



Driving Tax Expenditure Reform in Times of COVID-19

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Tax Incentives in Developing Economies
in Times of COVID-19

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COVID-19: unprecedented economic impact

- The latest estimates by the [OECD](#)* show that global economic activity will fall by 6% in 2020
 - Highly heterogeneous effect, ranging from -1.2% in Korea and < -3% in China and Indonesia, to > -11% in Italy, France and Spain
- First increase in [global poverty](#) since 1998 ([WB, 2020](#))

Developing economies will be hit particularly hard

- The [impact on economic growth](#) is not necessarily 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
- 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
 - Africa (OECD) has 1.4 (12.3) health workers per 1 000 people ([OECD, 2020](#))
 - Central African Republic has 3 ventilators for 4.7 million people and Malawi 25 intensive care beds for 17 million inhabitants ([OECD, 2020](#))
 - 2 billion people live in countries experiencing high water stress ([UN, 2019](#))
 - Reduced **fiscal space**

Fiscal Space, developing economies' Achilles heel

- 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 donor 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](#))
- Average **tax-to-GDP ratio** for advanced economies is 26% > 15% (or less) in roughly half of developing countries, a threshold often accepted as the minimum to allow these economies to take-off economically ([IMF, 2017](#))
 - **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](#))
 - Tax revenue will shrink: collapse in activity, behavioral responses (compliance), **tax policy**

Fiscal policy responses: Tax expenditures (1/2)

I. Fiscal cost

- 1.5 trillion USD (roughly 36% of direct government spending and 7.5% of GDP) in the US (own calculations, based on [US Treasury, 2018](#))
- LATAM: between 0.7% and 6.6% of GDP ([CIAT](#))
- [Africa](#): between 0.65% (8.61%) and 7.8% (58.41%) of GDP (Tax Revenue) – (GTED, forthcoming)
- Net effect? [Significant negative impact on tax revenue](#) ([Kronfol and Steenbergen, 2020](#))

Fiscal policy responses: Tax expenditures (2/2)

I. (In)effective in reaching their policy objectives

- Tax incentives for **investment** are often ineffective, e.g. [high redundancy ratios](#) and [windfall gains](#)
- VAT-related tax expenditures are ineffective in mitigating [inequality](#) (e.g. VAT reductions for merit products) or in increasing employment in labour-intensive, low-skill, industries ([de la Feria, 2015](#))
 - Earned Income Tax Credit is a successful scheme ([Bastian, 2018](#))

II. Negative externalities, no matter effectiveness to reach stated goals

- 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](#)) – and > 60% of the total are granted as tax benefits
- Distributive effect: [Electric vehicle tax credits](#)

Policy Implications

Policy implications: No one-fits all approach to weather the storm the world is going through, but the use tax expenditures should definitively be rationalized...for every country and in any context, but particularly for developing economies in times of COVID-19

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

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



Thank you for your attention

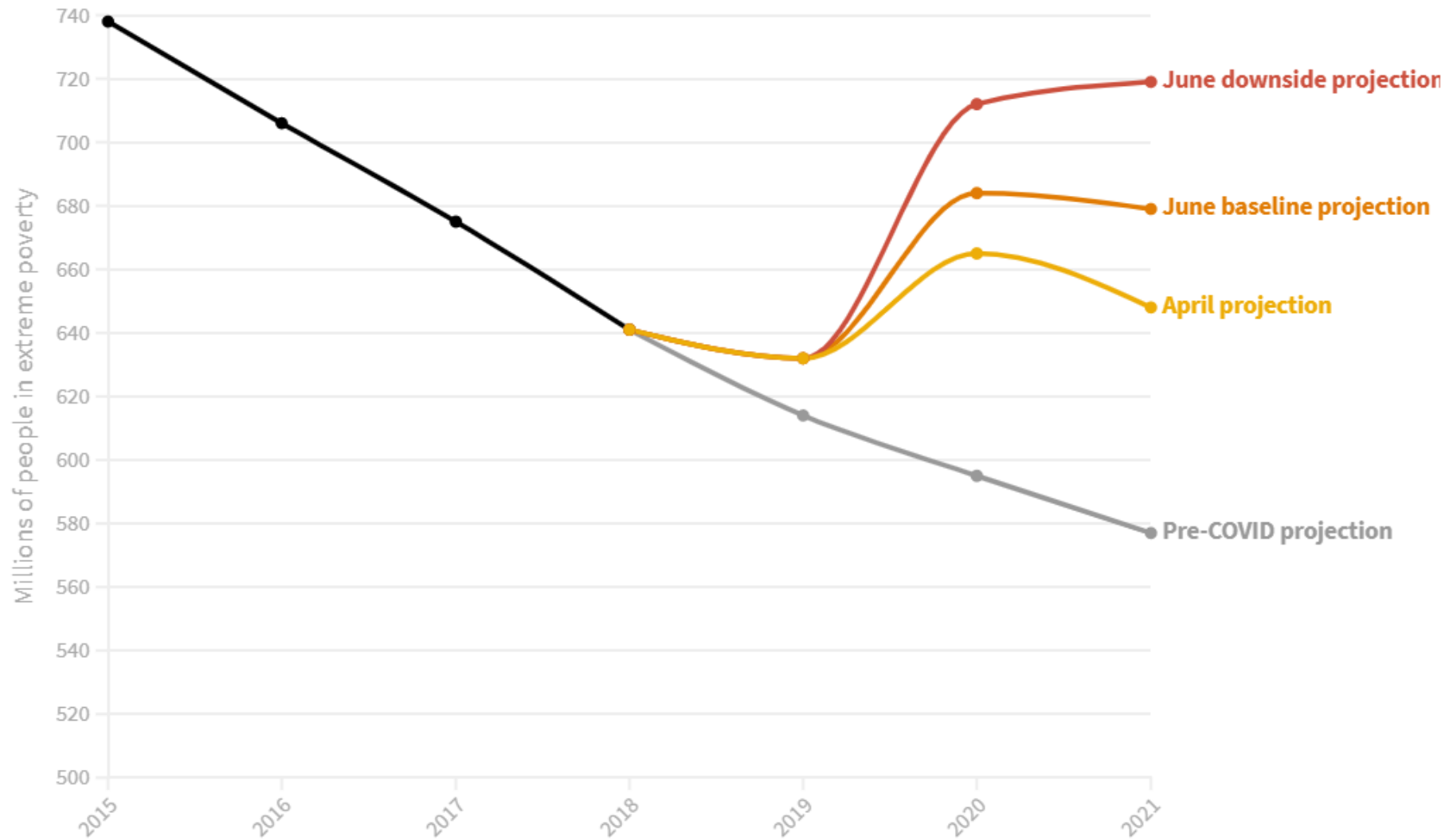
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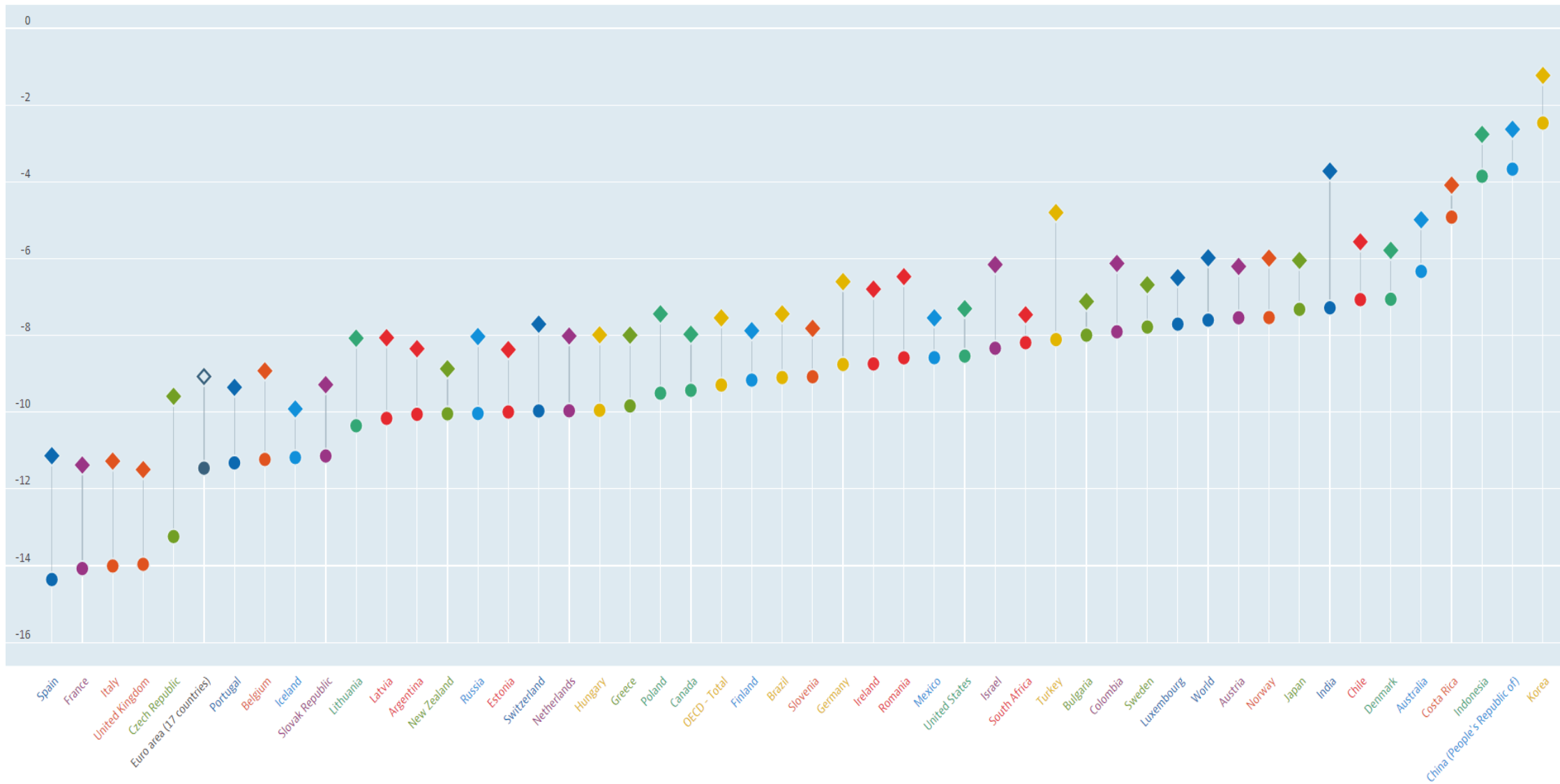
Website: www.cepweb.org

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.





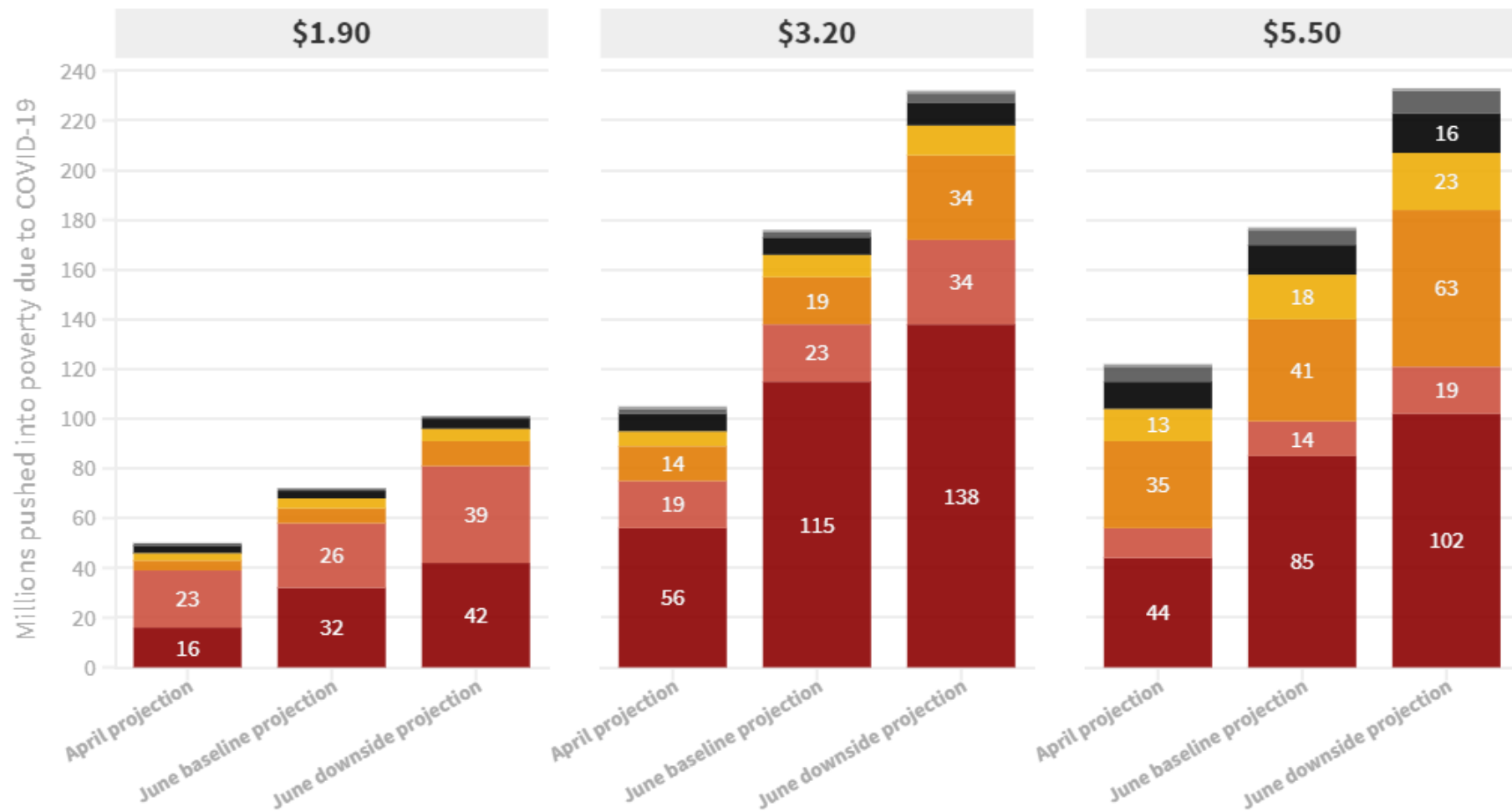
● Double-hit scenario ◆ Single-hit scenario

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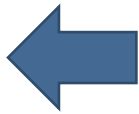


The Regional Distribution of the COVID-19-Induced Poor

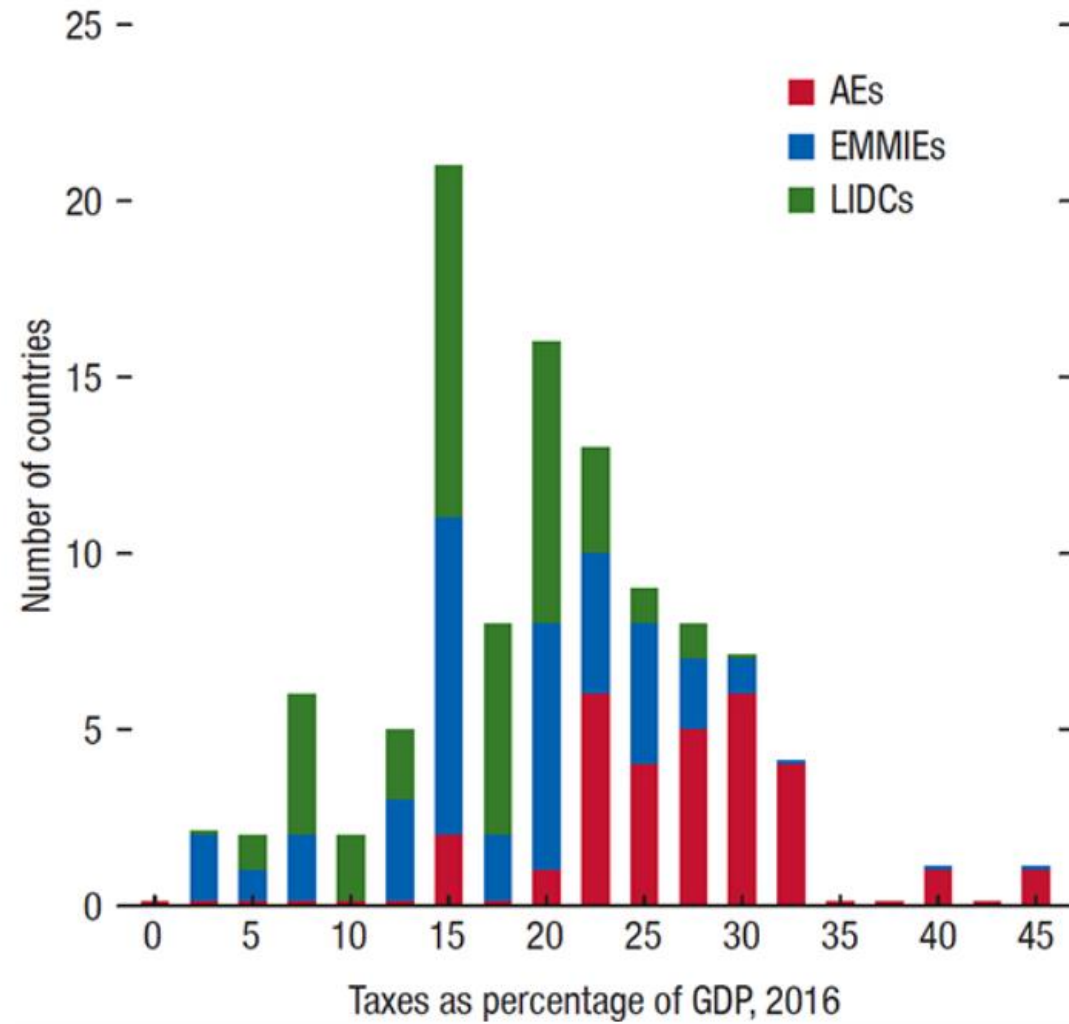
■ South Asia
 ■ Sub-Saharan Africa
 ■ East Asia & Pacific
 ■ Latin America & Caribbean
 ■ Middle East & North Africa
 ■ Europe & Central Asia
 ■ North America



Source: [Lakner et al. \(2020\)](#), [PovcalNet](#), [Global Economic Prospects](#)



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.

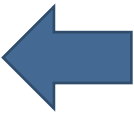
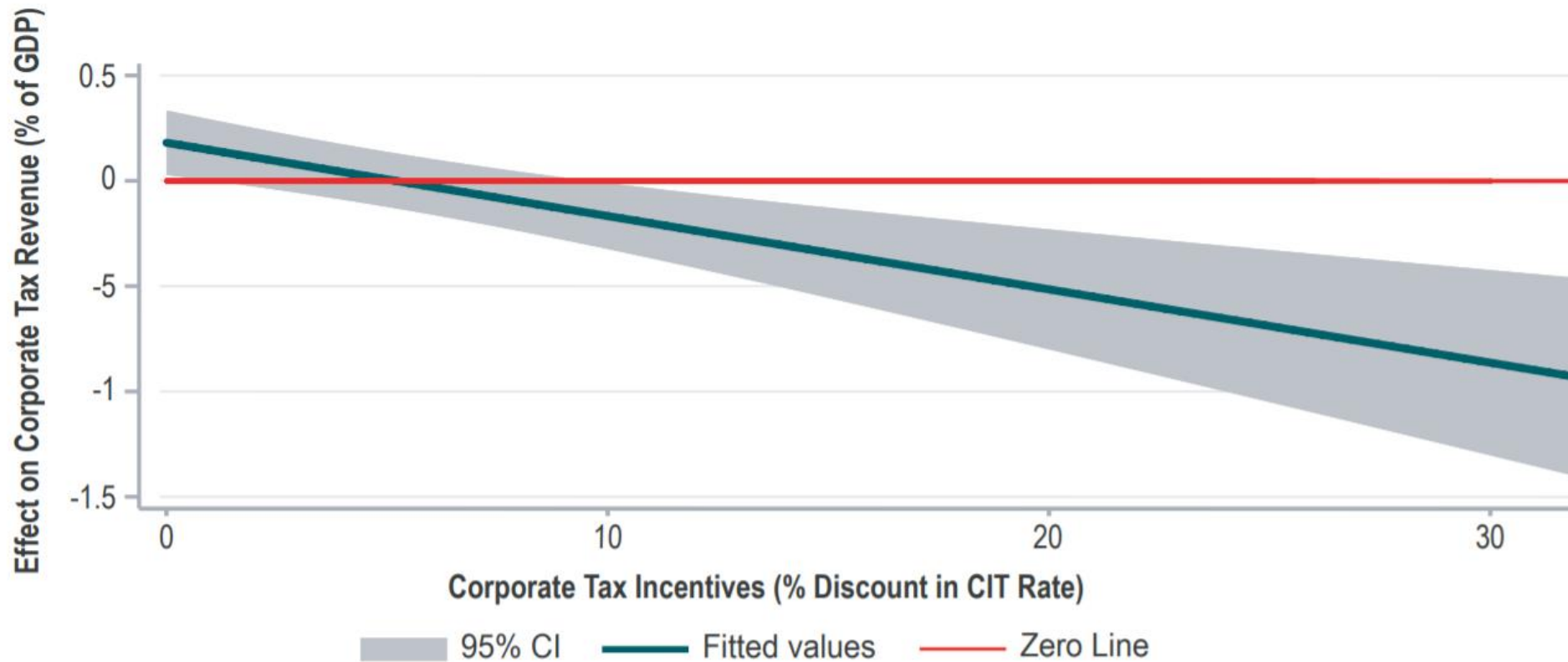


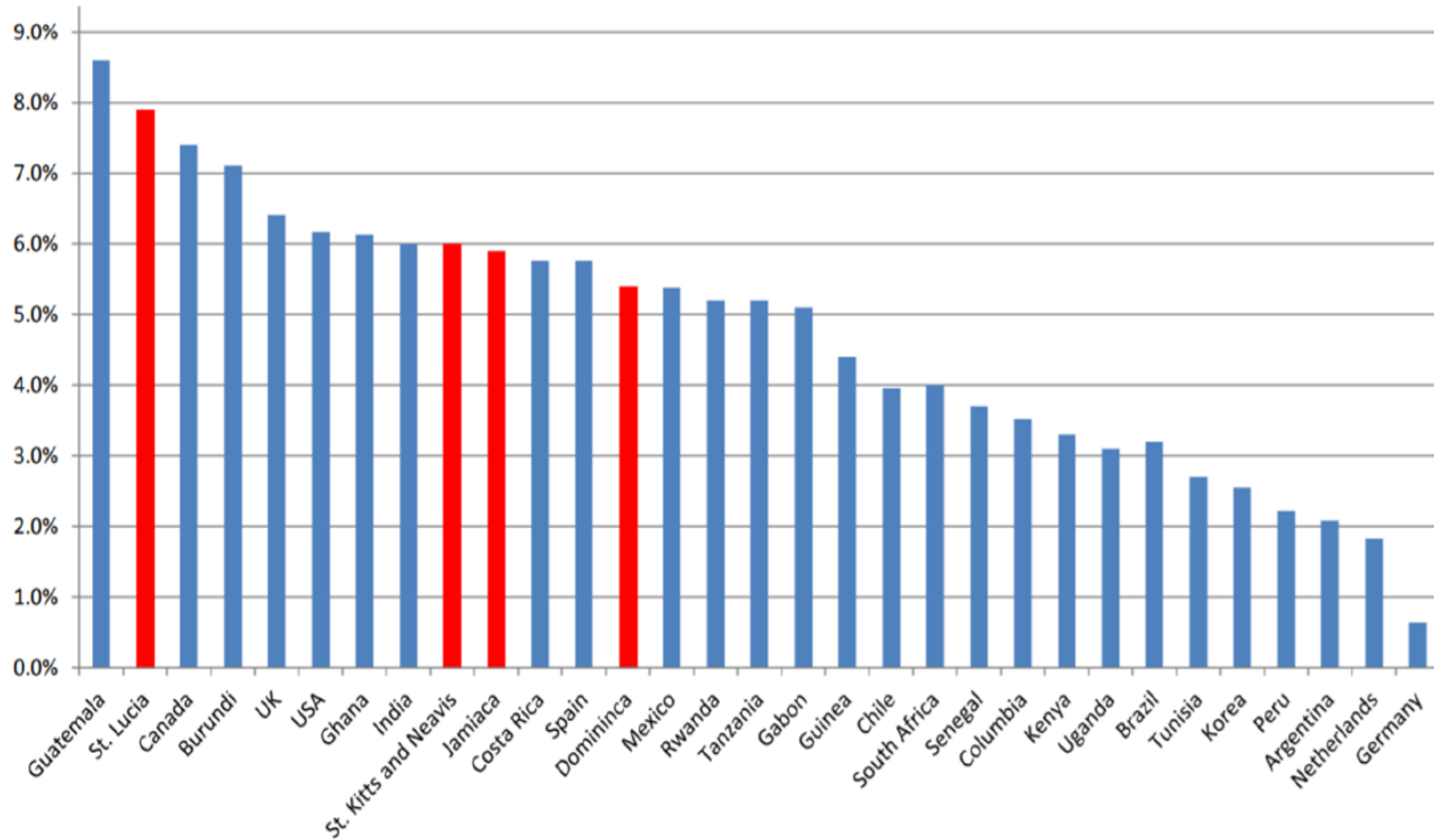
Figure 2. More Generous Tax Incentives are Associated with Lower Corporate Tax Revenue



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.

Tax Expenditure as % of GDP



Source: James (2014)



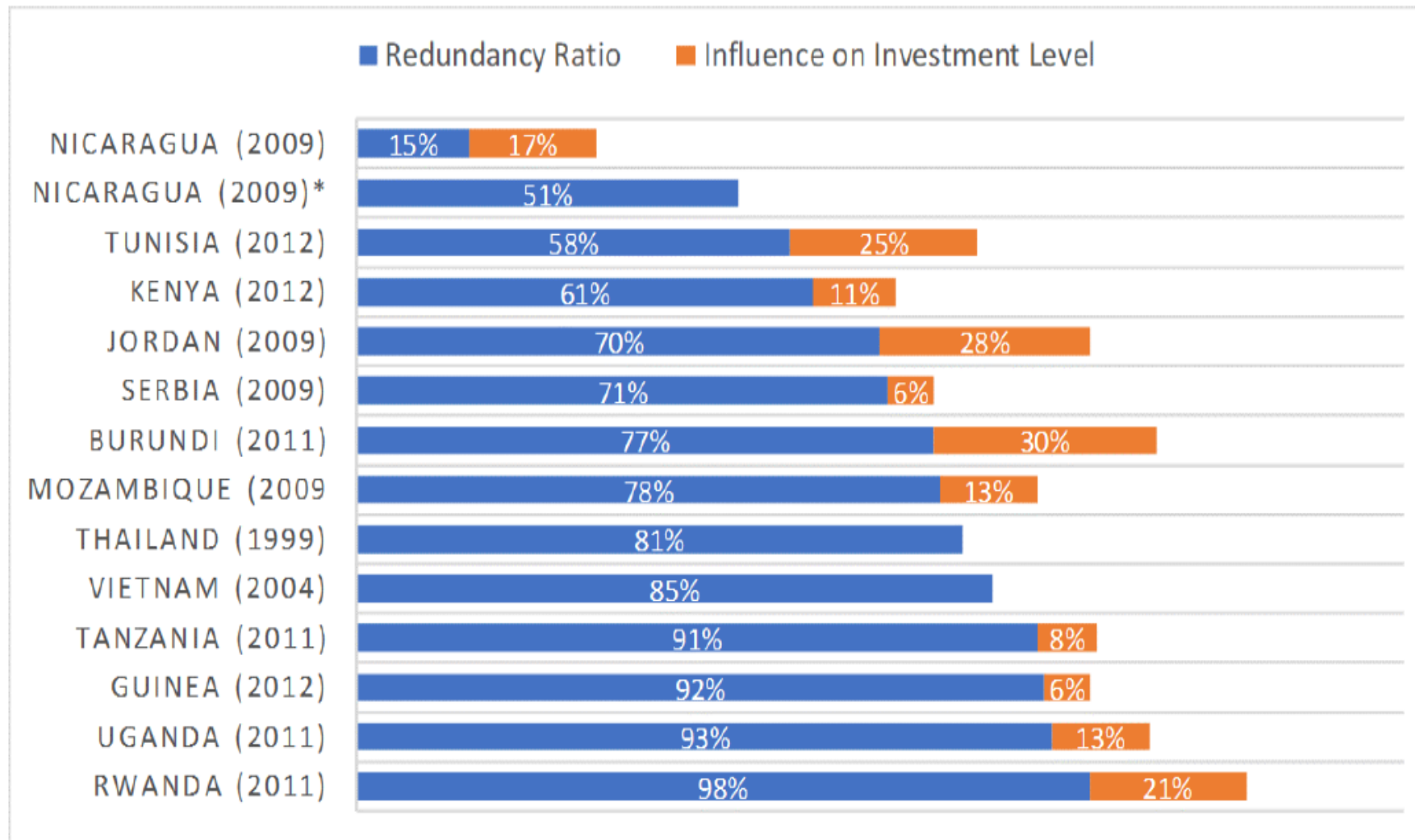
TABLE 3. TE AS A PERCENTAGE OF TOTAL TAX COLLECTED & GDP¹²¹³

| Country | Year | % of Tax Collected | % of GDP |
|----------------|------|--------------------|--------------|
| Benin | 2017 | 18.20% | 2.40% |
| Burkina Faso | 2016 | 8.61% | 1.38% |
| DR Congo | 2016 | 10.21% | 0.65% |
| 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% |
| Sierra Leone | 2017 | 8.76% | 1.20% |
| South Africa | 2017 | 14.90% | 3.90% |
| South Sudan | 2018 | | |
| Tanzania | 2012 | 27.00% | 4.40% |
| Average | | 18.70% | 2.89% |

Source: Global Tax Expenditures Database (GTED), forthcoming

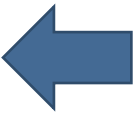


Salience of Tax Incentives based on Investor Surveys



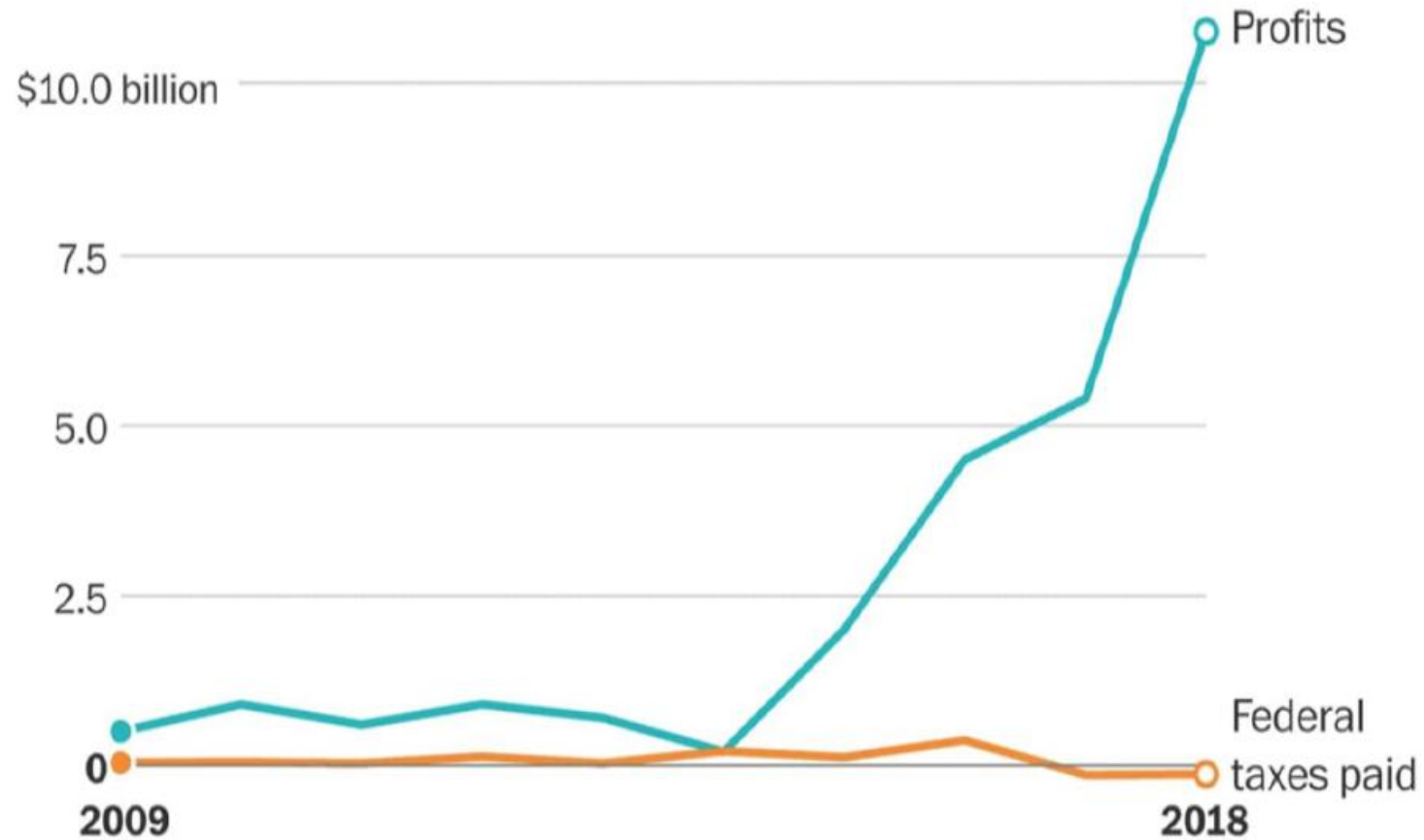
Note: *Non-exporting firms outside free zones.

Source: Own elaboration based on James, 2013.



Amazon's profits rapidly outpace its tax burden

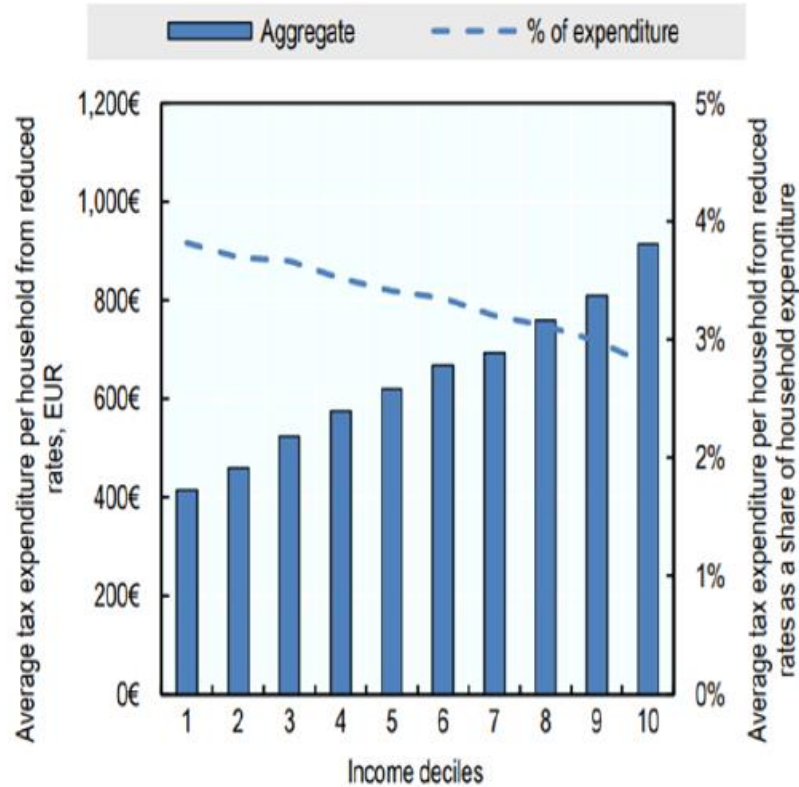
From 2009 to 2018, Amazon paid an effective federal tax rate of 3.0 percent on profits totaling \$26.5 billion.



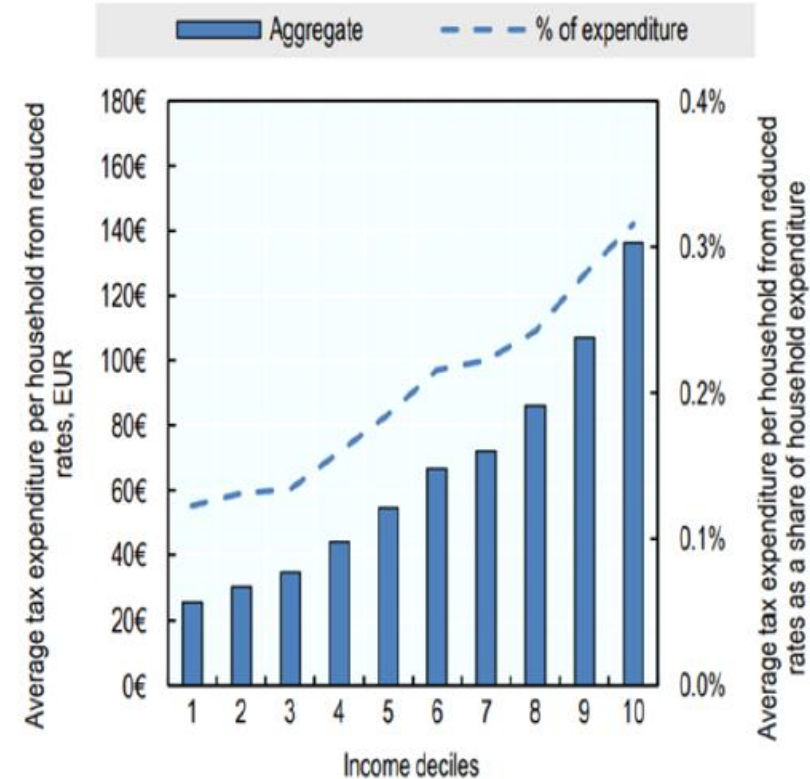
Source: Institute for Taxation and Economic Policy analysis of Amazon corporate filings

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

All reduced rates

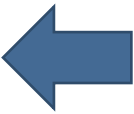


Restaurant food

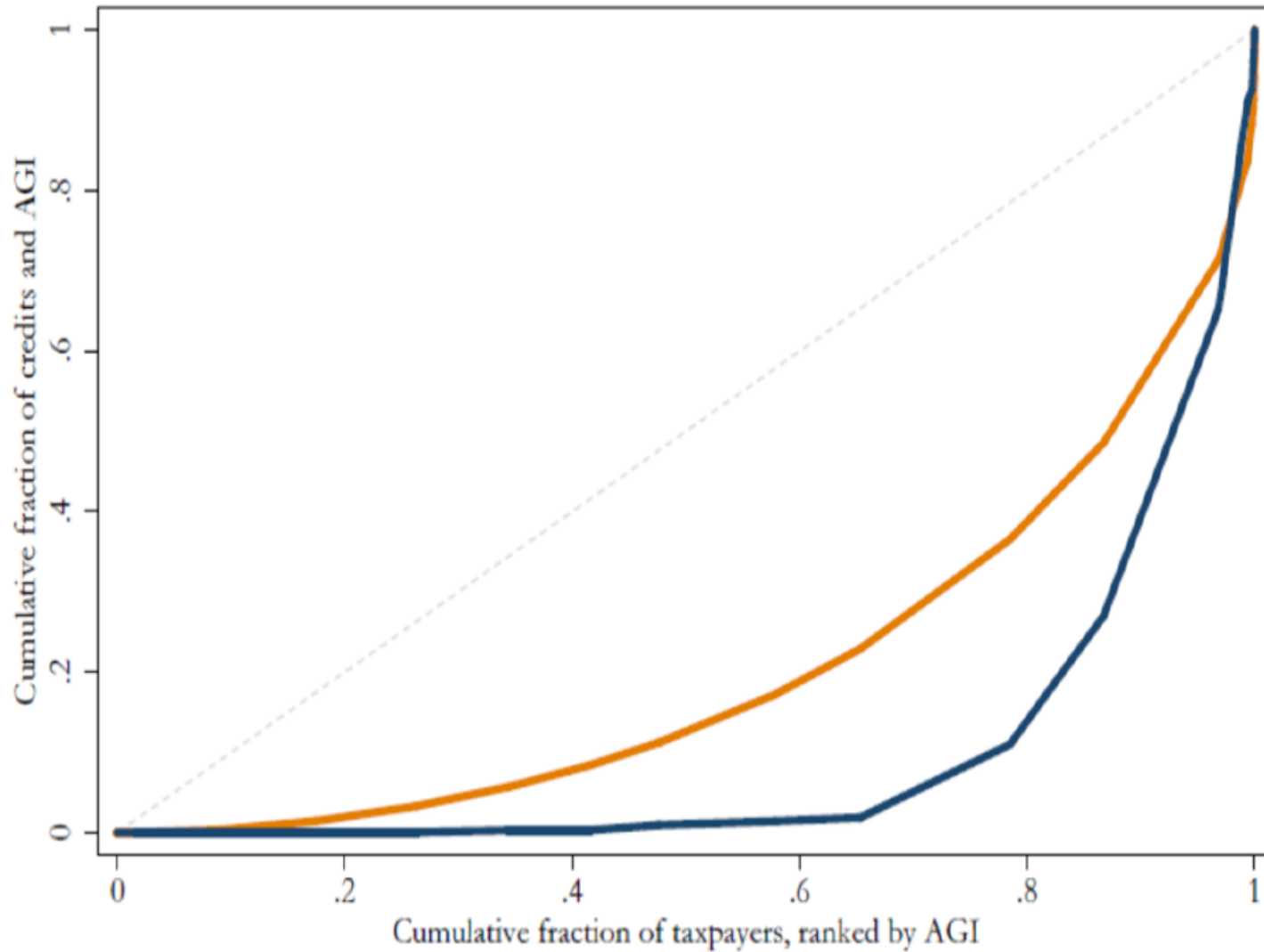


Source: The Distributional Effects of Consumption Taxes in OECD Countries (OECD/KIPF, 2014_[50]).

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).



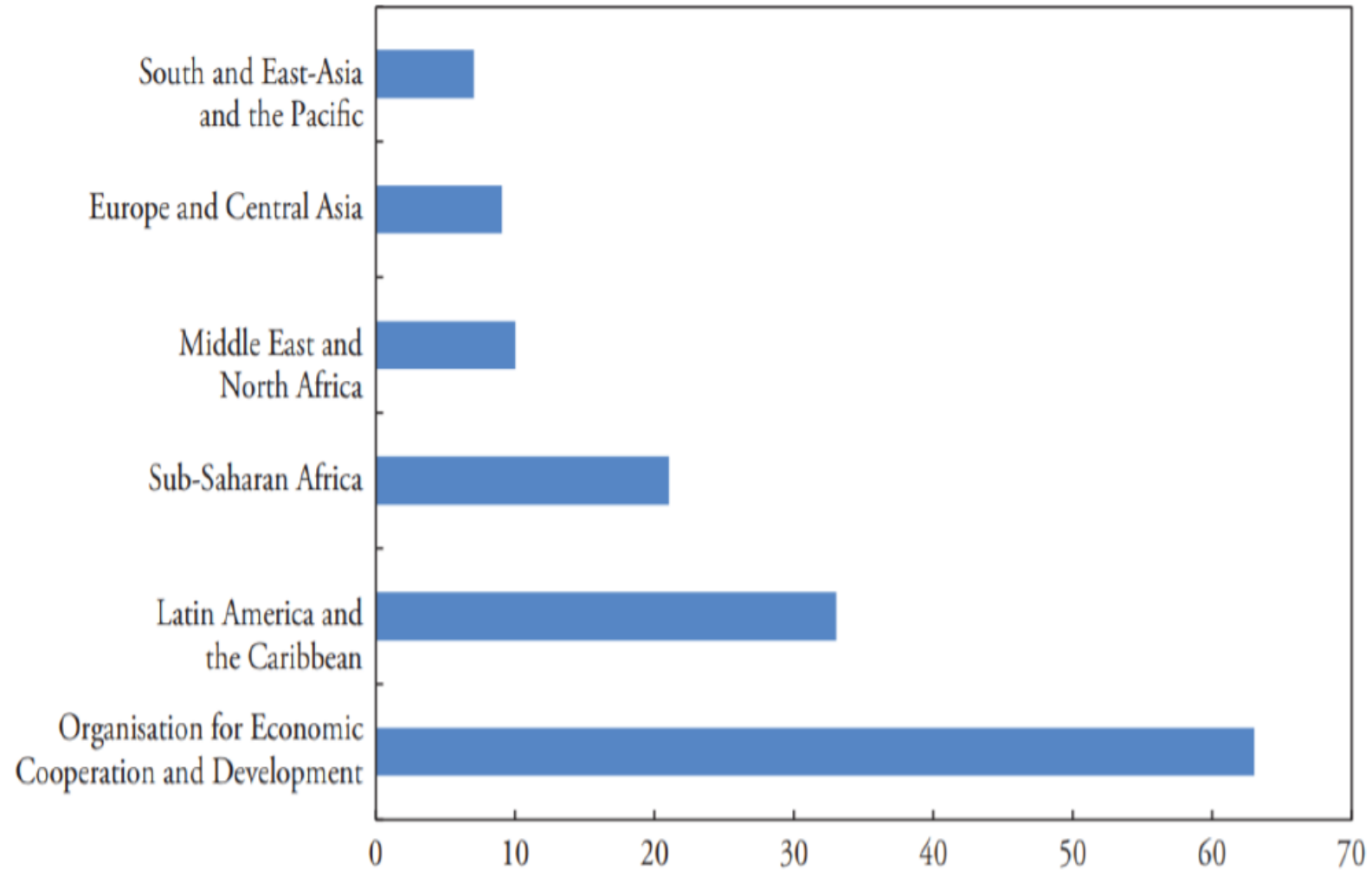
Concentration Curves of Adjusted Gross Income and Electric Vehicle Tax Credit



Source: Borenstein and Davis, 2016

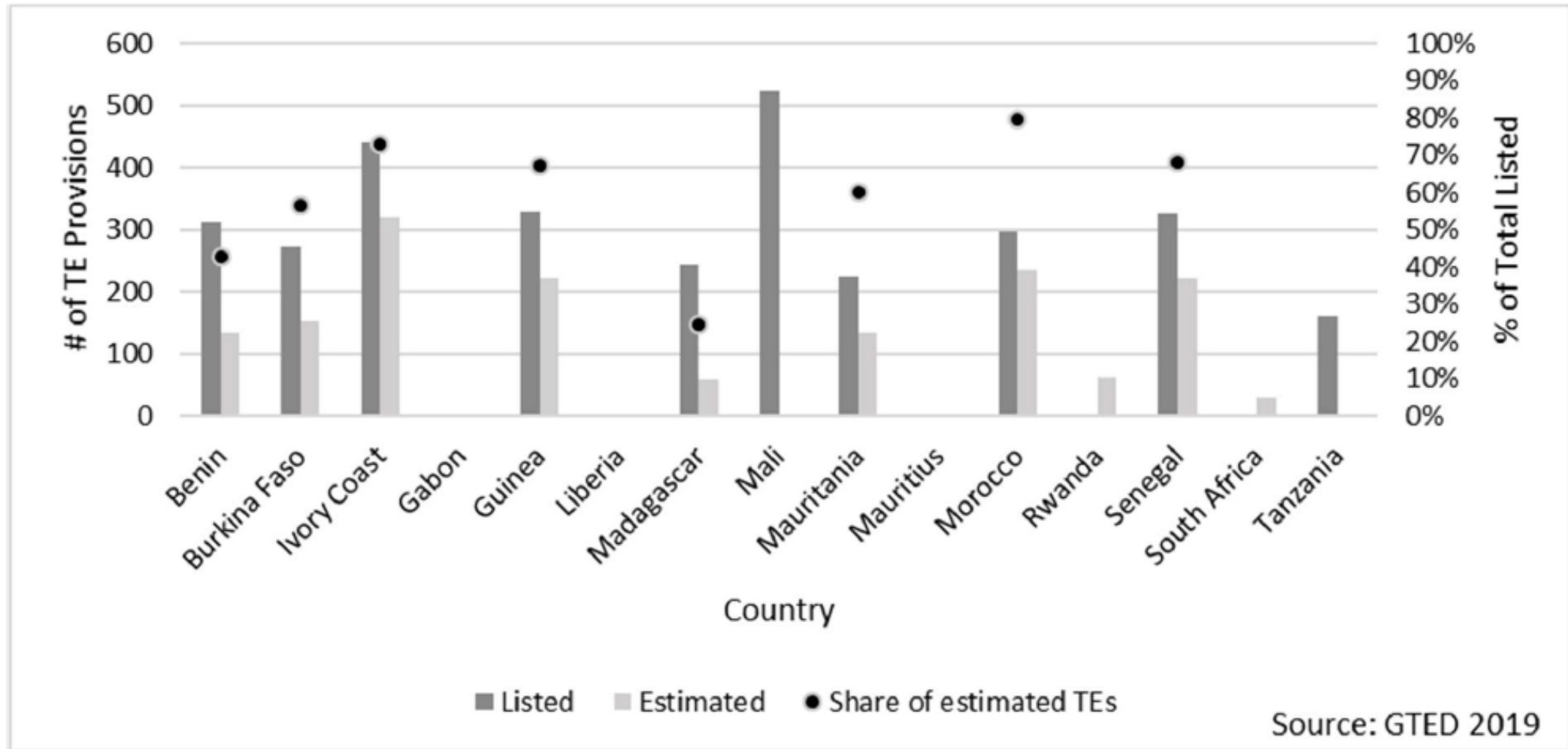


Percentage of Countries where Tax Expenditures Are Periodically Calculated



Source: World Bank (2015).

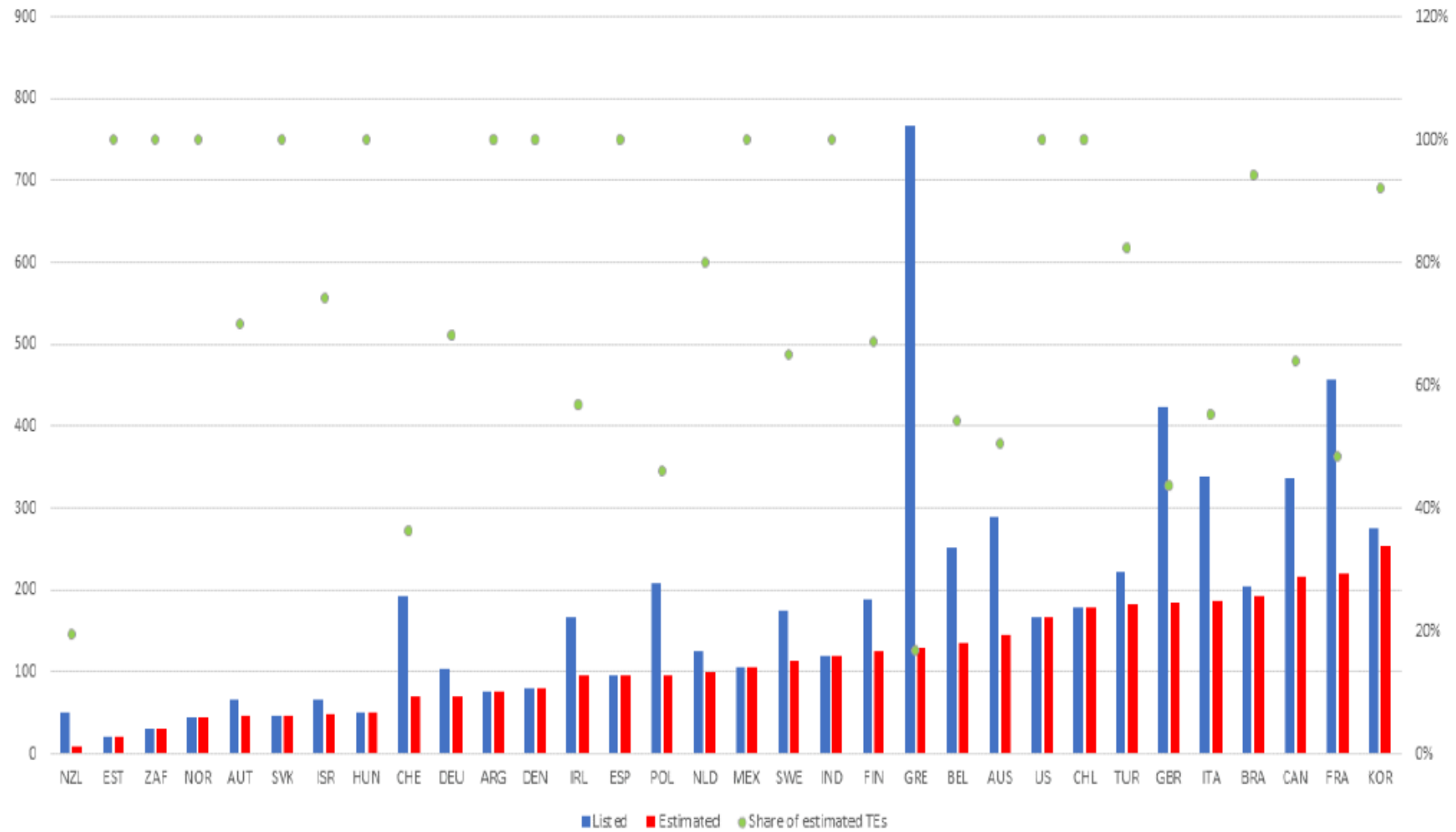
FIGURE 4. PERCENTAGE OF TE PROVISIONS EVALUATED



Source: Global Tax Expenditures Database (GTED), forthcoming



Estimation of Tes (Number of provisions)



Source: Redonda and Neubig (2018)

