Fiscal Policy and Its Impact on Poverty and Inequality

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Abstract: The purpose of the study is to update the concept of fiscal instruments in order to reduce inequality, which will improve fiscal policy in the face of changing socio-economic trends. In the context of criticism of the neoliberal movement, the growing influence of demographic problems, the decrease in the incomes of the middle class, the increase in automation that frees up labor resources, the instability of the dominant paradigm of economic development, becomes obvious. Growing inequality has a negative impact on economic growth, carries serious risks for the political stability of state, and creates the preconditions for the growth of populist sentiments in developed countries and the strengthening of authoritarian tendencies in developing countries. The research objective is to identify the consequences of the use of individual tools and their combinations. The article presents the results of the study of foreign experience in the use of fiscal instruments, defines the nature of the impact of global trends on the growth of poverty and inequality and ways to reduce them. The results of the research in theoretical terms are expressed in ordering the world experience of using fiscal instruments to reduce poverty and inequality and systematizing ideas about the possibilities and limitations of the state in determining the fiscal course under the influence of global trends. The significance of the study lies in the possibility of identifying imbalances in the application of fiscal instruments in the Russian Federation in comparison with world experience and the development on this basis of practical recommendations for the implementation of a balanced state policy of regulating socio-economic development.

1 INTRODUCTION

At present, the scientific community and the professional community are trying to revise the neoliberal economic approach prevailing in many aspects on the international scale of the movement of goods and capital and the inequality it generates, both among countries and the social groups in these countries. The prerequisites for these trends were fundamental changes in the structure of the world economy and the accumulated contradictions that exacerbated during the spiral of recessions caused by the global economic crisis of 2008 and the COVID-19 pandemic in 2020.

Since the 1980s, the neoliberal direction is becoming one of the dominant economic doctrines in the world due to the growing influence of international financial institutions such as the International Monetary Fund and the World Bank. The developing countries in order to obtain stabilization loans often were forced to undertake obligations to reform their economies in accordance with the requirements of these creditors.

The neoliberal approach, focused on economic freedom, envisages the elimination of trade barriers to expand free trade, deregulation of industry, and privatization of state-owned enterprises, cuts in public expenditures, which should ultimately contribute to increasing economic activity, building efficient supply channels, balanced economic growth

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and the diffusion of technological innovation. At the same time, government intervention in economic activity of economic entities in any form is undesirable.

Over the past four decades of the neoliberal transformation of the world economy, there have been structural changes in both the economy itself and the deepening of global and local inequality. In addition, fundamental contradictions arose among the neoliberal economists themselves.

Practice has shown that by transferring production facilities to developing countries, corporations significantly reduced their labor costs due to lower minimum wage requirements in these countries, lack of compensation for overtime work and underdeveloped mechanisms for protecting workers' labor rights. In conditions of low labor protection requirements, workers have to perform their work duties in unsafe conditions, they expose themselves to the risk of injury, since meeting all safety requirements reduces the final output. Workers are often in direct contact with pesticides and various toxic chemicals.

In addition to benefiting from the exploitation of natural resources and cheap labor, corporations in developing countries also benefit financially from low taxes and underdeveloped environmental legislation. Developed countries export environmental pollution outside their territory not only by physically relocating production, but also by removing used household appliances and plastic waste, saving on recycling costs. In fact, globalization has exempted corporations from their obligations to comply with strict rules and regulations in force in the countries of export. At the same time, they get the possibility of obtaining additional financial benefits, which are spent not to remunerate employees or implement environmental measures, but to reward shareholders by revising dividends upward or buyback of shares. Ultimately, these processes contribute to increasing inequality.

Possessing significant financial resources and the ability to influence lawmaking in many countries, the top management of corporations is not directly interested in solving the problem of inequality, since they are fully aware that the current state of affairs allows them to maintain status quo.

Neoliberal reforms in the former socialist countries involved privatization and reduced state participation in property management. At the same time, the social nature of the formation of privatized assets was excluded from the calculation. In accordance with the socialist principle "to each according to his work" assets were formed taking into account the fact that economic entities will receive a kind of dividend from these assets in the future in the form of material benefits generated by the created funds in proportion to their contribution to the reproduction process. However, in the course of privatization, socialist assets were appropriated by a narrow circle of people to the detriment of the interests of those who created these assets (Table 1).

Table 1: Proportion of former socialist billionaires who have made their fortunes through political connections and access to resource extraction.

Country	Percentage of total
Georgia	100
Romania	100
Russia	64
Ukraine	56
Czech Republic	50
Poland	20

(Freund, 2016)

Neoliberal economists believed that trade liberalization could make domestic producers more competitive. In reality, however, the producers were unable to resist imported products, which could be largely subsidized. In the case of agriculture, the neoliberal approach has made small farmers in developing countries more vulnerable and exacerbated food security risks.

Economists note that the introduction of a free market economy has failed to attract foreign investment to African countries or to bring them the sustainable growth, and the application of a standard set of free market mechanisms has contributed to the formation of "unprecedented poverty" in many countries (Birsen, 2020). According to Credit Suisse, the richest 1% of the population owns 43% of the world's wealth, in Russia this figure is 57% (Global wealth report, 2020).

According to the Federal Reserve, the richest 1% of Americans own 53% of corporate shares and investment funds, while the bottom 50% of Americans own only 0.6%. They own real estate worth more than half of American families do.

The neoliberal approach significantly weakened the function of redistributing wealth and changed the relationship between the state and society. The main role of the state shifted from providing social services and programs to the population towards supporting large corporations, which became the engines of economic growth, which, in turn, provided the formation of instruments of protection the well-being of the elite from the encroachments of the population with low incomes.

Neoliberal theory views inequality as a natural phenomenon and poverty as an unfortunate coincidence. Hayek believes that there are no barriers for the poor to get rich in a free market system. Friedman has a similar opinion. Unlike Hayek, who assumed that a system of free markets would ultimately lead to inequality in society, and inequality drives people to achieve well-being, Friedman believed that inequality would decrease as capitalism developed. Hayek and Friedman oppose that the state should promote social justice by supporting low-income groups through income redistribution and the provision of public social services, as this creates injustice and forces people to spend their money in the interests of others. Hayek believed that the progressive taxation aimed at equitable income equalization actually contributed to inequality of subjects. In addition, he believed that the increasing government spending on social services would increase government debt, which would ultimately lead to higher poverty instead of greater equality. Thus, the seemingly noble goal of achieving equality will not only lead to greater inequality, but also to the loss of freedom due to the growth of public debt.

Stigler takes the opposite point of view. In his opinion, the state should regulate access to resources, which can cause large differences in income. It is possible to achieve equalization of labor incomes through access to various educational systems, increasing labor mobility, strengthening labor rights, and providing medical care to the low-income segments of the population. Stigler advocated an increase of inheritance tax. Globally, 30% of billionaires inherited their wealth (Freund, 2016), which makes people not only unequal, but also provides the heirs with greater opportunities to achieve well-being compared to their peers, if all the other things are equal. Knight, supporting Stigler, noted that social and economic inequalities are not limited to just one generation, flowing from one generation to another through the transfer of inheritance and benefits. Knight believed that the stratification of society greatly reduces the level of its overall satisfaction, and the complete economic freedom of rich people, who have obvious advantages, is destructive because rich people can use their wealth to become even richer.

Based on the foregoing, the main attention of the authors of the current study was focused on the problem of accumulation and maintenance of global imbalances that cause an increase in poverty and inequality. The hypothesis of the study is the provision that the current stage involves the readjustment of tax policy and the system of granting subsidies in order to level the consequences of the impact of global trends. Based on the study of materials from leading financial institutions of the countries of the world, an attempt was made to streamline the directions of development of fiscal instruments and identify their specifics.

2 MATERIALS AND METHODS

In the course of the work, general scientific methods of theoretical research were used:

– induction to observe the application of individual fiscal policy instruments and to form, on this basis, the hypotheses about the patterns of its influence on socio-economic processes under the influence of global trends;

– deduction for the dissemination of general patterns of the impact of fiscal policy on certain areas of socio-economic development and further formulation of recommendations to improve the distribution of income between various social groups;

– analysis to identify and study individual instruments of tax regulation and the social security system for vulnerable groups of the population;

– synthesis to form a holistic view of the mechanism of the impact of fiscal policy on reducing inequality.

The instruments of fiscal redistribution of incomes in different countries were monitored; a comparison is carried out aimed at identifying similar and different features in the consequences of the use of the considered tools. The application of the description method consisted of recording the results of observation and the formation of key characteristics that determine the consequences of the application of fair taxation instruments. In addition, general logical research methods were used – abstraction, generalization, idealization, analogies – in order to identify the patterns of changes in poverty and inequality and the consequences of the use of fiscal regulation tools.

3 RESULTS AND DISCUSSION

A number of studies indicate that inequality negatively affects the rate of GDP growth and the sustainability of a country's economic development. The income growth of the richest 20% of citizens by 1 percentage point over the next five years reduces the GDP growth rate by 0.08 percentage points, while income growth of the 20% poor population, on the contrary, increases GDP by 0.38 percentage points (Dabla-Norris, 2015). A 1-percentage point gain in the Gini coefficient over the next five years reduces a country's GDP per capita by 1.1% (Brueckner, 2015).

The growing influence of the wealthy part of society, while the income of the rest stagnates, leads to economic crises. In particular, studies assert that the steady rise in inequality in developed countries led to the financial crisis through lobbying by a small group of individuals for indulgence in the mortgage sector.

Growing inequality undermines citizens' confidence in the state, can lead to social instability and to the decrease in investment activity. Initially, globalization made a small contribution to the rise in inequality, but structural changes in technology have changed the economic order. The labor market has changed, the demand for medium-skilled labor has decreased, and the demand for highly skilled, higher-paid professions has grown. The following changes can be identified that have an impact on the request for a change in the neoliberal paradigm:

1) Demographic changes

The aging of the population and the decline in the birth rate are forcing governments to increase social spending (Table 2). Since 1990, in OECD countries, the proportion of the elderly (over 65) has increased from 11.6% of the population to 17.2% in 2018; the proportion of children (under 15) has decreased from 22.54% to 17.69% over this period.

Table 2: Share of social spending in OECD countries.

Expenditures	Percentage of expenditures from GDP	
	1990	2019
Social expenses	16,5	20,0
including		
Old age	5,7	7,4
Health	4,3	5,6
Family	1,6	2,1

Source: https://www.oecd.org/social/expenditure.htm

If earlier the growth of social spending depended on the party composition of the government, today social policy is dictated primarily by socio-economic conditions (Wulfgramm, 2016).

Health care costs are rising because of technological and medical advances, as well as of demographic changes.

Family social spending is now taking on a broader meaning: education and gender equality. The bias towards community childcare has at least two mechanisms. First, the state takes on childcare responsibilities and promotes the involvement of mothers in the labor market. Second, in the long term, high-quality community childcare can fulfill important social functions by promoting equality of opportunity, especially for children from low-income families.

2) Automation and digitalization

There are two key reasons why changing technologies are contributing to worsening income inequality. First, automation raises wealth inequality through increased capital income. Secondly, automation leads to stagnation of wages with the increase in profits. The key to understanding both results is that the long-term capital supply will grow (Arkadeva, 2021). Automation increases the demand for capital in relation to labor and, as the supply increases in accordance with demand, the income from capital will constantly increase the wealth of the owners of capital. The condition of households that have the opportunity to receive an increased income from owning assets is growing at a faster pace.

The well-being of households focused on receiving income from wages tends to stagnate. When productivity increases because of the introduction of new technologies, the additional value added will be transferred to the owners of capital in the form of a higher return on their assets. Another side effect of automation is the reduction in the wages of replaced workers, not only in relation to other types of skills, but also in absolute terms. (Moll, 2021).

3) Increased household debt burden

With the increase in household debt burden, there is a shift in national income towards households with a low marginal propensity to consume (MPC). If the ratio of debt to GDP in the United States was 45% in the early 1980s, then by the world financial crisis of 2008 this figure reached 100%. With the existing negative correlation between income and MPC, inequality will continue to grow (Cairó, 2020).

4) Supply chain vulnerabilities

COVID-19 has shown the vulnerability of the system of free markets, in which individual states can impose restrictions on the export of certain products in the interests of their own country's consumption, thus cutting off other countries' access to food, components for the production, personal protective equipment, medical equipment, pharmaceuticals. Vulnerable supply chains not only create conditions for inequality in the receipt of essential goods such as medicines, but also pose a threat to national security.

Fiscal policy is one of the most important tools for eliminating inequality in developed countries; however, the tax system in the United States and many other developed countries has become less progressive over the past 50 years. The search for a fair taxation system is going on in a three-dimensional system.

Vertical equity in taxation should take a progressive form to equalize income, horizontal equity in taxation implies that people with the same income level should be taxed the same regardless of their source of income. Vertical and horizontal taxation does not involve redistribution, but adherence to these two principles should at least ensure that taxation does not exacerbate existing inequalities. With the development of globalization, a third dimension has been added – the ability of a country to ensure an independent tax policy and tax equality between different countries.

The basic model of tax competition shows that capital openness leads to tax cuts, especially taxes on capital (Wulfgramm, 2016) When investors are free to choose a country to invest in, they choose the jurisdiction with the lowest tax level, therefore, governments reduce tax rates one after another to attract capital from abroad. The basic model of tax competition has implications for all three principles of fairness and therefore also indirectly for ensuring equality in society.

First, if capital gains are taxed less, then the tax system becomes less progressive, implying that the rich pay less. In addition, in the face of growing budget expenditures, governments are forced to look for alternative sources of revenue, such as taxes on the purchase of non-essential items or wage taxes. As a result, the population with lower incomes bears a larger share of the tax burden. The tax system becomes potentially regressive, therefore, in the models of tax competition, the principle of vertical equality of taxation remains unfulfilled.

Second, tax competition affects horizontal equity. The same income from different sources – one from capital, the other from work – is taxed differently.

Third, countries can no longer set their tax policies independently, thus international equality is violated. Taken together, tax competition potentially violates all three principles of equality and, at least in the case of horizontal and vertical equality, limits the balancing of the tax system. While all governments are limited in their choice of tax policy instruments, income redistribution does not occur equally between countries; the risks are not the same (Arkadeva, 2019). Asymmetric tax competition models show that the opportunities for competition vary with the size of the country. Small countries have a fundamental advantage, and large countries lose out in tax competition. If the country is small enough, then the additional income received from capital inflows from other countries by increasing the tax base will cover the shortfall in income from tax cuts on domestic capital because of the tax rate cut. These capital flows affect the distribution of income among countries.

The average OECD income tax rate has been cut by about half from 43% to 25%, and the personal income tax rate has been reduced from 58% to 40% (Wulfgramm, 2016), reflecting tax competition for capital and highly skilled professionals. At the same time, taxes on low-mobile tax bases – value added tax and property tax – were increased. To correct the existing situation and international equalization of taxation, a working group has been created within the OECD to develop recommendations to counter the understatement of the tax base and the withdrawal of profits. Within the framework of the working group, negotiations are underway to establish a global minimum income tax of at least 15%. Thus, it is envisaged to form an international tax system that meets the principles of stable development of states and the establishment of justice. The US Treasury notes the need for international cooperation in this direction and the devastating effect of the "race to the bottom of corporate tax", which undermines the ability of states to collect taxes necessary for infrastructure investment, innovation stimulation and sustainable growth.

One of the negative aspects of the Russian tax system is its focus on indirect taxes, which are the easiest to administer. About 70% of tax revenues to the federal budget of the Russian Federation today are indirect revenues in the form of value added tax (VAT), excise taxes and customs duties. If in developed countries, for the purpose of fair taxation, budget revenues are formed from taxes on property, profit, land and capital, then in Russia the main bases of taxation are consumer spending and labor. Indirect taxes are included in the prices of goods sold, as well as in tariffs for services and works. They act as price-forming elements, causing, in turn, a decrease in consumption, primarily of the poorest part of the population. The richer the consumer, the smaller the share of his income he pays to the consolidated budget of the Russian Federation. Taking into account the flat scale of personal income tax, the tax system of the Russian Federation takes a regressive form and contributes to the strengthening of social inequality in society and the increase in poverty in the country.

4 CONCLUSIONS

Two approaches are popular today to overcome inequality. The first approach was developed by a team with the participation of a recognized researcher of the problem of inequality T. Piketty, who proposes to increase the upper income tax rate and introduce a global progressive tax on capital (Novokmet, 2018). However, his approach is limited by international tax equalization.

L. Summers, US Treasury Secretary 1999-2001, formulated the second approach. He proposes boosting middle-class incomes, making it harder to accumulate huge fortunes, enforcing antitrust laws, and encouraging option schemes for workers to give them a stake in wealth accumulation. In addition, Summers recalls A. Alesina's hypothesis: inequality is perceived more calmly by society, which means that it is associated with lower costs if social elevators work well and if it is compensated by equal opportunities.

At the present stage, fiscal incentives to maintain the income of low-income groups of the population are becoming a priority. Providing expanded assistance to the unemployed is the most effective tool in driving demand growth through increased lending. Providing one-time payments to all citizens is low-cost but less efficient (Faria-e-Castro, 2020).

There are debates among economists about whether helping the unemployed will reduce the supply of the labor market. According to the results of IMF research, the positive effect of unemployment benefits outweighs the negative effect of a possible reduction in the labor market. For every dollar of unemployment benefits, $ 1,925 in private sector income is created. This multiplier is achieved because the unemployed have a high marginal propensity to consume, which gives a stronger effect according to the Keynesian model. Confidence in the future reduces the need to build savings for employed workers. Unemployment benefits, which cover shortfalls in income, play a strong role in stabilizing property prices, creating a welfare effect that affects all property owners. The construction and development sector is particularly affected by benefits (Hellwig, 2021).

Thus, the COVID-19 pandemic has spurred a neoliberal paradigm shift with a focus on poverty and inequality and the consequent need to revise a number of conceptual principles for taxation and public social expenditures

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