CEP council on economic policies

Driving Tax Expenditure Reform in Times of COVID-19

Agustin Redonda

ECLAC – GFPN Workshop

October 13-14, 2020

COVID-19: Unprecedented economic impact

- The latest estimates by the OECD show that real GPD will fall by roughly 5% in 2020
  - Highly heterogeneous effect, ranging from + 1.8% in China and < 3% drop in Korea and Turkey, to > 10% fall in Argentina, India, Mexico, South Africa and the UK
- First increase in global poverty since 1998 (WB, 2020)
- Exacerbation of inequality, with groups and sectors that were already under stress before the pandemic being hit the hardest
  - Informal workers
  - Women
  - Racial minorities

Developing economies will be hit particularly hard

- The impact on economic growth is not necesarilly larger in emerging and developing economies – no correlation with GDP
  - Yet, the consequences (e.g. poverty) will definitively be more severe in emerging and developing economies than in rich countries
- Why? These economies are less resilient to face the pandemic and have significantly less resources to reboot their economies
  - Health systems are less resilient and living standards are considerably lower
    - 2 billion people live in countries experiencing high water stress (UN, 2019)
  - Reduced **fiscal space**

Fiscal space, the Achilles heel of poor economies

- High **debt service burdens**: 26 low-income countries face high risk of external debt distress, and 6 are already in distress (WB, 2020)
- **International aid:** will decrease due to budget constraints in donnor countries
- **Capital outflows**: in two months, > USD 100 billion flew out of emerging markets, i.e. > than three times than during the 2008 crisis (IMF, 2020)
- Sharpest decline of **remittances** in recent history: roughly -20% (WB, 2020)
- **Already narrow tax bases (**e.g. informal employment amounts to 90% in developing countries, 70% in emerging markets and < 20% in the developed world - ILO, 2018) will be particularly affected
- **Tax revenue** will shrink**:**
  - Collapse in activity,
  - behavioral responses (compliance) and
  - **tax policy**

Tax policy responses: Tax expenditures (1/2)

I. Fiscal cost

- 1.3 trillion USD (> 30% of direct government spending and > 7% of GDP) in the US (US Treasury, 2020)
- LATAM: between 1.3% and 8% of GDP (CIAT)
- Africa: can be as high as 7.8% (58.41%) of GDP (Tax Revenue) – Global Tax Expenditures Database (GTED), forthcoming

II. (In)effective in reaching their policy objectives

- Tax incentives for **investment** are often ineffective, e.g. high redundancy ratios and windfall gains
- Mortgage interest deductions have a negligible impact on homeownership (Hilber and Turner, 2014)
  - Earned Income Tax Credit (EITC) → successful TE provision (Bastian, 2018)

Tax policy responses: Tax expenditures (2/2)

III. Negative externalities – The Case of Energy-related Tax Expenditures

- **Environmentally harmful**: fossil fuel subsidies accounted for roughly USD 340 billion a year in 2017 (OECD, 2018) – USD 5.2 trillion if externalities are considered (IMF, 2019)
  - > 60% of the total are granted as tax benefits
- **Tax competition**: When CO2 pricing exists: "*Energy intensive firms should be compensated to mitigate a negative impact on international competitiveness and to avoid a leakage effect*"
    - *National perspective*: ↓ tax revenue and ↑ economic distortions
    - *Global perspective*: the reduction of GHG emissions is jeopardized, i.e. TEs go against energy taxes' primary goal
- Not all that glitters is (green) gold: **Distributive effect**, e.g. Electric vehicle tax credits

Policy implications (1/2)

Policy implications: No one-fits all approach to weather the storm the world is going through, but rationalizing the use of tax expenditures could both ease budget constraints and align tax systems with a more resilient and sustainable come back

Three-stage process to drive tax expenditure reform (De la Feria and Redonda, 2020):

I. Estimating and Reporting on Tax Expenditures
II. Assessing the Effectiveness and Efficiency of Tax Expenditures
III. Reforming Tax Expenditures

Policy Implications (2/2)

COVID-19 increases *momentum* for tax expenditure reform:

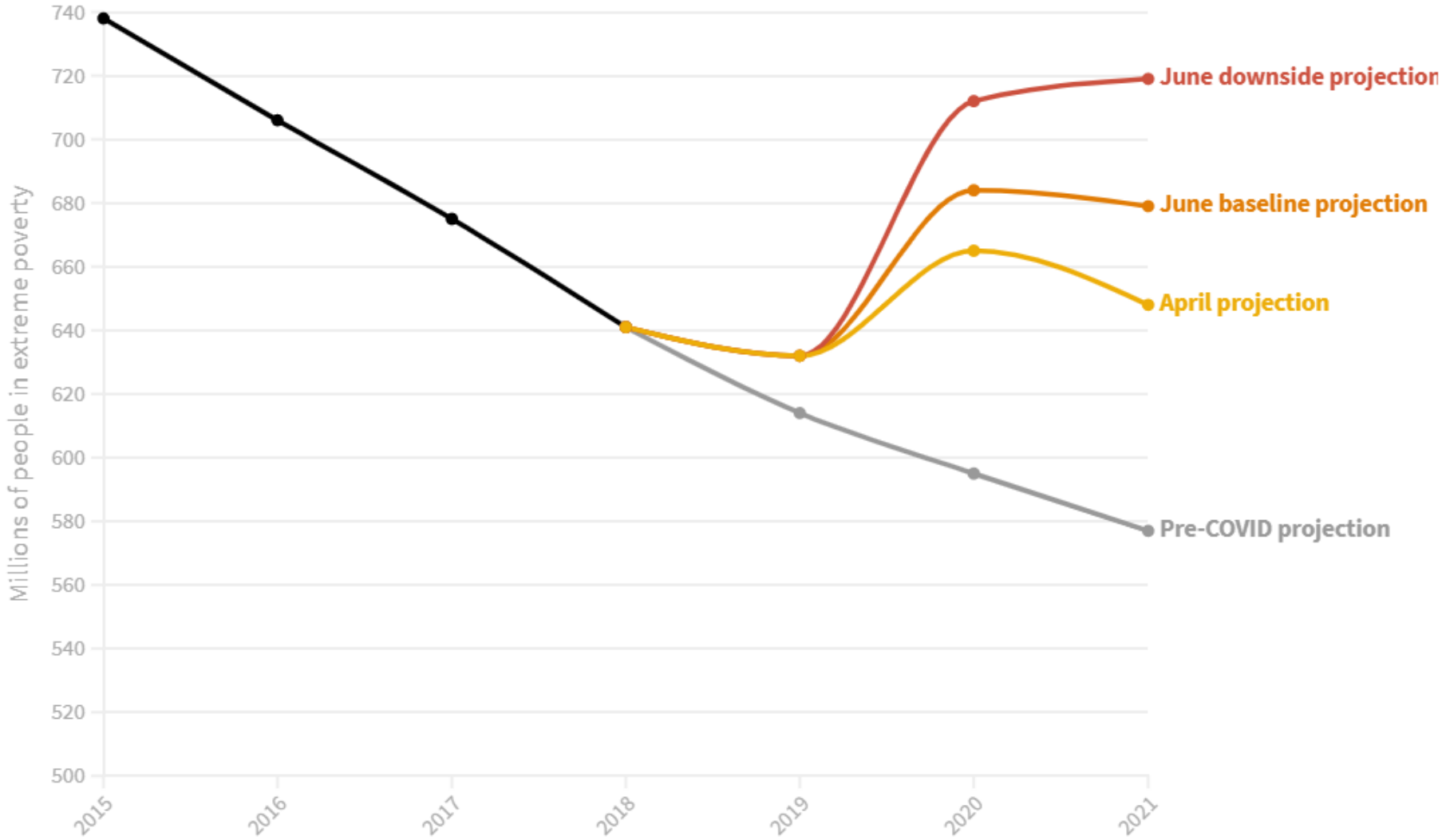
- Governments desperately need to **mobilize resources** to fund costly support and recovery packages
- The need of resources (e.g. to fund health and other essential public services) as well as the crash of oil prices might significantly reduce **social opposition** to TE reforms
- **Conditionalities** open the door to shape the economy of years to come

CEP council on economic policies

Thank you for your attention

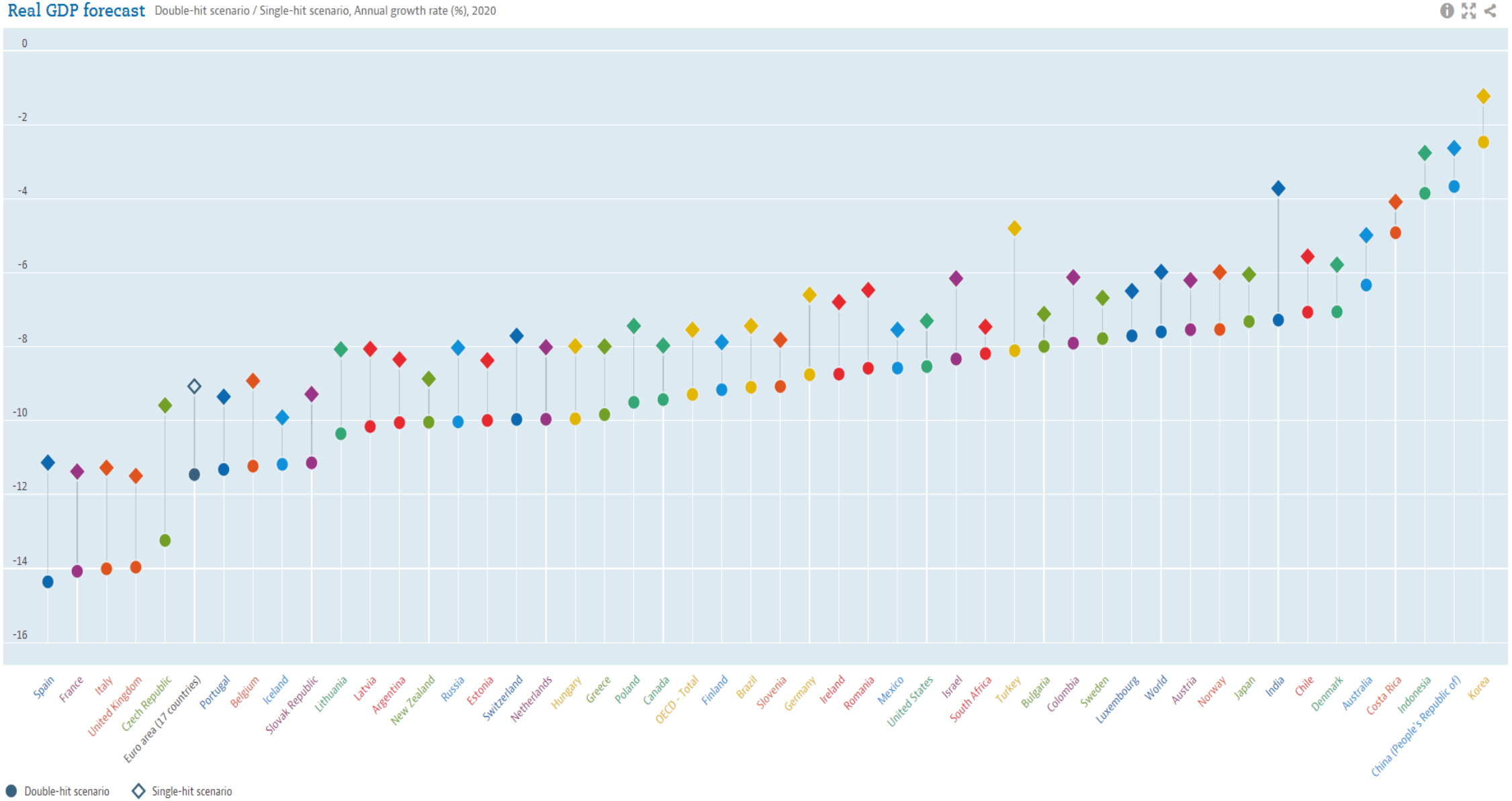
Contact details:
E-mail: ar@cepweb.org
Twitter: @aredonda
Website: www.cepweb.org

The Impact of COVID-19 on Global Extreme Poverty



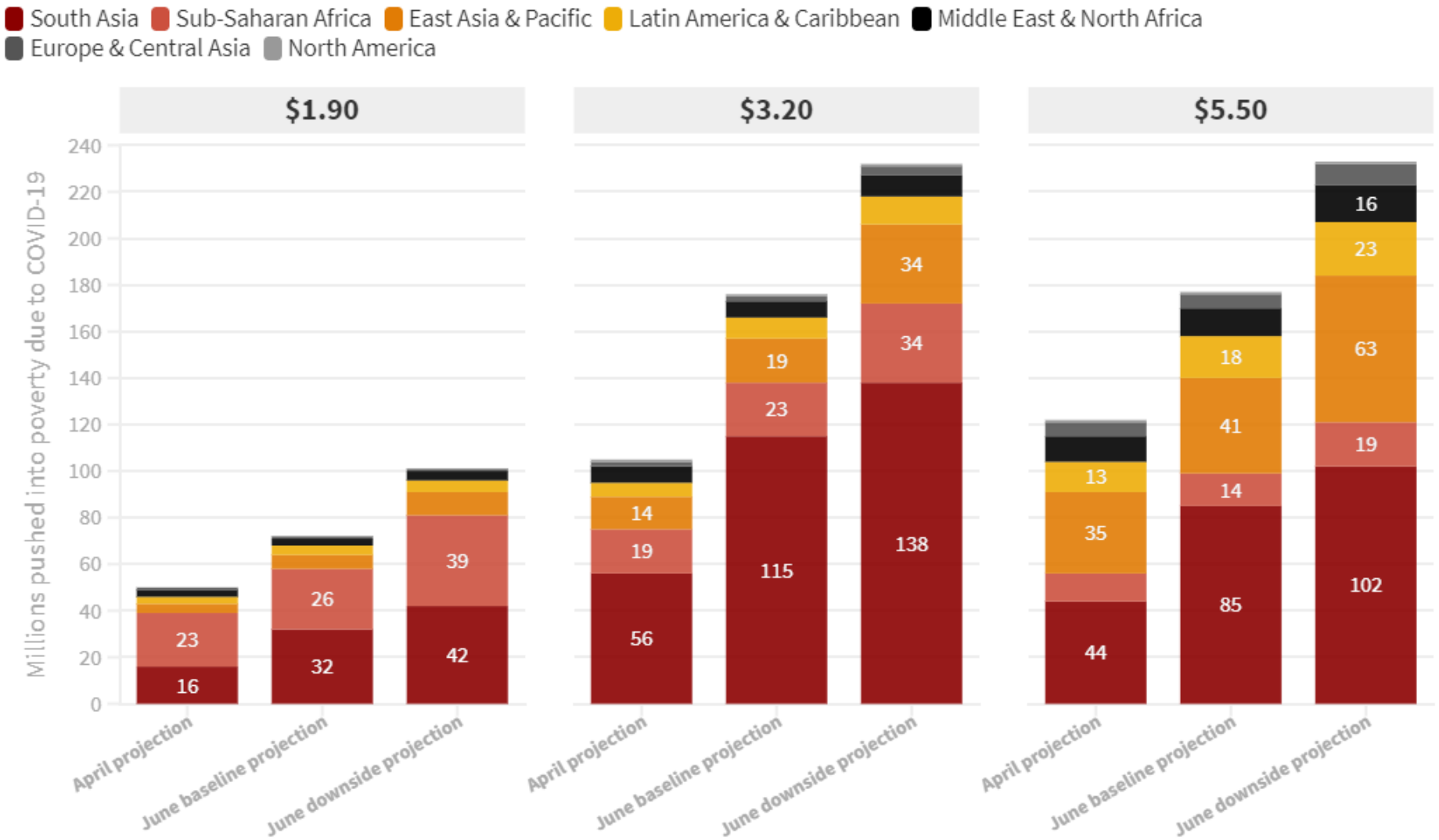
Source: Lakner et al (2020), PovcalNet, Global Economic Prospects, • Extreme poverty is measured as the number of people living on less than $1.90 per day.

CEP


Real GDP forecast
Double-hit scenario / Single-hit scenario, Annual growth rate (%), 2020
0
-2
-4
-6
-8
-10
-12
-14
-16
Spain
France
Italy
United Kingdom
Czech Republic
Euro area (17 countries)
Portugal
Belgium
Iceland
Slovak Republic
Lithuania
Latvia
Argentina
New Zealand
Russia
Estonia
Switzerland
Netherlands
Hungary
Greece
Poland
Canada
OECD - Total
Finland
Brazil
Slovenia
Germany
Ireland
Romania
Mexico
United States
Israel
South Africa
Turkey
Bulgaria
Colombia
Sweden
Luxembourg
World
Austria
Norway
Japan
India
Chile
Denmark
Australia
Costa Rica
Indonesia
China (People's Republic of)
Korea
Double-hit scenario
Single-hit scenario
©
Compare countries on data.oecd.org
OECD

CEP

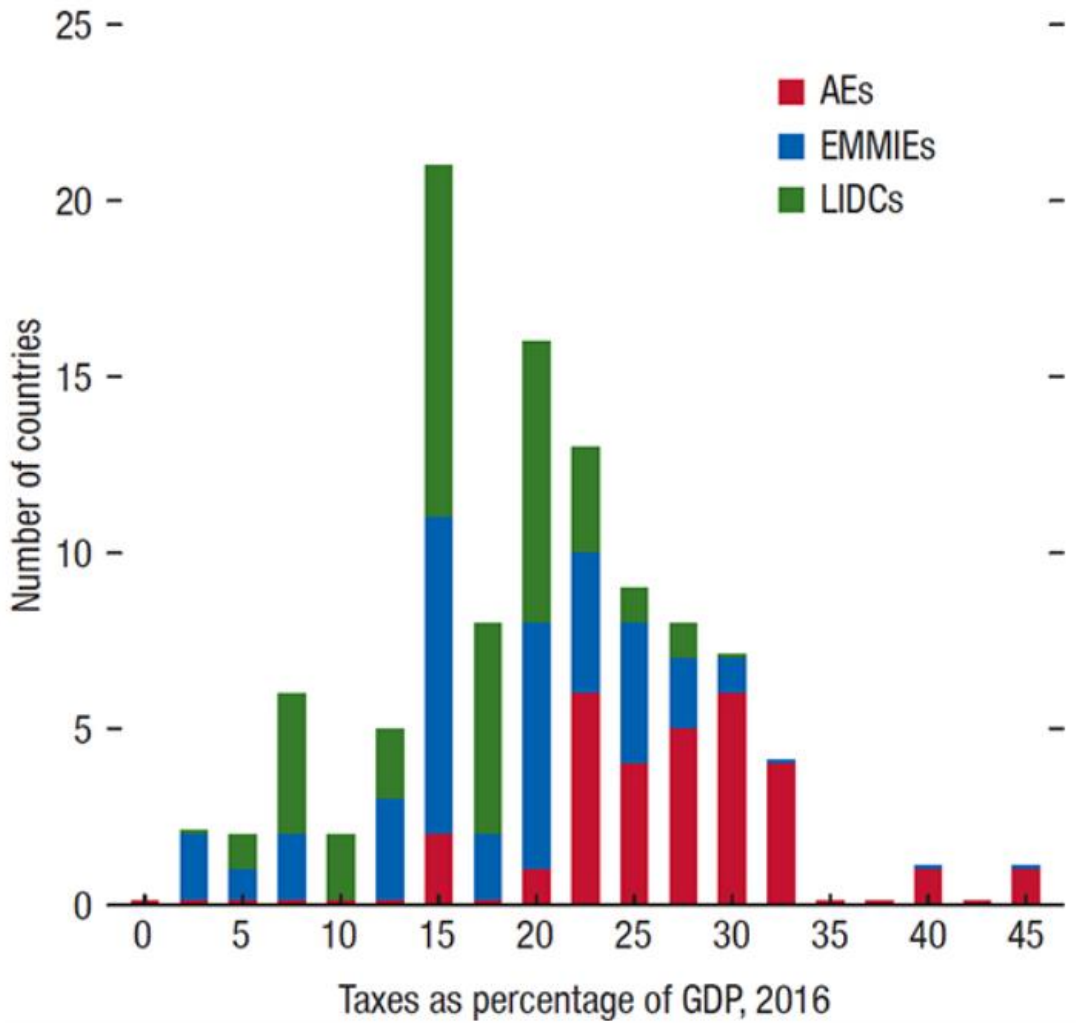
The Regional Distribution of the COVID-19-Induced Poor



Source: Lakner et al. (2020), PovcalNet, Global Economic Prospects

CEP

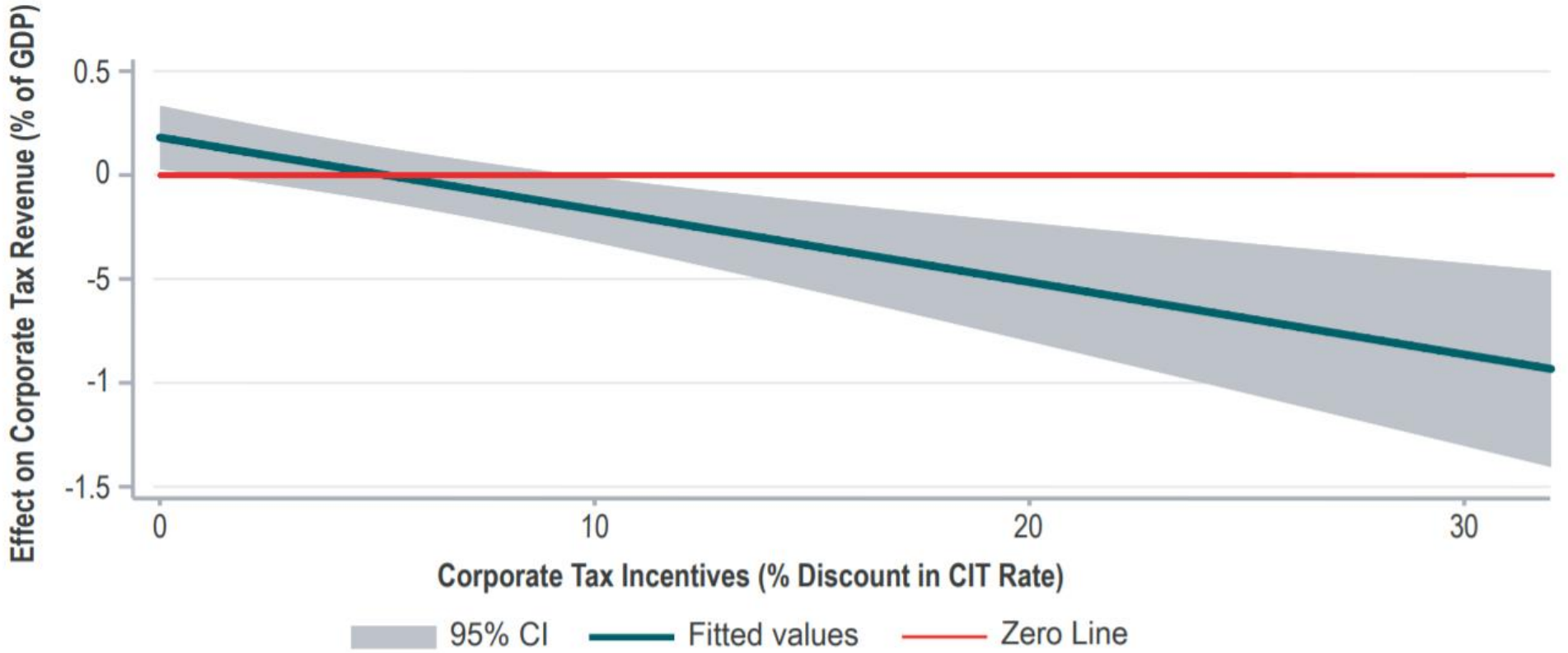
Revenue mobilization remains limited in low-income developing countries.



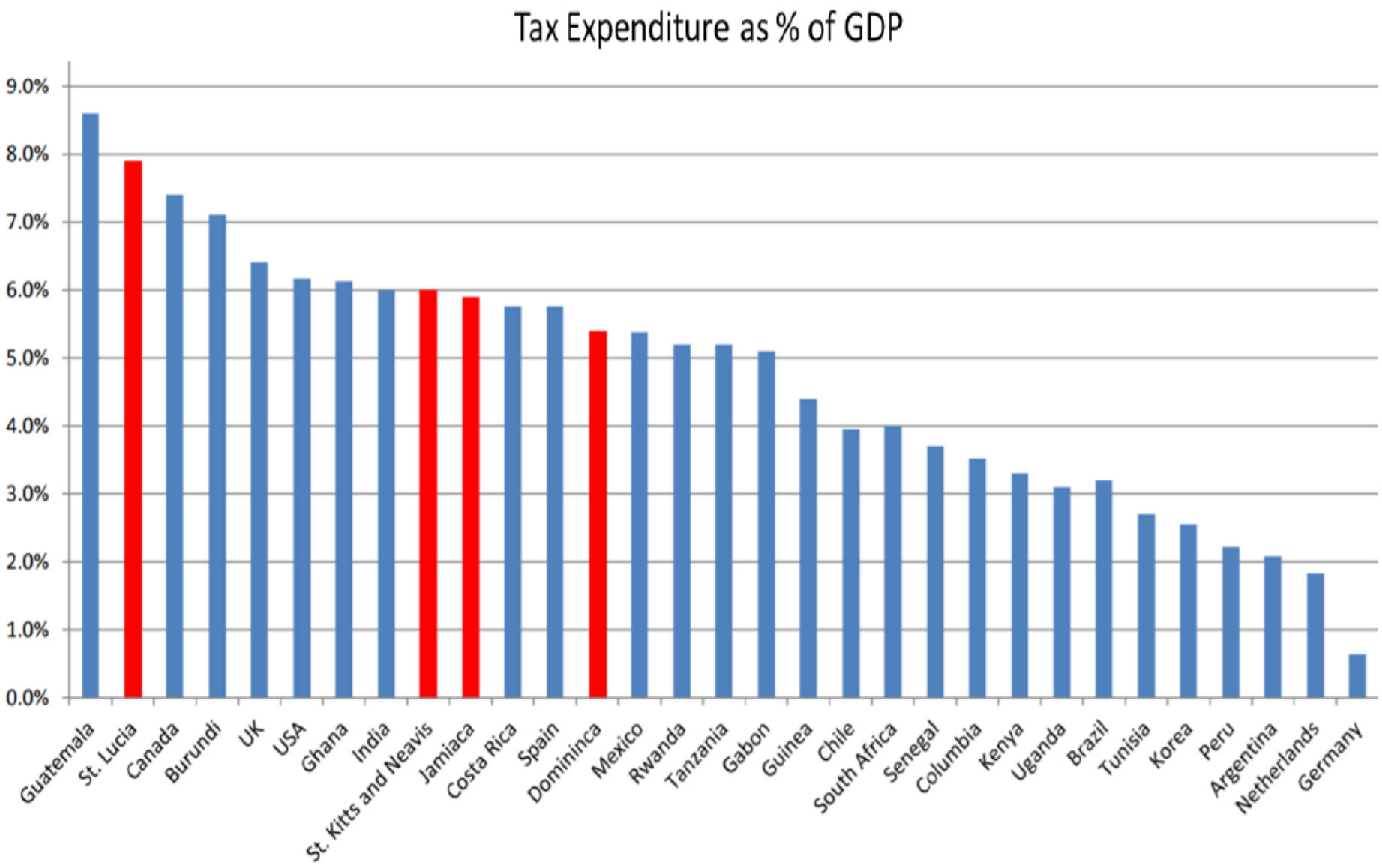
Source: IMF staff estimates.
Note: AEs = advanced economies; EMMIEs = emerging markets and middle-income economies; LIDCs = low-income developing countries.

CEP

Figure 2. More Generous Tax Incentives are Associated with Lower Corporate Tax Revenue



Source: Authors' calculations based on the World Bank Group's Global Tax Incentives Database (Andersen, Kett, and von Uexkull 2018) and World Development Indicators (WDI), covering 109 countries: 72 developing countries and 37 high-income countries, for 2009–15.
Note: Corporate tax incentives are measured as percent-point difference between the standard corporate income tax (CIT) rate and tax incentive CIT rate. See annex table A.1 for details. CI = confidence interval.



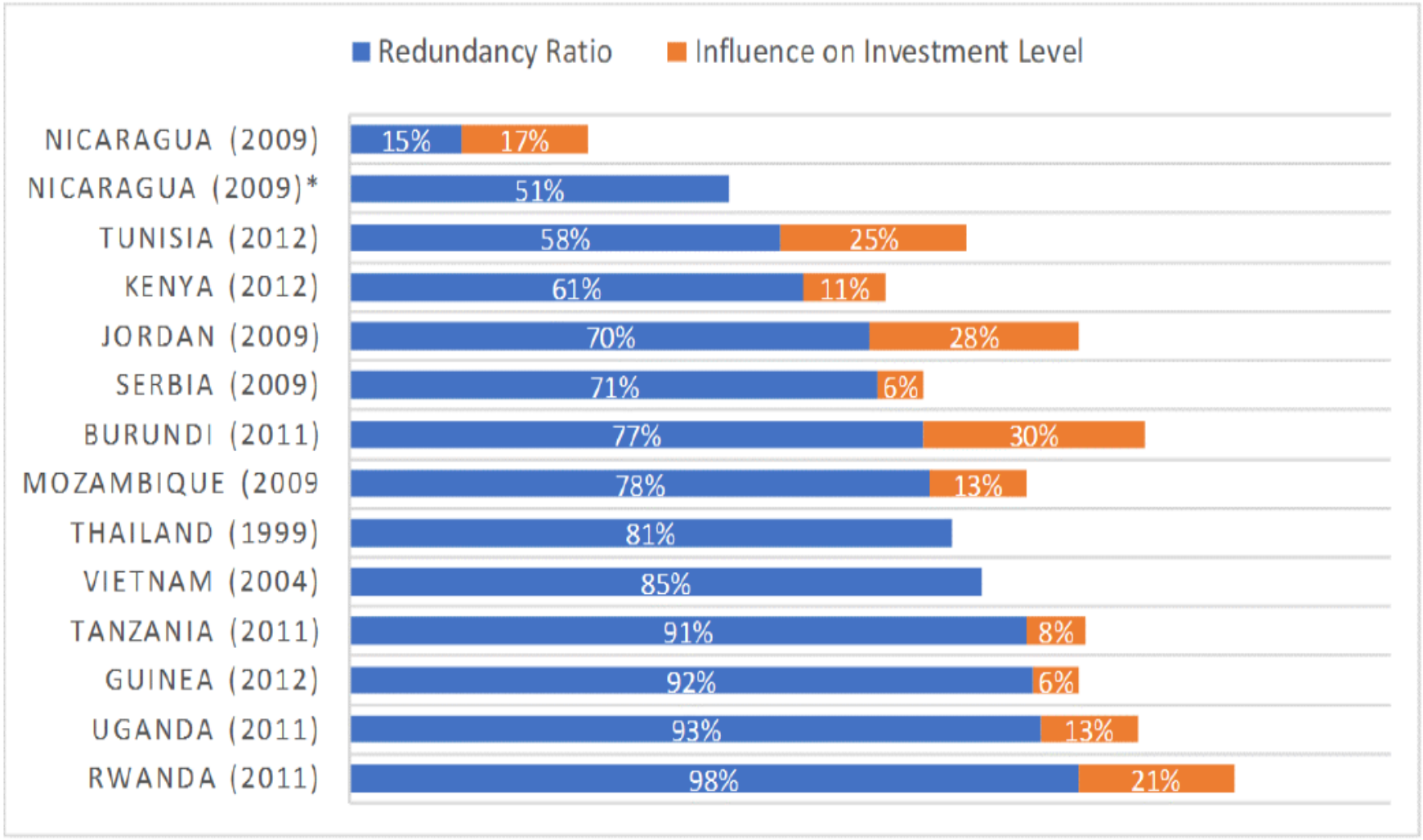
Source: James (2014)

CEP

Country	Year	% of Tax Revenue	% of GDP
Benin	2017	18,20%	2,40%
Burkina Faso	2016	8,61%	1,38%
DR Congo	2017	17,75%	1,28%
Eswatini	2016	18,84%	3,15%
Ivory Coast	2017	9,80%	1,32%
Gabon	2017	12,10%	1,24%
Guinea	2017	21,70%	2,63%
Lesotho	2016	17,60%	3,96%
Liberia	2016	18,89%	4,70%
Madagascar	2015	17,00%	1,79%
Mali	2017	17,32%	2,64%
Mauritania	2013	58,41%	
Mauritius	2017	9,22%	1,76%
Morocco	2018	13,01%	2,78%
Rwanda	2018	14,30%	4,60%
Senegal	2014	39,60%	7,80%
Seychelles	2019	1,04%	0,34%
Sierra Leone	2017	8,76%	1,20%
South Africa	2017	14,90%	3,90%
Tanzania	2012	27,00%	4,40%
Average		18,20%	2,80%

Source: Global Tax Expenditures Database (GTED), forthcoming

Salience of Tax Incentives based on Investor Surveys

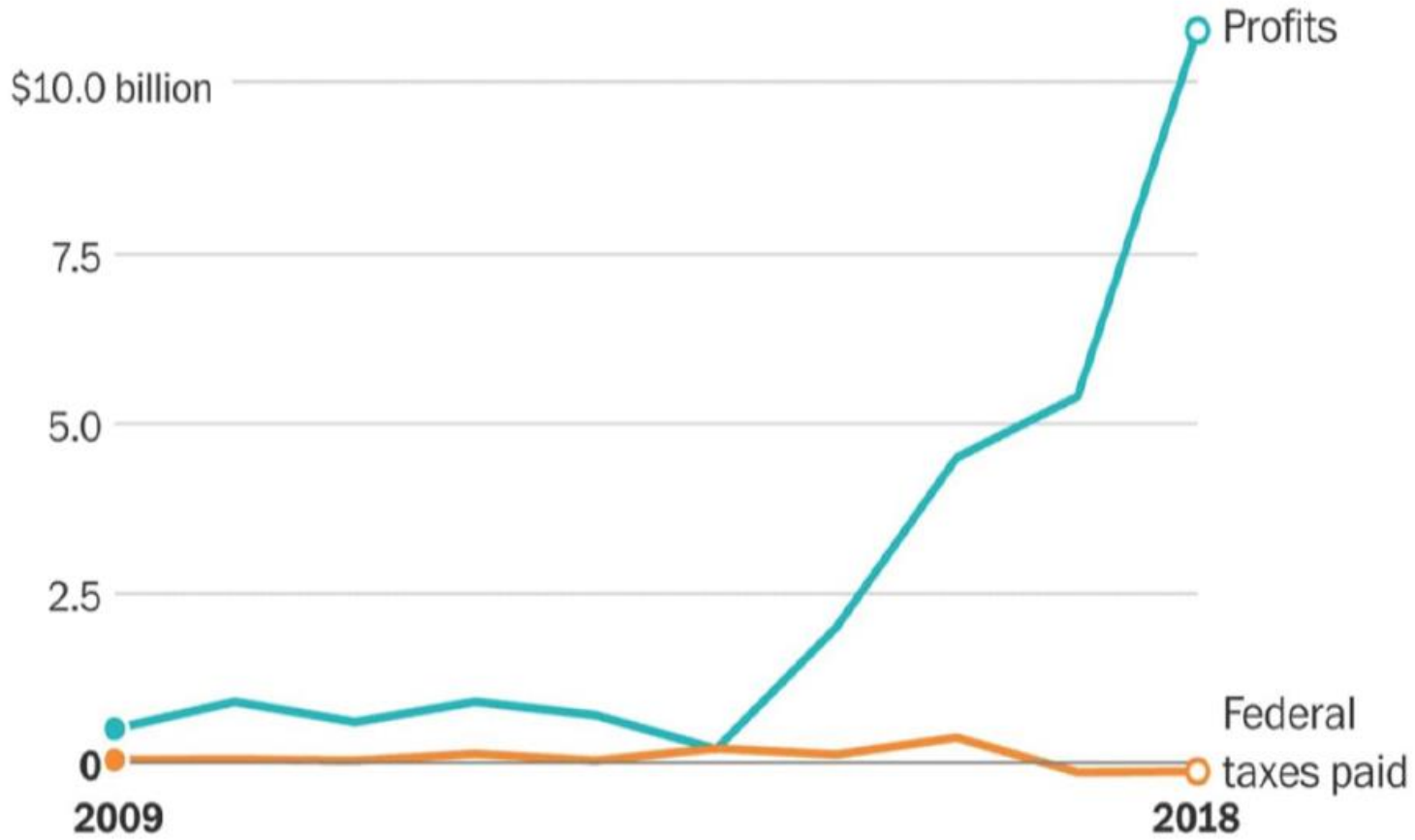


Note: *Non-exportingfirms outsidefree zones.

Source: Own elaboration based on James, 2013.

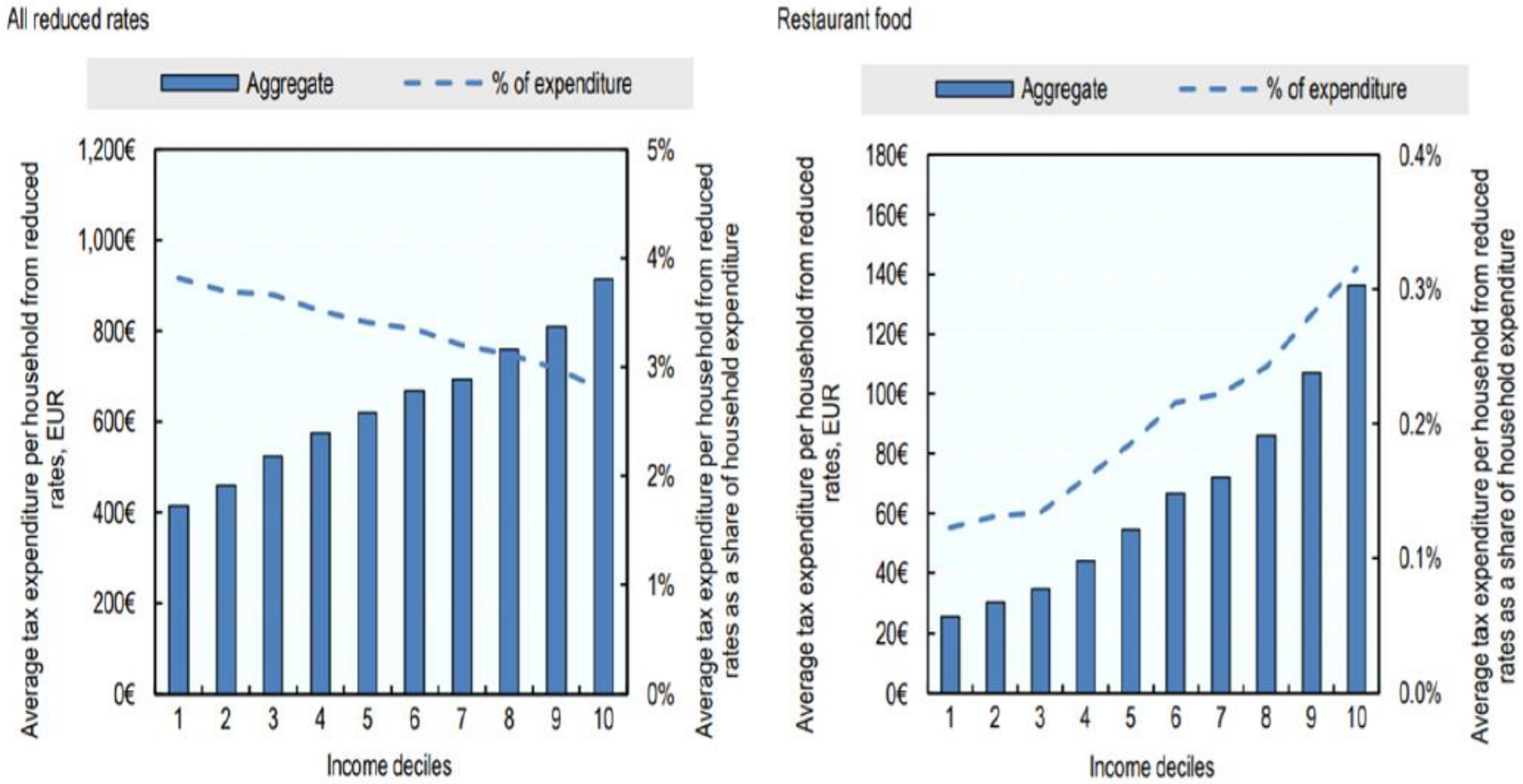
Amazon's profits rapidly outpace its tax burden

From 2009 to 2018, Amazon paid an effective federal tax rate of 3.0 percent on profits totaling $26.5 billion.

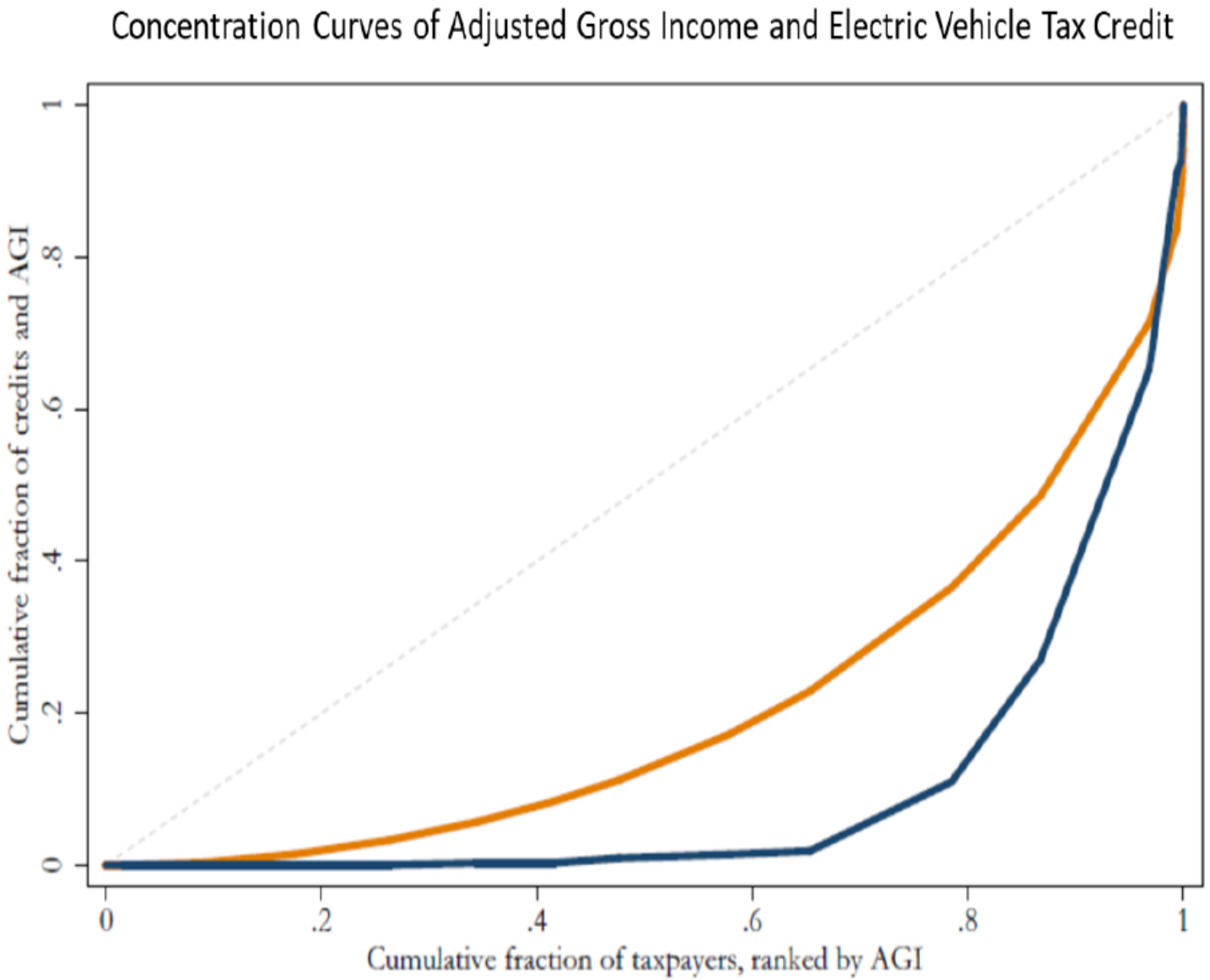


Source: Institute for Taxation and Economic Policy analysis of Amazon corporate filings

The value of VAT tax expenditures across the income distribution - average tax expenditure per household from reduced rates (EUR), 2010

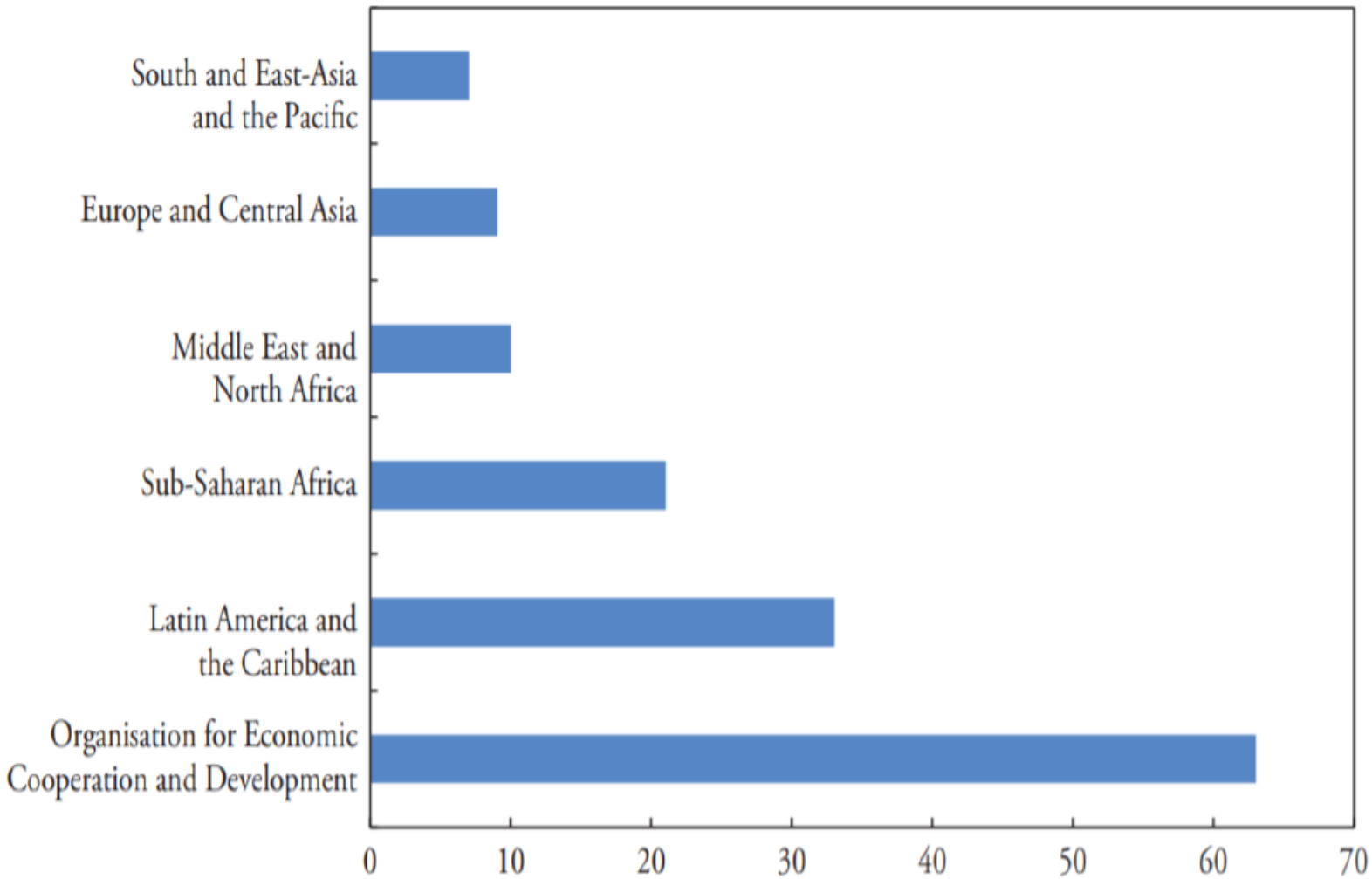


Source: The Distributional Effects of Consumption Taxes in OECD Countries (OECD/KIPF, 2014[50]).
Note: Unweighted average for Austria, Belgium, Czech Republic, Estonia, Germany, Greece, Hungary, Ireland, Italy, Luxembourg, Netherlands, Poland, Slovakia, Slovenia, Spain, Turkey, and United Kingdom. Figures are from 2010 for all countries except Austria (2009), Germany (2008), Ireland (2004), and Netherlands (2004).



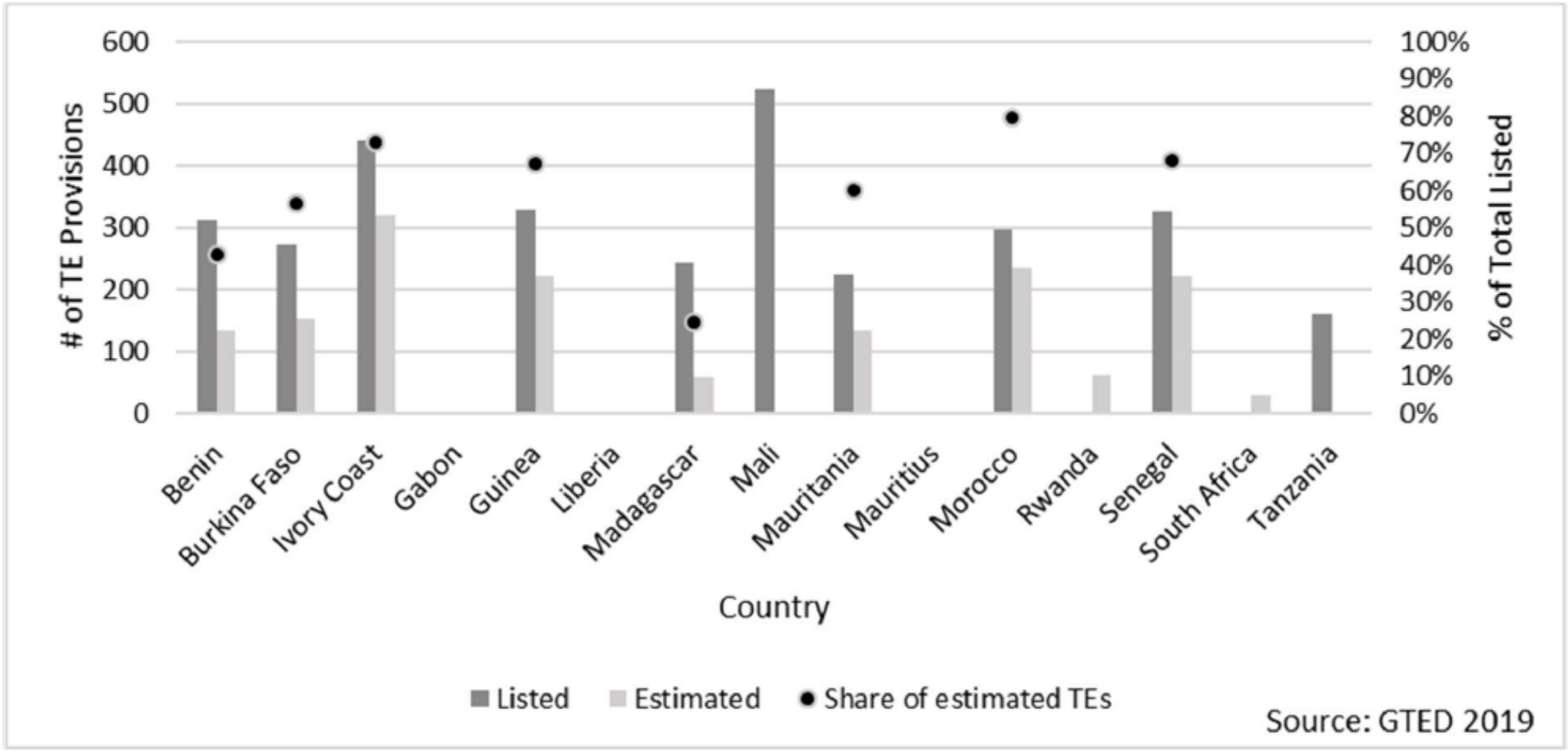
Source: Borenstein and Davis, 2016

Percentage of Countries where Tax Expenditures Are Periodically Calculated



Source: World Bank (2015).

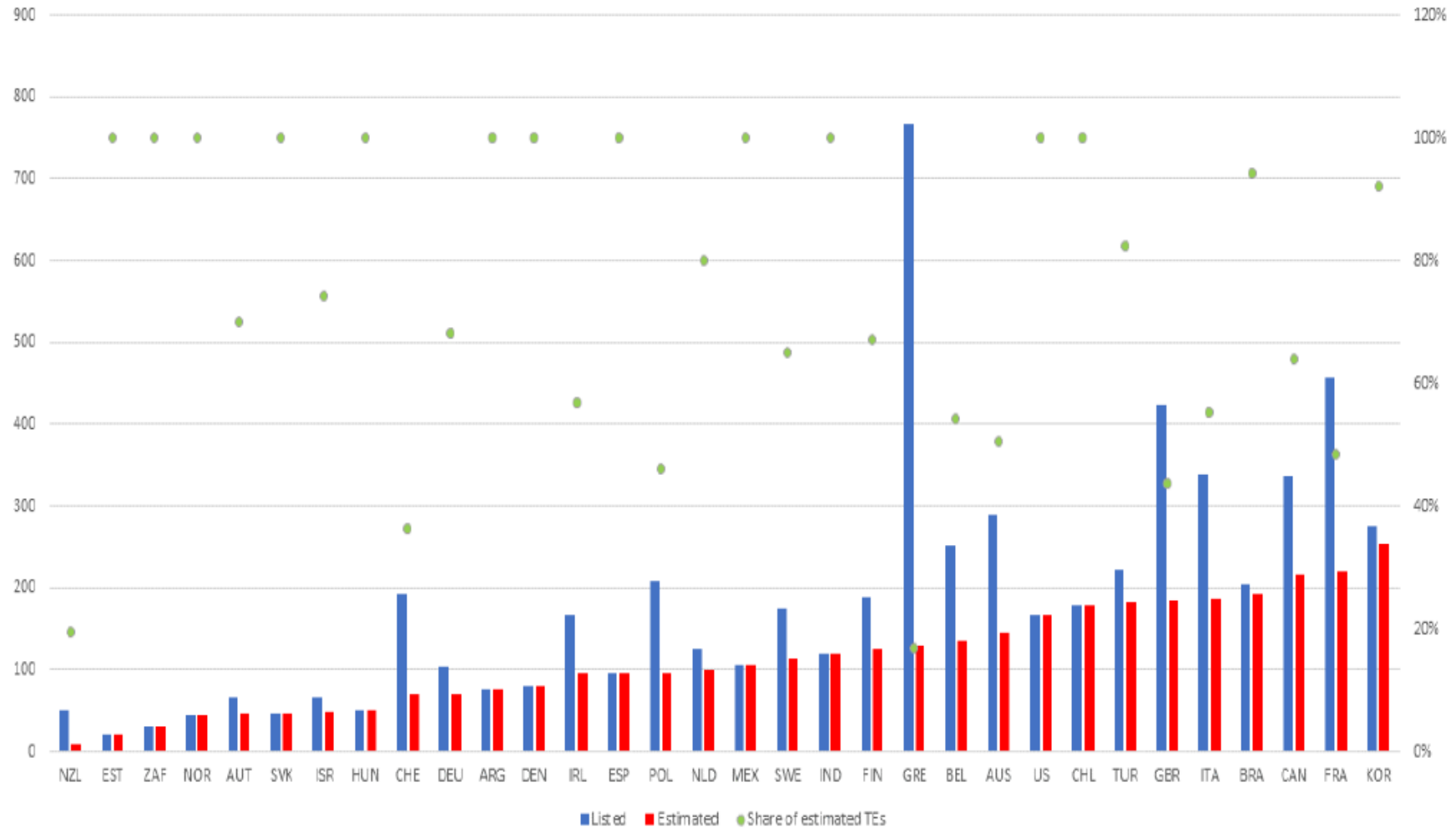
FIGURE 4. PERCENTAGE OF TE PROVISIONS EVALUATED



Source: Global Tax Expenditures Database (GTED), forthcoming

CEP

Estimation of Tes (Number of provisions)



Source: Redonda and Neubig (2018)

CEP