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Authors: Andrew Feltenstein, Carolina Mejia, David Newhouse, Gohar Sedrakyan

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The Poverty Implications of Alternative Tax Reforms: Results from a Numerical Application to Pakistan

By

Andrew Feltenstein (Georgia State University, afeltenstein@gsu.edu)¹
Carolina Mejia (World Bank)
David Newhouse (World Bank)
Gohar Sedrakyan (Georgia State University)

Abstract
This paper presents results from four simulations of the impact of potential tax reforms in Pakistan on poverty, shared prosperity, and inequality. The simulations are carried out in the context of a dynamic computational general equilibrium (CGE) model that incorporates endogenous tax evasion. The simulations link the CGE model to household survey data that is incorporated in a micro simulation model. The combined models suggest that equal yield increases in sales and corporate tax rates differ mildly in their impacts on consumption and poverty. Endogenously modeled tax evasion plays an important role in the results.

I. Introduction

Many countries, particularly in the developing world, suffer from volatile revenue sources, which make it difficult to finance essential projects. They also have large numbers of poor people and there are concerns that revenue increases will negatively impact those people. Accordingly, attempts are often made to increase public revenues, while at the same time trying to minimize the impact of these revenue increases on the poor. The general intuition is often that increases in regressive taxes, such as the sales tax, will have a more negative impact upon the poor than will increases in progressive taxes, such as the corporate income tax. In this paper we will analyze the problem of how to increase tax revenues while trying to minimize the impact of this revenue increase on the poorest segment of society. We will use a numerical analysis calibrated and applied to Pakistan, a country that faces both problems of poverty, as well as very poor public revenue performance. Our results will indicate that the standard intuition, at least in this case, may often be incorrect.²

¹ This paper was written as part of a World Bank project on fiscal policy and poverty alleviation in Pakistan. The views expressed here are our own.
² Many authors have examined the relationships between tax regimes and poverty. See, for example Tanzi and Zee (2001, 2000), and Keen and Simone (2004) for a number of general insights, and Lustig (1998) for an
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