

TAX POLICIES AND THEIR INFLUENCE ON INCOME DISTRIBUTION: THE PHILIPPINE EXPERIENCE

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INTRODUCTION

The Philippines, like any other developing country, is confronted with the serious problem of unequal distribution of income. While the problem would take years to resolve or even ameliorate, the trend in the last decade indicates a favorable development. The rich have slowed down their tendency to get richer. The middle class now has a bigger share of the total income. The average income of the poor has noticeably increased, despite their difficulties in improving their share of the nation's income.

Inequality of income distribution in our country is one of the principal problems which the government has been trying to solve for decades. Of course, as an economist of note, Simon Kuznets, pointed out, the presence of inequality of income distribution is one of the natural stages in a country's drive for development. However, the solution that we seek is not a completely egalitarian society, but realistically only the reduction or narrowing of the wide gap in income sharing between the overly rich and the extremely poor. In consonance with this goal, it is understandable why our development efforts over the last two decades has been geared towards industrialization, the creation of more employment opportunities, and the expansion of essential social services and better standards of taxation.

This paper will discuss only the effects of taxation on income distribution and how taxation is being utilized to attain a more desirable level of income distribution.

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Table 1. DISTRIBUTION OF TOTAL FAMILY INCOME
BY TENTHS OF FAMILIES
1961, 1965 and 1971

Ranking of Families (from lowest to highest income)	1 9 6 1		1 9 6 5		1 9 7 1	
	Average Income Within Group (pesos)	Percent of Total Income	Average Income Within Group (pesos)	Percent of Total Income	Average Income Within Group (pesos)	Percent of Total Income
PHILIPPINES	1,804	100.0	2,541	100.0	3,736	100.0
First tenth	271	1.5	293	1.1	466	1.2
Second tenth	487	2.7	601	2.4	909	2.4
Third tenth	613	3.4	880	3.5	1,318	3.5
Fourth tenth	812	4.5	1,161	4.6	1,728	4.6
Fifth tenth	992	5.5	1,458	5.7	2,191	5.9
Sixth tenth	1,190	6.6	1,804	7.1	2,748	7.4
Seventh tenth	1,497	8.3	2,272	8.9	3,416	9.1
Eighth tenth	1,984	11.0	2,851	11.2	4,432	11.9
Ninth tenth	2,795	15.5	3,910	15.4	6,307	16.9
Last tenth	7,394	41.0	10,178	40.1	13,850	37.1
Total number of families (thousand)	4,426		5,126		6,347	
Total income (million pesos)	₱7,982		₱13,024		₱23,714	

NOTE. Details may not add up to the totals because of rounding.

SOURCE. Bureau of the Census and Statistics, Special Bulletin Release No. 139-C, Series of 1973.

INCOME DISTRIBUTION IN THE PHILIPPINES

There was a slight trend toward equitable income distribution from 1961 to 1971. This was the finding of the 1961, 1965, and 1971 surveys of family incomes and expenditures of the Bureau of the Census and Statistics (Table 1).¹ The income share of the upper twenty per cent of the families declined from 56.5 per cent in 1961 to 54.0 per cent in 1971. In contrast, the share of the poorest twenty per cent of the families dropped markedly from 4.2 per cent in 1961 to 3.6 per cent in 1971. Thus, it is evident that the middle income families have improved their income shares from 39.3 per cent in 1961 to 42.3 per cent of total income in 1971. This is a clear indication of the redistribution of income as far as the middle income class is concerned.

Another measure of income sharing is the distribution of the families by income classes (Table 2). Over the decade

Table 2. NUMBER OF FAMILIES, BY BROAD INCOME CLASS, 1961, 1965, 1971

Income Class (pesos)	1 9 6 1		1 9 6 5		1 9 7 1	
	Number (thous.)	Distribution (%)	Number (thous.)	Distribution (%)	Number (thous.)	Distribution (%)
All income classes	4,426	100.0	5,126	100.0	6,347	100.0
Less than 3,000	3,485	86.9	3,945	77.0	3,745	59.0
3,000-9,999	517	11.7	1,044	17.4	2,214	34.9
10,000 & over	63	1.4	136	2.6	386	6.1

the distribution of families by income classes has remained highly skewed to the right, indicating that the distribution of families weighed heavily towards the lower income groups. Nevertheless, a marked shift towards the higher income group over the period was observed. In 1961 there were 86.9 per cent (3.8 million) of total families with income less than ₱3,000 per annum. In 1971, there was a significant improvement in income distribution. The proportion of families in the lowest income bracket, declined to 59.0 per cent (3.7 million). In contrast, the proportion of families in the highest income bracket, with income of ₱10,000 or more, increased from 1.4

¹ Bureau of the Census and Statistics, Special Release No. 139-C, Series of 1973, p. iii.

per cent (63 thousand) of the families in 1961 to 6.1 per cent (386 thousand) in 1971. The shift towards the middle income group, i.e., ₱3,000 to ₱9,999, was even more impressive. In 1961, only 11.7 per cent (517 thousand families) were in this class. In 1971, the middle class families represented 34.9 per cent (2,214 thousand families) of total families.

Despite the modest overall improvement over the decade, there still remains a wide income disparity between the rich and the poor. Such that in 1971, the richest tenth of the families (635 thousand) still claimed the highest proportion of 37.1 per cent of the total income and the poorest tenth of the families only accounted for a meager 1.2 per cent of total income. On this basis, the poorest tenth of families had an average income of ₱466 as against ₱13,850 of the highest tenth. This means that the income of the latter was almost 30 times that of the former. By all measures, this glaringly magnifies the inequality of income distribution.

This very uneven distribution of income poses two broad problems to the country: the socio-political aspect and the economic aspect. On the socio-political level, the persistence of a highly skewed income distribution threatens the very fabric of society. If the greater number of the population belongs to the low income class, which is generally characterized by malnutrition, disease, illiteracy, squalid housing, and unemployment, the country can then be likened to a building erected on hollow foundations. In due time, the building will collapse. Moreover, social dissatisfaction will ensue which, if unchecked, will eventually lead to more disastrous consequences to existing socio-political institutions.

In economic terms, the presence of a large segment of the population in the low income class means that the majority of the population is not actively engaged in production. Therefore, the economic development of the country is being retarded.

THE ROLE OF TAXATION IN INCOME DISTRIBUTION

Obvious distributional effects arise from the imposition and collection of taxes from income recipients in unequal or comparable proportions. To the extent that a particular group of income recipients pay a larger or smaller percentage of the total tax bill compared to the percentage of their corresponding

income to total income, then, incomes have been redistributed. This can be termed the direct redistributive effects of taxation.

Properly directed taxes have long-run redistributive effects. Changes in relative prices, consumption patterns, employment structure, and investment decisions brought about by taxation necessarily affect the share of income recipients from total income.

The relative emphasis given by tax policy makers to direct and indirect taxes also has a very significant bearing on income distribution. Direct taxes — taxes levied on income and property — are generally progressive which tend to redistribute income towards the low income earners. On the other hand, indirect taxes — taxes levied on production, sale, and privileges — which are generally regressive have the opposite tendency to redistribute income towards the high income groups. A tax is progressive when the effective rate increases as income increase and it is regressive when the effective rate decreases as income increases. If the effective rate of tax is constant despite increases in income, the tax is proportional. Indirect taxes can also be progressive. For example, higher tax rates could be imposed on commodities usually consumed by the high income group. Similarly, commodities mostly consumed by low income earners could be subject to lower tax rates or totally exempt from taxation. However, indirect taxes are regarded as generally regressive, that is, the low income group pays a greater proportion of taxes to income than the high income group.

STUDY ON TAX BURDEN BY INCOME CLASS IN 1960²

A pioneering study on the effects of taxes on income distribution was done by the Joint Legislative-Executive Tax Commission (now the National Tax Research Center). This study was based on a sample survey of family income and expenditures on selected commodities and tax data obtained from the Bureau of Internal Revenue, Bureau of Customs, General Auditing Office, SSS, GSIS, and other licensing government agencies.

² *A Study of Tax Burden by Income Class in the Philippines*. Joint Legislative-Executive Tax Commission, 1964.

Methodology of the Study. The total number of families was classified into thirteen income classes, ranging from less than P500 to P10,000 and over. Families with income of less than P2,000 were classified under the low income group; those with income of P2,000 but less than P10,000, the middle income group; and families with income of P10,000 or over, the high income group.

Taxes were classified into two broad classifications: (1) taxes on production and sales, and (2) taxes on income and property. This classification was adopted to avoid the difficulties in terminology that arise in distinguishing between direct taxes from indirect taxes.

For each tax, an allocation factor was developed taking into account the various factors affecting tax shifting, such as market structure, cost conditions, elasticities and other external influences. By and large, the taxes on income and property were apportioned among the various income classes by level of income earned or property owned.

On the other hand, the taxes on production and sales were allocated according to the pattern of expenditure of the households on taxable commodities. Taxes paid by both the business and household sectors were equitably apportioned between them whenever possible. Otherwise, the entire amount of tax was allocated to the sector which paid the greater portion of the tax.

Finally, two ratios were estimated: the average money burden and the effective rate for each income class. The average money burden is the tax burden per household, while the effective rate of tax or effective tax burden is the ratio of total taxes paid to gross income.

The Redistributive Effects of Taxes. In order to determine the redistributive effects of the various types of taxes, the effective rates of each tax as well as their influence on income distribution were examined (Table 3). The study showed that taxes on income and property are progressive with an effective rate ranging from 2.5 per cent in the low income group, 3.2 percent in the middle income group, to 21.8 per cent in the high income level. Comparing the income distribution before and after the imposition of the taxes on income and property (under the assumption that taxes on production and sales are constant), redistribution of income from

Table 3. DISTRIBUTION OF INCOME BEFORE AND AFTER CONSIDERATION OF TAXES, BY BROAD TYPE OF TAX AND INCOME CLASS, 1960

Type of Taxes and Income Class	Total Family Income (Million Pesos)	Distri- bution Before Tax (%)	Total Taxes (Million Pesos)	Effective Rate (%)	Total Income Net of Taxes (Million Pesos)	Distri- bution After Tax (%)
All Taxes	<u>7,004</u>	<u>100.0</u>	<u>1,413</u>	<u>20.17</u>	<u>5,591</u>	<u>100.0</u>
Less than 2,000	3,300	47.1	608	18.42	2,692	48.1
2,000 — 9,999	2,660	37.9	455	17.11	2,205	39.4
10,000 and over	1,044	14.9	350	33.50	694	12.4
Production and Sales Taxes	<u>7,004</u>	<u>100.0</u>	<u>1,024</u>	<u>14.62</u>	<u>5,980</u>	<u>100.0</u>
Less than 2,000	3,300	47.1	526	16.00	2,774	46.5
2,000 — 9,999	2,660	37.9	370	13.93	290	38.2
10,000 and over	1,044	14.9	128	12.22	916	15.3
Income and Property Taxes	<u>7,004</u>	<u>100.0</u>	<u>389</u>	<u>5.55</u>	<u>6,615</u>	<u>100.0</u>
Less than 2,000	3,300	47.1	82	2.48	3,218	48.7
2,000 — 9,999	2,660	37.9	85	3.18	2,575	38.9
10,000 and over	1,044	14.9	222	21.78	822	12.4

the high income group to the low income group was observed as earlier expected. The income share of the low income group rose from 47.1 to 48.7 per cent; the middle class increased from 37.9 to 38.9 per cent; while the high income class declined from 14.9 to 12.4 per cent. The redistributive effect, however, is not very significant since the effective rate of taxes on income and property as a whole is very low, estimated at about 5.0 per cent.

On the other hand, the taxes on production and sales as a whole are regressive, with effective rates from 16.0 per cent in the lowest income bracket, 13.9 per cent in the middle income class, and 12.2 per cent in the highest income class. It is to be expected that their influence would be the opposite to that of income and property taxes. The distribution of income before and after the taxes on production and sales (assuming that taxes on income and property are constant) showed a shift from the low income group to the high income group. The share of the low income group dropped from 47.1 to 46.5 per cent; the middle income group, rose slightly from 37.9 to 38.2 per cent and the high income group also increased from 14.9 to 15.3 per cent. The redistributive effect of taxes on production and sales are more significant than those of taxes on income and property as the former's over-all effective rate (15.0 per cent) is much higher than the latter.

On the whole, the over-all effect of taxes on the distribution from the high income is salutary as evidenced by the mild shift in income distribution from the high income families to the middle and low income families. Low income families improved their share from 47.1 to 48.1 per cent; while the middle income families, from 37.9 to 39.4 per cent; which resulted in the decline of the share of the high income families from 14.9 to 12.4 per cent. In spite of this, the acute inequality in income distribution remained.

The significant inequality in the distribution of income before and after tax is confirmed by the Lorenz distribution curve (Table 4).

Table 4. DISTRIBUTION OF INCOME IN THE PHILIPPINES

Percentage of Households Cumulative	Cumulative Percentage of Income			
	Before All Taxes	After All Taxes	After Taxes on Income and Property	After Taxes on Production and Sales
Lower 20	4.2	4.6	4.9	3.9
Lower 50	17.3	17.9	18.2	16.7
Lower 70	57.8	59.7	60.2	57.2
Upper 10	42.2	40.3	39.8	42.8

Before all taxes, the lowest twenty per cent of the household owned only 4.2 per cent of total income, whereas the highest ten per cent owned a significant 42.2 per cent. The middle seventy per cent, therefore, owned 53.6 per cent of total income. After the taxes had been considered, the lowest twenty per cent of the households were left with only 3.9 per cent of total income; the upper ten per cent almost remained unchanged at 42.8 per cent. The middle seventy per cent owned 53.3 per cent of total income.

All these point to the compelling need to improve the Philippine tax system and structure. A good tax system should not only be able to meet the financial requirements of government, but it must also promote a fundamental fiscal policy goal — equitable distribution of income. The foregoing findings call for the infusion of a greater degree of progressivity in the tax system, particularly in taxes that mostly affect the middle and high income groups. Such a program should, however, take into account equally worthwhile objectives, as capital accumulation and business incentives, with the support of an efficient and effective tax collection machinery.

TAX POLICY TO PROMOTE A MORE EQUITABLE INCOME DISTRIBUTION

Even before the pioneering study on tax burden by the National Tax Research Center, tax policy makers in the government were already aware of the existing acute inequality in the distribution of income. The reality of this economic problem is clearly visible even to the common man. This problem was not only confirmed and quantified by the tax burden study, but it also elicited the causes of such inequity.

The advent of martial law on September 21, 1972 gave a tremendous push to the country's determined effort to promote equitable distribution of income along with other tax objectives. Martial law did not diminish but rather complemented the gains. Of the significant tax legislations passed prior to martial law, the most important is R.A. 6110 enacted in 1969. However, sweeping tax reforms were achieved with the promulgation of Presidential Decree Nos. 69 and 34, which revised the National Internal Revenue Code and the Tariff and Customs Code, respectively. These two decrees struck deep to the weaknesses of the tax and tariff systems by revising many provisions of the two codes to hasten the accomplishment of the following broad objectives: (1) increase in tax revenue, (2) improvement in tax administration, (3) redistribution of wealth, (4) equity, and (5) promotion of business through incentives.

The success of these determined efforts to achieve social and economic justice in the distribution of the nation's income is evidenced by two important statistical measures.

First, the distribution of families by income class, as previously noted (Table 2), has become less skewed to the right from 1961 to 1971. The coefficient of skewness has lessened from 144 to 95 per cent over the decade. This means there is now a lesser number of families in the lower income groups and more families in the higher income groups than a decade ago. Of course, this trend is not solely attributable to the institution of progressive rates of taxation. But, it can not be denied, however, that the achievement of a progressive tax system has been pursued vigorously over the last decade.

Secondly, the increase in the proportion of direct taxes to total tax collection indicates that the emphasis on progressive taxation is gaining headway (Table 5). In 1961, total tax collection amounted to P978 million, of which 24.8 per cent (P243 million) came from direct taxes and 75.2 per cent (P735 million) from indirect taxes. In 1972, the ratio of direct taxes to total taxes has improved by 2.2 per cent points. In that year, of the total collection of P3,997 million, 27.0 per cent (P1,077 million) came from direct taxes and 73.0 per cent (P2,920 million) from indirect taxes. Direct taxes are taxes on income, estate, gifts, inheritance, residence, immigration and real property. Considered indirect taxes are the excises, licenses, import duties, documentary stamps, wharfage fees, charges on forest products, franchises, and other minor taxes. Direct taxes are progressive levies which tend to redistribute

income towards the lower income families. On the other side, indirect taxes are regressive levies which tend to aggravate inequality in the distribution of income.

Table 5. TOTAL TAX COLLECTION, BY BROAD CATEGORY

Year	Total		Direct		Indirect	
	Million Pesos	Million Pesos	Ratio	Million Pesos	Ratio	
1961	978	243	24.8	735	75.2	
1965	1,524	389	25.4	1,135	74.5	
1971	3,717	886	23.8	2,831	76.2	
1972	3,997	1,088	27.0	2,920	73.0	

NOTE: Collection from Stabilization Tax, enacted into law in 1970, amounting to ₱108M and ₱370M in 1971 and 1972, respectively, were not included to render comparison from 1965 to 1972 valid.

The efforts in the last decade, particularly in the martial law period, brought about tax reforms whose impact changed the pattern of income distribution from 1961 to 1972. Enumerated below are some changes in the tax laws which affected the income distribution of the country.

Taxes on Income and Property. — The individual income tax structure was revised by R.A. 5225 by increasing the number of tax brackets from 23 to 37. The rates on the first three brackets were retained, those on the middle brackets reduced, and those on the upper brackets increased. The increase of the number of tax brackets also infused greater flexibility in the income tax system. This means that it would only take a much lesser increase in income to escalate the taxpayer to a higher tax bracket than what would have been required under the old law. A primary objective of this revision is to make the individual income tax more progressive and shift the greater tax burden on the taxpayers in the high income classes.

Corporate income tax has also been revised upwards in 1968. From 22 per cent on net taxable income not exceeding ₱100,000 and 30 per cent in excess of income over ₱100,000, the rates were correspondingly raised to 25 per cent and 35 per cent, respectively.

Under Presidential Decree No. 69, the estate and inheritance taxes were integrated into an estate tax only, and the donor's and donee's taxes, into just the donor's tax. In addition, higher rates on the estate tax, as compared to the donor's tax, were imposed to encourage the breaking up of estates and their transfer to those in a better position to make them more productive. Broadening of the ownership base of property would also result. Furthermore, under the old transfer of property law, the rate of inheritance and donee's taxes varied depending on the relationship of the recipient of the property to the decedent or donor. This encouraged the tendency to keep property within the family, which is inconsistent with the government policy to redistribute wealth. P.D. No. 69 thus removed rate differentiation according to the degree of relationship of the transferee to the transferor of the property.

The real property tax has also been amended by Presidential Decree No. 76 in order to get the true, current and fair market value of real properties and improvements thereon. Since real property holdings can be assumed to directly vary with income, the upward revision of property values and the payment of higher taxes due the government on these properties, would increase the tax payments of the high income group. To that extent, income will be shifted from the high income classes to the lower income classes.

License and Business Taxes. Higher rates of taxes on non-essential or luxury commodities and lower rates on essential commodities are provided in Title V of R.A. 6110 and P.D. No. 69. For example, the rates of sales tax on luxury items (jewelry, perfumes and other toilet preparations) under Section 184 and on semi-luxury items (sporting goods, or certain household electrical appliances) under Section 185 were increased by R.A. 6110 from 50 to 70 per cent and from 30 to 40 per cent, respectively. R.A. 6110 also increased the rate of amusement tax on cabarets and nightclubs from 10 to 20 per cent. Considering that these places are generally patronized by individuals with relatively high incomes, it is obvious that the increase in amusement tax would impinge more on the higher income classes. On the other hand, the rate of tax on certain food products was reduced from 7 to 5 per cent. Since food constitutes a sizeable proportion of the poor family's budget, a reduction in taxes on basic commodities as food certainly has the effect of redistributing income in favor of the low income group.

Specific Taxes. P.D. 69 has adjusted upwards the rates of specific taxes enumerated in Title IV of the Tax Code. Among the commodities affected are distilled spirits, wines, fermented liquors, cigarettes, cinematographic films, and fire-works. The rationale for the general upward revision of rates were revenue considerations and protection of similar locally produced products. Since consumption of these products constitutes a big proportion of the total consumption expenditure of the low income group, the upward revision of rates increases the relative tax burden of the low income group. In effect, the result shift income redistribution against the low income group.

Import and Export Duties. Presidential Decree No. 34 made drastic changes in the Tariff and Customs Code. It simplified the tariff structure by reducing the rate levels from 34 to only 5. A uniform rate of 10 per cent ad valorem was imposed on all tariff headings and sub-headings. Likewise, five protective levels of 10, 20, 40, 60 and 90 per cent are levied over the ad valorem rate. Catch-all headings as the classification "others" were given the highest rate under each corresponding heading in order to plug loopholes for technical smuggling. The number of tariff headings and sub-headings was reduced from 1939 to only 1096. There is much reason to believe that the existing rates of import duties have the same regressive effects on the whole tax structure, as established in the 1960 JLETC tax burden study. This survey indicated that the two lowest income brackets shoulder the highest effective burdens.

R.A. 6125 or the Stabilization Tax Law but popularly known as the Export Tax Law was enacted shortly after the adoption of the floating rate in 1970 as a revenue and stabilization measure. The rationale for its enactment was that it was but fair and equitable that the exporters share part of their windfall with the government. Although initially intended as a stop gap measure, Presidential Decree No. 230 not only made it a permanent feature of the Tariff and Customs Code under a new title (Title III) but also increase the export tax rates provided under R.A. 6125.

The export tax will not increase the tax burden of the lower income groups, rather, will give added burden on those who are financially better off. With the prices of export products dependent on the world market, it cannot easily be shifted

forward. Backward shifting is also improbable in view of institutional constraints like the minimum wage law. Hence, in all likelihood, it is borne by the exporters themselves who are in the top rung of the income ladder. Similar basis were considered when the NTRC proposed the new taxes on stock transfer and foreign travel.

Revenue Allotment System. — Prior to Presidential Decree No. 144, a number of formulae were used in determining the share of local government in national taxes. But these schemes generally favored only a very few affluent localities. Under P. D. 144, only one formula applies in allocating the share of local units from the national internal revenue taxes (except those accruing to special funds). The new formula distributes the allotment on the basis of population, land area and equity. (equal sharing on the 10 per cent of the internal revenue allotment of the local units). This change is primarily intended to benefit the poor local units by giving them more share from national taxes than what they used to receive under the old allotment system. Hopefully, the residents of these areas who have low per capita incomes will be the ultimate beneficiaries from the new scheme in terms of more and better government services. Of course, this is redistribution through government expenditure, rather than through taxation.

There are other changes in the tax structure not covered in this paper. Many more major amendments are being contemplated. As a matter of fact, a new and totally revised internal revenue code is now the subject of serious discussion. It is hoped that recent and future amendments would adhere to and promote the present policy objectives of the government.

CONCLUSION AND RECOMMENDATIONS

Of the tax policy objectives, the attainment of a more equitable distribution of income must be an urgent and consistent goal of the government. Existence of a highly uneven income distribution is a serious threat to the stability of our present socio-political-economic institutions. The problem requires immediate resolution.

The 1960 study of the NTRC on the effects of taxation on income redistribution elicited no significant change on the income redistribution. The preponderance of taxes on produc-

tion and sale (indirect taxes) which are regressive, effectively neutralized the built-in progressive effects of income and property taxes (direct taxes).

The obvious solution lies in strengthening income and property taxes and de-emphasizing taxes on production and sales. But this is easily said than done. Low level of per capita income and the existence of a very large number of small-size agricultural units and marginal producers, whose output do not enter the market channels, render direct taxes not very productive. Other direct taxes, i.e., transfer taxes, residence, immigration, and the real property tax, cannot by their very nature be depended upon to bring in substantial revenue. Another alternative to the problem is to infuse more progressivity to taxes on production and sales. The recent changes in the tax code lowering the imposts on essential consumers items and increasing the taxes on luxury and semi-luxury items are steps toward progressivity of the tax system.

As a complementary effort at income redistribution, it is advisable for policy makers to reexamine the expenditure policy of the government. Expenditure on public education and health, subsidies to commodities that are mainly expenditure items of the low income group, and provision for more employment opportunities, among others, directly enhance the ability of the low income group to climb up the income ladder. On the other hand, government outlays on interests and loan repayments and rental expenses directly benefit the high income classes.

To round off the efforts at redistributing income through the review of tax policies and nature of government expenditures, their effects should be determined and evaluated through a series of surveys covering the current incidence of taxation and direction of government expenditures.