The redistributive effects of Personal Income Tax reforms during the Great Recession in Spain

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Abstract
In recent years, a variety of tax reforms aiming for fiscal consolidation have taken place in Spain. This has been regarded as crucial when the economic crisis is strongly hitting the Spanish labour market and the unemployment rate has boosted largely over 17 percent since 2009. In fact, public expenditures in the last three years have grown strongly due to the expenses on unemployment benefits and other welfare state protection programs. Regarding Personal Income Tax (PIT) most changes introduced have generally implied more tax brackets and larger tax rates for medium to high incomes. So far, however, little is known about the impact these changes may have had on the income distribution. Making use of the tax-benefit model for the European Union – EUROMOD – this paper undertakes an evaluation of the redistributive effects of the Personal Income Tax (PIT) on the distribution of personal disposable income in Spain in the period 2005-2011 and evaluates the recent 2012 PIT reform.

Keywords: personal income tax, redistribution, microsimulation, Spain.

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Introduction

Personal tax payments and a large list of benefits play a predominant role within governmental monetary redistributive policies in the aim of equalizing household effective disposable income in Spain. During the last decade of the past century and the first years of this current century most tax reforms in this country were conducted following the OECD trend of a reduction in the number of tax brackets and of the maximum tax rate. Thus, most generally, the role of changing household disposable income in order to decrease household income inequality was moving more and more from the action of personal income tax to that of monetary benefits. In fact, in 2005, old-age pensions was the most equalizing monetary policy in Spain followed by unemployment benefits, while the action of the personal income tax was only a 10 percent of the Spanish Gini coefficient that year.

In recent years, particularly since the beginning of the Great Recession in 2008, due to the need for a reduction of government deficit there have been a variety of tax reforms and expenditure cuts aiming for fiscal consolidation in many southern European countries. In the case of Spain, fiscal consolidation has been regarded as crucial when the economic crisis has been hitting the Spanish labour market most strongly and the unemployment rate has boosted largely over 17 percent since 2009. In fact, public expenditures in the last three years have grown strongly due to the expenses on unemployment benefits and other welfare state protection programs.

At the same time, during these years of deep economic crisis the level of inequality in household disposable incomes in Spain has been continuously rising in contrast with what had been happening in the last decade when the evolution of inequality was most stable. The stability of disposable income inequality in previous years was most likely a result of a decrease in market income inequality cohabiting with a fall in the redistributive impact of government action as a result of the several reforms of the personal income tax and the stability of government monetary transfers. In this setting, both regional and central governments have introduced personal income tax changes during the last two years in order to increase tax collection and thus with a completely different aim in comparison with that of previous reforms. In general the reforms have
implied more tax brackets in many regions and increasing tax rates for medium to high incomes.

So far, however, little is known about the impact of these changes in personal income tax on the Spanish income distribution. In this paper, making use of the tax-benefit model for the European Union – EUROMOD –, we undertake an evaluation of the redistributive effects of the Spanish Personal Income Tax (PIT) on personal disposable income in the period 2005-2011 and assess the particular impact of the recent 2012 PIT reform.

The structure of the paper is the following. The next section describes the structure of the Personal Income Tax in Spain and details its main reforms put in place in recent years. Section 2 presents the methodology we follow in order to evaluate the redistributive effects of the PIT in Spain and Sections 3 and 4 include all our results. The last section concludes.