a fair tax system trusted by the public, and making sure that everyone pays their fair share are all ways of regaining trust in the tax system. Increased transparency complements that picture.

Finally, we should not be constrained by past perception. Instead, it would be better to reevaluate why we have taxes and how to make them more effective in a radically changing technological environment. The next wave of technologies could redefine the role of the state, how the state interacts with citizens, and how public goods are financed. With the use of technology, we have a better capacity to evaluate tax reforms and their impact, modeling them in advance before changes are introduced. The rise of populism will force us to conduct an in-depth review of our tax systems.

### Conclusion

Populist parties and political movements often bring to the discussion issues of relevance even though the solutions proposed may be counterproductive, because they fail to take into

<sup>18</sup> OECD, "OECD Secretary-General Tax Report to G20 Finance Ministers and Central Bank Governors," at 15 (Feb. 2020).

<sup>19</sup> Jamie Morgan, "Corporation Tax as a Problem of MNC Organizational Circuits: The Case for Unitary Taxation," 18(2) *Brit. J. of Pol. and Int'l Rel.* 463-481 (2016).

account trade-offs between different policy objectives. A coordinated action is therefore necessary at both the European and the global level to help generate synergies and internalize negative spillovers.

The EU has already become a strong actor in striving for fairer taxation systems, as exemplified by efforts to tackle profit shifting, tax evasion, and the erosion of tax bases; the emphasis on good tax governance; and the use of competition policy instruments to address tax benefits granted selectively to companies. The experience has

shown that where there is a political will, governments can reduce inequalities in income and wealth and improve tax certainty, all of which can lead to greater social cohesion and the decline of populism.

The question to ask is whether this populist moment will turn into a populist age — and cast doubts on the very survival of liberal democracy. Answering it could be difficult because of the complexity of factors driving populism. The international tax community has a role to play in this debate. ■