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TAXATION AS A FACTOR IN ECONOMIC INEQUALITY

ОПОДАТКУВАННЯ ЯК ФАКТОР ЕКОНОМІЧНОЇ НЕРІВНОСТІ

Introduction. Taxation is now seen not only as an instrument for generating income for state budget, but also as a regulation tool, as well as an instrument for achieving economic equality and stability within a country. That is why the impact of taxation on economic inequality had become such a popular topic. However, while the majority of authors cover the impact of taxation on economic inequality in the developed countries, the experience of developing countries often require local expertise to properly highlight. Thus, the aim of this study is to show the impact of taxation on economic inequality in Ukraine.

Materials and methods. In order to achieve the designated aims, the article was structured as follows: after the literature review there is an overview of currently available data including its sources. Unfortunately, the data available is found unfit for econometric modeling, and thus comparative analysis of Ukrainian tax rates against the tax rates of a selection of countries with similar Gini index was used, as well as the structure of tax income to state budget for 2018-2023 were used instead.

Results and discussion. Ukrainian tax rates appear to be generally lower than the EU average, although higher than in some of its neighboring countries. The majority of tax income comes from regressive taxes like value added tax, and Ukraine currently lacks progressive taxation of both personal income and corporate profit. Thus, Ukrainian tax system can be characterized as being regressive by design, i.e. taxing mostly the lower income brackets that receive official wages.

Conclusions. It can be reasonably concluded that prevalence of regressive taxes coupled with the majority of tax income stemming from regressive taxes results in Ukrainian tax system being a negative factor in economic inequality. The possibility of increasing taxation of the higher income brackets, however, is restricted by the ability of economic agents of that bracket to more effectively avoid taxes by changing their business activity jurisdiction. This leaves development of prevention mechanisms, including usage of modern technologies, as a promising direction of research.

Keywords: Taxation, Economic Inequality, Gini Index, Tax evasion

Вступ. Оподаткування наразі розглядають не тільки як засіб генерації бюджетних доходів, але і інструмент регуляції та досягнення економічної рівності та стабільності в країні. Тому тема впливу оподаткування на економічну нерівність наразі набула популярності. Однак більшість авторів концентруються на дослідженні впливу оподаткування на економічну нерівність у розвинутих країнах, в той час як для розгляду цього питання в рамках економіки, що розвивається, потрібна місцева експертиза. Таким чином, метою даної статті є висвітлення впливу оподаткування на економічну нерівність в Україні.

Матеріали та методи. Задля досягнення поставленої мети, дана стаття структурована наступним чином: після розгляду наукової літератури з теми проведено огляд доступних даних із деталізацією їх джерел. Нажаль, доступних даних недостатньо для проведення повноцінного економетричного моделювання, а тому натомість було проведено порівняльний аналіз ставок оподаткування та ставок оподаткування по вибірці країн із подібним рівнем індексу Джині, а також середніх по ЄС ставок відповідних податків, а також проаналізовано структуру податкових надходжень до зведеного бюджету за 2018-2023.

Результати і обговорення. Ставки оподаткування в Україні є як правило нижчими за середні значення по ЄС, однак вищими за ставки у деяких сусідніх країнах. Більшість податкових надходжень походить від регресивних податків, зокрема ПДВ, і наразі в Україні відсутнє прогресивне оподаткування доходів фізичних осіб. Це дає підстави стверджувати про регресивність дизайну податкової системи в Україні, тобто орієнтованої на оподаткування насамперед населення із нижчим за середній рівнем доходів, які отримують офіційну заробітну платню.

Висновки. Таким чином можна зробити висновки, що переважання регресивних податків укупі із фактом, що більшість податкових надходжень походить від регресивних податків, призводить до того, що в Україні оподаткування негативно впливає на економічну нерівність. Можливість збільшення оподаткування категорій населення із вищими за середній рівнем доходів, однак, обмежується більшою спроможністю такого населення до ухилення від оподаткування, в тому числі через перенос своєї ділової діяльності в інші юрисдикції. Це робить розвиток механізмів обмеження такої мобільності, в тому числі через використання новітніх технологій, перспективним напрямком для подальших досліджень.

Ключові слова: оподаткування, економічна нерівність, індекс Джині, ухилення від оподаткування

JEL Classification: E62, D63

Introduction. In addition to maintaining its primary function of filling the state budget, taxation is now considered an instrument for wealth redistribution within the society. Income equalization is seen as a crucial part of maintaining society's stability, stimulating economic activity via widening the consumer base and increasing population approval ratings, in addition to suppressing unwanted economic activity. While this topic as a whole is quite well-documented, including but not limited to historical retrospectives on impact of major tax reforms on both tax revenues and economic inequality, comparative studies of impact of different taxes on economic inequality, or even philosophical and moral works on designing a "righteous" tax system, dedicated to maximizing social justice, most of these works are based on data from developed countries. This approach leaves the impact of taxation on economic inequality in developing countries – which is currently of most use in countries like Ukraine – understudied and of secondary concern. Thus, the aim of this study is to show the impact of taxation on economic inequality in Ukraine.

Taking into account the sheer volume of available materials on the topic, this article is not meant to be a complete or comprehensive overview of taxation impact on economic inequality, and thus only the most relevant articles will be referenced. In this context, relevant are the articles that either relatively new, have useful insights into the nature of taxation and inequality interrelation, or have valuable structural or methodological components that can be replicated. For instance, a study of impact of tax reforms on economic inequality in the US (Troiano, 2017), challenges the preconception that increase in tax burden is ought to reduce economic inequality. The supposed mechanism of such transition functions as follows: additional budgetary income facilitates increase in state spending, which directly addresses the wealth and income inequality via social transfers. In practice, the result of three major tax reforms studied (namely, introduction of personal income tax, introduction of tax withholding bundled with third-party reporting and introduction of intergovernmental audit exchange agreements between federal and state governments) had the effect of increase in economic inequality across the board. The mechanisms of such increase (economic migration, overburdening the middle class and transforming individual income into corporate income respectively) do not match, however, and this leaves the reasons behind it open for interpretation. The likely explanation comes from the mismatch between increase in tax income and public spending, which was out of the scope of his article. These US trends do not match the Latin American trends described in another article (Martorano, 2018), which was dedicated to study of interrelation between the taxation and economic inequality in Latin America. Author substantiated that increase in direct taxes (i.e. on personal income, corporate profit and capital gains) consistently correlates with decrease in economic inequality in different Latin American countries. The reason behind it was due to decrease of the income gap between the rich and the middle class. Therefore, either the Latin American governments managed to tax the rich more efficiently than the US, or the starting points of the reforms were so far apart that even a moderate taxation of the highest income bracket had shown a visible increase in the main inequality metrics. There may be another reason for such trends (Biswas, 2017). Having studied the interrelation between inequality and economic growth, the authors conclude that taxation affects different strati of income asymmetrically. Namely, decrease of the gap between different economic agents via the progressive taxation stimulates the economic activity of households with median or below median level of income, while the households with higher level of income reduce their economic activity. As the gap between the median and above median income decreases, so does the country's GDP due to the decline in small business activity and decrease in economic activity of women with above median income. This conclusion is consistent with the conclusions from another study, dedicated to the impact of taxation on economic inequality in the US (Avi-Yonah, 2014). The author concludes that progressive taxation has a greatly reduced impact on income inequality in the US (measured by Gini Index) starting from 1979, when the apparent saturation point was reached. Starting from 1986 author cannot confirm the existence of taxation impact on reducing the inequality at all, with all of the existing effects being contributed by the social transfers instead. The author argues that the reasons behind it are in the design of the US tax system, which is oriented mostly towards taxing the individual income, which, in turn, creates the incentive towards tax avoidance among the demographic that is the most capable of tax avoidance in the modern conditions. That is, it is no longer possible to set the effective tax rate for the rich at 70% (as it was in 1980), as the rich can instead just emigrate to less restrictive tax jurisdictions and/or move their business to offshore. Thus the author concludes that the marginal rate for taxing profits in the US had been reached, and any further decrease in economic inequality can only be achieved by increase in social transfers. This, however, poses another problem, for such increase needs additional sources of financing – which the authors sees in introducing federal value added tax. His assessment is that increase of social spending made possible with introduction of value added tax will counteract the regressive effect of the tax itself, a rather optimistic perspective, which is not supported by the data from countries that actually have a value added tax. For instance, the paper on "righteousness" of the Croatian tax system (Skalamera, 2016), focused on answering the question whether or not said tax system is designed for promoting economic equality, quotes the prevalence of value added tax income in total tax income as an example how Croatian tax system is actually regressive. The other arguments the authors use are the comparably higher rates of personal income tax over corporate tax, and a slew of legal mechanisms that can be used to reduce tax burden, which were introduced as a way to stimulate economic activity. Some authors argue, that in order for the tax system to be truly progressive, a wealth tax must be levied (Tadem, 2023; Pysmenny, 2010). On the other hand, other authors (Davies, 2002) argue that progressive and proportional taxation are interchangeable, since for every progressive taxation scale there is a proportional tax rate that achieves the same impact on income equalization.

Therefore, the current consensus is that the degree, to which taxation can currently affect the economic equality, is mostly limited by the ability of the rich to not pay taxes, which leaves the social transfers as the main mechanism for reducing economic inequality. Sustaining social transfers, however, require increase in tax income, which is achieved by introducing and maintaining regressive taxes such as value added tax. Many authors emphasize this point since the efficacy of social transfers in mitigating economic inequality had been steadily increasing across 15 OECD countries during 1982-2013 (Caminada, 2019), as well as in the US during 1970-2010 (Avi-Yonah, 2014). Some disagree, however, quoting the increase in taxation efficiency in equalizing household income in OECD countries during 1999-2016 (Guillaud, 2020). The difference in conclusions stem from the difference in methodology, the first two studies used total households' income data, while the last one excluded pensioners from the sample to concentrate on working households.

Tax evasion, especially by the rich, is also widely documented. For one, a study on tax evasion in Nordic countries (Alstadsæter, 2019) substantiates that the 0,01% of the richest populace has 13 times higher probability of tax dodging than the richest 1% of populace, and is able decrease their effective tax rate by 25%. Another study, dedicated to in-depth analysis of the impact of modern technology on the tax avoidance (Alm, 2021), concludes that only people with access to the cutting edge technology and skills to use it can consistently succeed in tax evasion. Other authors, however, argue that the growth in economic inequality is being over-estimated due to flaws in methodology, such as not taking into account increase in number of subjects of taxation due to families dispersing into individual tax subjects, as well as narrow definitions of household income, which do not account for social transfers (Auten, 2024).

As was mentioned before, the impact of taxation on economic inequality in Ukraine remains somewhat understudied. There is an overview of level of economic inequality in Ukraine in comparison to the EU countries measured by Gini index, which is indeed one of the lowest in the world, and hypothesizing how to reconcile apparent low level of economic inequality with commonly known but poorly documented high level of wealth inequality in Ukraine (Markina, 2022). The author correctly assumes the explanation to lie in high levels of shadow economy, which generate income that is not shown by the Gini index, since it is calculated based on official data. Another similar study focuses on the end expenses of Ukrainian households during 2010-2015 in order to substantiate the existence of high levels of economic inequality in Ukraine, which is, however, not captured by the official sources due to standard inequality indices not taking into account the difference between the income of richest and poorest households (Fomina, 2016). Another study, focused on mathematical interrelation between progressive taxation and Gini coefficient in Ukraine, provides a formulaic solution for such an interrelation, which allows to calculate target taxation level based on target Gini coefficient, and vice versa (Merkulova, 2017). These studies, however, do not directly address their topic, since they don't take into account the design of Ukrainian tax system and distribution of tax income. Therefore, this study will supplement these results with basic assessment of ability of Ukrainian tax system to promote or maintain economic equality.

Materials and methods. The data used in this article was mostly taken from official Ukrainian sources. The current Ukrainian tax rates were taken from the official State Tax Service of

Ukraine website[1]. For tax shares calculations, the data was taken from the Open Budget web portal[2]. Tax shares were calculated as the share in total tax revenue. Tax income data is available from 2018 to 2024, although the data points from 2024 are not yet available for a comparable period due to 2024 not having ended yet (i.e. it is currently available from January to August, as opposed to January to December for the rest of the years), and can only be seen in graphic format. For Gini Index, World Bank Open data platform[3] was used. Unfortunately, the latest available data is from 2020. Thus, for any data points beyond 2020, the forecasts from Statista.com[4] were used. For tax rates and other relevant information, Deloitte Tax Guides and Highlights[5] was used. This makes the intersection between these two data sets insufficient for purposes of econometric modeling since it only consists of three consecutive periods of observations. Additionally, since Gini Index during this period is mostly unchanged (see table 1), thus it cannot be used as a dependent variable, as it is common.

The summary statistics on available data can be provided as follows:

Table 1

Summary statistics

Indicator	Mean	Median	Standard Deviation	Minimum	Maximum
Gini Index, %	26.0	26.0	0.35	25.60	26.60
Tax Income, %	74.69	81.89	14.14	57.77	87.46
Personal Income Tax, %	24.92	25.85	6.85	12.17	31.32
Corporate Profit Tax, %	10.82	10.69	1.17	9.72	12.85
Excise Tax, %	12.45	12.6	2.36	8.59	15.77
Value Added Tax, %	37.91	35.42	5.81	34.77	49.68

Source: Author's calculations based on (World Bank Open Data Platform, Statista.com, Deloitte Tax Guides and Highlights)

As can be seen from the table, the Gini index had changed for exactly one percentile point during 2018-2023; and while there is visible volatility in total tax income during this period, both in total and by different taxes, attempts at building a regression model using Gini index as a dependent variable result in a regression with R squared of one, and none of the variables being significant.

Due to the fact that the available data is insufficient for econometric modeling, the analysis of impact of taxation in Ukraine on economic equality will be conducted by comparing the main Ukrainian tax rates to their counterparts from countries with similar levels of income inequality, while the structure of tax income in Ukraine will be shown to illustrate the shares of progressive and regressive taxes.

Results and discussion. Ukraine is in the top ten countries worldwide by its Gini index, with its values being firmly within 25-26 range for the last five years. This means that distribution of the official income is rather equal, however, this indicator doesn't take into account neither the existing wealth disparity between individuals nor the unofficial income, that is relatively common in Ukraine. Therefore, the low levels of Gini Index alone are not completely representative of economic equality, which can be seen from grouping of countries by Gini index (table 2).

[1] URL: https://zir.tax.gov.ua/main/index/stavki (Accessed 2.11.2024)
[2] URL: openbudget.gov.ua/national-budget/incomes (Accessed 2.11.2024)
[3] URL: https://data.worldbank.org/indicator/SI.POV.GINI?locations=UA (Accessed 2.11.2024)
[4] URL: https://www.statista.com/outlook/co/socioeconomic-indicators/ukraine (Accessed 2.11.2024)
[5] URL: https://dits.deloitte.com/#TaxGuides (Accessed 2.11.2024)

Table 2

Comparative tax rates of the top countries by Gini Index, 2024

State	Gini Index	VAT, %	Income Tax, %	Corporate Tax, %	Inheritance and Gifts tax, %
Norway	22.7	0/12/15/25	0/1.7/4/13.6/16.6/17.6	22	N/A
Slovakia	23.2	0/5/10/25	19/25	15/21	N/A
Slovenia	24.0	0/5/9.5/22	16/26/33/39/50	22	0-39
Ukraine	25.6	0/7/14/20	0/5/9/18+1.5	18/25/50	0-18
Moldova	25.7	0/8/20	12	12	N/A
Netherlands	26.0	0/9/21	36.97/49.5	19/25.8	10-40
Belgium	26.0	0/6/12/21	25/40/45/50	25	3-80
Czech Republic	26.2	0/12/21	15/23	21	N/A
EU Average	N/A	22	37	22	23

Source: compiled by author based on (State Tax Service of Ukraine website, Deloitte Tax Guides and Highlights)

There are two distinct kinds of countries present: old European countries like Belgium and Netherlands, which tend to have relatively high levels of wealth redistribution via the state budget, and accordingly high tax rates, and new European countries like Ukraine and Moldova, which, at least on paper, have rather low tax burden coupled with high social spending. In the latter case low Gini index shows mostly equality in poverty – a surprising conclusion, given that, for instance, the average cost of the cars found on the roads of Kyiv is well above that of any European capital. The reason behind this is the high levels of shadow economy in Ukraine (Markina, 2022, p. 13), since the Gini index is calculated based on official income, which is indeed equally low for Ukrainian citizens, and is highly dependent on social spending.

The second significant part of the table is the comparative sets of tax rates per country. The table includes both the main rate and the special rates, except for the inheritance tax, which only shows the minimum and maximum rate due to abundance of possible taxation variants. Personal income tax rates generally show different taxation for different levels of income, except for Ukraine, where different rates are applied to different sources of income – including selling of property, dividends and inheritance. That is, if, for instance, Norway, has 6 income brackets with different tax rate, Ukraine has a flat 18% tax rate for personal income plus 1,8% of wartime tax, with an option for an exemption (0% income tax rate) if one's official wage is less than 50% of a living wage, which in practice can only apply for a part-time worker who filed a request for it, and the 5% and 9% rates are applicable for dividends, receiving inheritance and selling valuable property under certain conditions. That also means that receiving inheritance is considered personal income and is not governed by a special inheritance tax. Thus, while it may look like Ukraine has progressive income tax, it doesn't. It is also worth noting that Ukraine has one of the lowest VAT tax rates on the list, and a main rate for corporate profit tax second only to Moldova. The rates of 25% or 50% are exclusive to banks, and are temporary wartime rates[6]. Thus, it can be concluded that on paper Ukraine has one of the less overall restrictive tax systems among its peers grouped by Gini index. However, by design, Ukrainian tax system is mostly regressive, with no progressive personal income tax, low-ceiling

[6] URL: https://zir.tax.gov.ua/docs/stavki/podatok_na_pributok_pidpriemstv.pdf (Accessed 2.11.2024)

corporate tax (which was introduced in order to stimulate business activity), no wealth tax and low-ceiling inheritance tax.

In a sense, a question whether or not Ukrainian tax system supports economic equality is unfair – since its design stems from the time when equalizing profits wasn't seen as a goal for taxation, and the structure of tax revenues reflects that (Fig. 1).

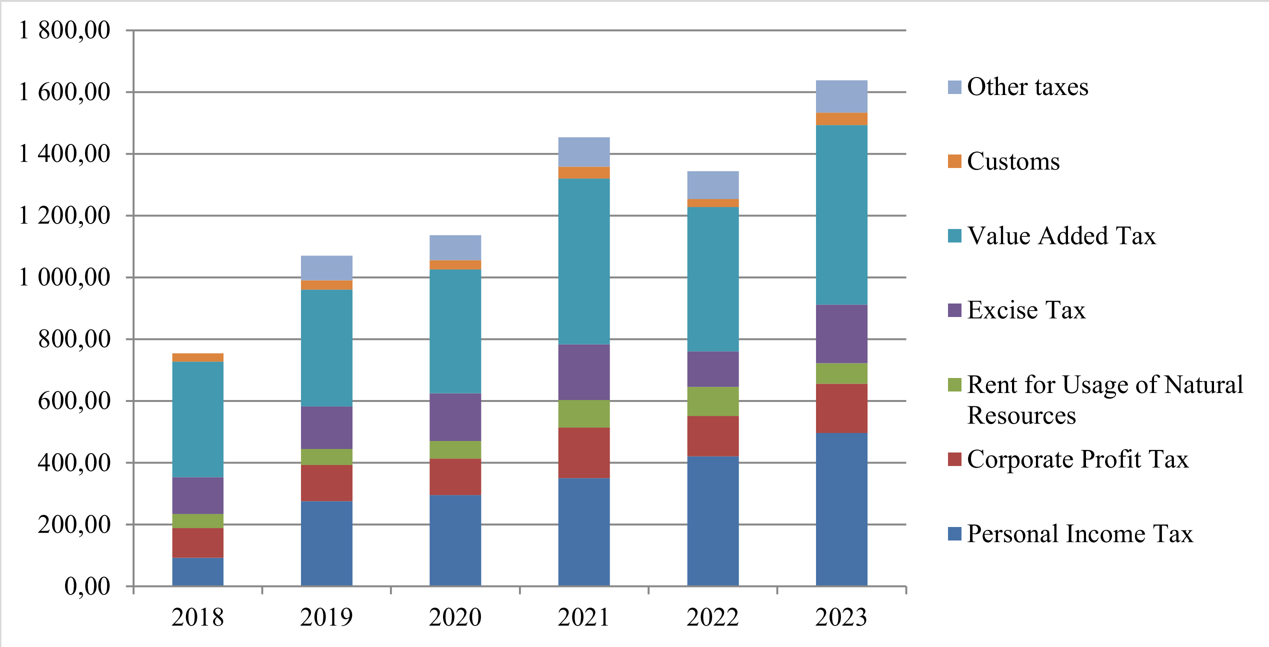

Figure 1. Tax income structure in Ukraine, 2018-2023
Source: author's calculations based on (Open Budget web portal)

The majority of tax income is received from value added tax (specifically from value added tax on imported goods), with second highest-grossing source being personal income tax. Corporate profit tax is third on the list, almost tied with the excise tax, which shows the extent to which local business can be persuaded to pay taxes. The rent for usage of natural resources is fifth income-wise, and then goes the customs and finally the "other taxes", which mostly consist of ecological tax. Value added tax is generally considered a regressive tax (Skalamera, Rubinic, 2016, p. 465), and as was previously established, Ukraine doesn't have a progressive personal income tax. The tax revenue, however, remains the main source of financing the budget, accounting for 80 and more percent of total budget income starting from 2018, only to be reduced to 61% in 2022 with the advent of a full-scale war. The difference in state income was compensated mostly by foreign aid, and with the perspective of decline in said aid, the taxes will likely have to cover the upcoming deficit. This paints a picture of economy that struggles to make money, since the only the lowest income bracket is being fully taxed. Increasing taxing of the higher income brackets and taxing of corporate profits would be a clear step towards income equalization and fulfillment of ability to pay principle, that is that the economic subjects in the same position should pay equally, but the economic subjects in different positions should pay differently – with higher pay corresponding to higher income.

This, however, faces the widely documented problem of tax avoidance by the richest strata of the population (Avi-Yonah, 2014; Alstadsæter, Johannesen and Zucman, 2019; Alm, 2021). The abnormally low tax income from corporate income taxe shows that the majority of Ukrainian business had either stopped functioning or migrated to less restrictive jurisdictions, namely off-shore ones like Cyprus, which is obvious from the fact that the majority of direct foreign investments to Ukraine originate from there[7].

Conclusions. Based on a thorough literature analysis, coupled with the review of Ukrainian approach to taxation, both in theory and practice, it is possible to conclude that Ukrainian tax system

[7] URL: https://me.gov.ua/Documents/Detail/9cb46b66-6285-4f7f-a08e-f450f32f0cb2?lang=uk-UA&title=InvestitsiinaDiialnistVUkrainiZa1-Kvartal2024-Roku (Accessed 2.11.2024)

is regressive by design, i.e. it consists mainly of regressive taxes that fully cover only the low-to-mid income segment, namely the people who receive official wages. Therefore, it negatively affects economic inequality in Ukraine.

The rates for taxing corporate income are kept lower than the EU average (which is around 22%) in order to stimulate business to return from off-shore jurisdictions and/or to start paying taxes officially, which doesn't exactly work, as is obvious from the share of total tax income that corporate profit tax contributes. The reason for this lies in the fact that off-shore jurisdictions still have lower corporate tax rate (for instance, in Cyprus its around 12,5%), while such jurisdictions generally provide better privacy, property rights protection and, due to the current ongoing invasion, security.

And while introduction of a progressive income tax, wealth tax and/or increase in corporate profit tax would have theoretically both made the tax system more progressive and provided more tax income to the state budget, the practical outcome would likely be much less positive. Namely, instead of paying the increased taxes, the people of higher income bracket and businessmen would simply cease their economic activity and move their assets towards other jurisdictions, likely escaping in process, despite the current travel ban for men who are subjects to mobilization. This means that the main problem is not the design of tax system (which has generally lower than EU average tax rates), but the mechanisms of enforcing taxation, which only work for people who receive official wages.

Therefore, there needs to be better information control (which is currently attempted via digitalization initiatives), and thus measures must be taken to research the capabilities of currently emerging new technologies (for instance, blockchain) and the potential of their application in taxation.

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