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Taxation & Development

UNITED NATIONS UNIVERSITY
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Introduction

- Using this session to put together research/policy ideas around taxation
- Motivation: is policy getting answers to the questions it most needs (from research)?
- Take-Away: Tax Policy not just about revenue mobilization: also about helping shape economies & societies for inclusive development

Taxation: top of policy agenda.

- **Why?** citizen-state contract in democracies; tax policy helps (& hinders) inclusive growth & poverty reduction (SDGs); diversify from resource revenues & vulnerability to price slumps; aid fatigue. Debate: not just technocrats: now inc. parliamentarians, civil society.

- **More action in tax reform.** Some progress (trade tax reform; move to VAT in >125 countries; rise in tax/GDP in many countries; better institutions).

- **But many concerns:** tax bases still too narrow; resource revenue dependence (magnified by commodities super-cycle over 2000-14); over-complexity & unfairness; weak compliance; international tax evasion & avoidance; risks: shocks, climate change, pandemics, conflict (Fragility)

Opportunities & challenges as LICs MICs

- **Formalization & New Sectors** more compliance (& new revenues from financial services, digital economy in MICs) in a process of structural transformation & social change (demographic transition, urbanization etc.) + state-building (effective & accountable state institutions) research

- **The politics is as important as the economics** political economy (tax policies as an outcome many agents interacting, with varying degrees of power: states, citizens, businesses, communities, international organizations). research

- **Importance of tax incidence (+ net fiscal incidence)** by income group, location (rural v urban etc.) & gender (as well as concern for horizontal inequality ⇔ unfair tax burden as a source of conflict).

- **Good policy delivers development in ways that deepen social inclusion**. So need a base of good information inc. data in all its dimensions (revenue sources, household data for incidence, enterprise data etc.). Yet the data is far from satisfactory.

Metrics : Tax/GDP

- **Tax/GDP**: strengths & limitations. Inaccuracy when either denominator &/or numerators are mis-measured (limited statistical capacities in LICs & conflict – '**fragile states**' - but also Argentina & India's GDPs are suspect).
- **Is tax/GDP the best indicator we have?** Governments like rules of thumb, but it's important *how* the Tax/GDP ratio is achieved: raising it via distortionary taxes will hit GDP itself. research
- **Policy Gap** & **Compliance Gap** – IMF (Keen) : Good way forward (with Policy Gap further decomposed across taxes etc.
- **Is Revenue Raised Doing its Development Job?** For human development, infrastructure, shaping the economy in ways that create more & better jobs? research

What Should Tax Policy Try to Achieve?

- **Public economics makes a strong set of statements on what is the best ('optimal') tax system.** But tax authorities in developing countries face much higher informational barriers than in HICs (informal sector etc). So what is optimal in LICs & MICs may differ to HICs "Second Best" tax policy (Chris Heady) & indeed 'Third Best' (Henrik Kleven)

- The tax system (& public finance) is often the outcome of **historical path dependence** (inc. 'inertia') & negotiation among powerful stakeholders (=> exemptions) than the ideal of public economics. Modern public economics recognizes this, & emphasises incentives & constraints in building fiscal capacity (Besley/Persson)

- Also acceptance & resistance of taxation by citizens: the centrality of **compliance** (Slemrod), resonating political science work on '**fiscal contracts**'(Moore & ICTD)

- **Macro-crises push tax reform**: but sometimes of the worst kind (& too late e.g. oil producers faced with price drop woken up to their undiversified revenue bases)

Financing v Other Development Goals

- **Economic & social development now has many goals**. Moved on from just a narrow focus on economic growth =>MDGs => SDGs. Correspondingly, discussion of what tax policy should try to help achieve - broadened out over time (e.g. **gender equality**).

- **Financing goal still drives the debate:** powerful set of interests pushes it that way: states need revenue; donors want exit from aid; Civil society & INGOs are concerned about imbalance of power between MNCs & states.

- **Financing focus for tax policy is reinforced by dominance of human development investment** in development policy discourse ⇔ MDGs & now SDGs require funding for large expenditures on health, education, social protection etc.

Tax Policy in Shaping Economy/Society

- In focusing on financing for development agenda, shouldn't ignore other key roles for tax policy.
- **Tax Policy also need to concern itself with goals of inclusive growth via private-sector development** (job creation & self-employment via SME development, FDI etc.). Could mean industrial policy (though watch the exemptions!) but often removing distortions & costs to tax payer
- **Environmental sustainability** (reduction of environmental bads such as air & water pollution, as well as climate change mitigation & adaption) => carbon taxes research
- Need to **apply public economics** to understand how tax policy can contribute to these goals.
- **Donors can help with technical assistance** not just to improve tax admins (which they do at present) but also the capacity for public economics (e.g. UNU-WIDER's SOUTHMOD) research

Policy Simulation

SOUTHMOD – simulating tax and benefit policies for development

This is part of the The economics and politics of taxation and social protection project.

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Tax-benefit microsimulation models, which combine representative household-level data on incomes and expenditures and detailed coding of tax and benefit legislation, have proven to be an extremely useful tool for researchers and policy makers alike. The models apply user-defined tax and benefit policy rules to micro-data on individuals and households and calculate the effects of these rules on household income. The effects of different policy scenarios on poverty, inequality, and government revenues can be analysed and compared.

Simulation in developing countries

While microsimulation models are routinely used by researchers and policy makers in developed countries, few developing countries have access to such tools. Many of the developing countries are now building up their social protection systems and the financing of public spending will need to be increasingly based on domestic tax revenues. In this process, understanding the system-wide impacts

National Tax Performance: Is the Development Past a Guide to the Development Future?

- **As they look to the future** & the evolution of their tax systems, today's LICs can learn from the tax histories of today's MICs & HICs – but by how much?
- Highlight 4 areas of importance for the future (doubt that next decades will replicate development past) □ research:
- (i) **informal sector** & its growth ⇔ demographic change ⇔ migration flows
- (ii) **digital economy** (e-commerce together with related ICT services)
- (iii) **climate change** & its impact as well as responses to it (adaption and mitigation, carbon taxes) & impact on producers of fossil fuels ('stranded assets/countries') & metals (⇔ renewables)
- (iv) **revenue risks** (climate, price shocks, pandemics, intensifying global competition, Trump border tax & contraction global trade, conflict). NB: Aid can be pro-cyclical, rather than counter-cyclical

Informal sector => formalization

- Much of the informal sector consists of the self-employed, often single-person enterprises, perhaps employing one or two workers when needed. In contrast, HICs have larger & more complex firms which keep detailed financial records, thereby assisting verification of compliance (Kleven's work).

- Tax compliance tends therefore to rise with per capita income: as more people become formally employed, as more of the self-employed start to use financial services (& thereby the ability of the authorities to verify compliance) & as firms become bigger in scale (with more financial records, facilitating verification).

- Central to development economics since its early days is the 'stylized fact' that informality declines as per capita incomes rise: more people find formal-sector employment (and therefore enter the personal income tax system) as changes in the economy's structure create more manufacturing & service jobs in formal enterprises (where firms are registered and pay taxes).

- But in many LICs and MICs the number of people in informality is rising not falling, as is the % in some countries (WIEGO evidence). Taxation of the informal sector is neither easy nor non-controversial – many young people with low skills => outward migration as well

Climate change

- move to carbon taxation: first used in some European countries in 1990s & quite wide bi-partisan support in US
- Policymakers concern over impact on energy-intensive firms, especially if unilateral adoption of carbon tax makes them less internationally competitive (South Africa discussion). Politics: Australia introduced & then reversed a carbon tax. Some temporary compensating payments may be viable to industries affected, provided they do not breach WTO rules on subsidizing exporters.
- Fossil fuel exporters, demand (& prices) face major headwinds from climate change action
- Revenue expectations based on proven reserves may be much too high if these constitute 'stranded assets': add to the existing impetus to diversify their revenue base (e.g. Saudi Arabia indirect tax reforms).
- Drought and flood are a major source of -ve revenue shocks (both are likely to rise in frequency & severity with climate change) (any evidence?). If your economy is under water then your tax base is under water. Low-lying countries like Bangladesh are highly vulnerable. Also the urban tax base as many of the world's major centres of economic activity are coastal cities or on major rivers, vulnerable to sea level rise

Extractive industries for Development

This is part of the 'Macro-economic management (M-EM)' project.

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Natural resource wealth has often turned out to be a 'curse' rather than a 'blessing' for developing countries. Growth based exclusively on natural resources—such as oil, gas, and minerals—is often of a very narrow kind which lacks opportunities for including the poor. This condition—also called 'the natural resource curse' is on the focus of this project.

Management is key to turning curse into blessing

Natural resource wealth needs to be carefully managed if inclusive growth is to be achieved in low- and middle-income countries. Natural resources can also negatively affect the democratic process—the sector has often been associated with corruption and the non-transparent use of resource revenues for private gain instead of national development.

The project focuses on the implications of natural resources and their management for economic development—aiming to find ways in which resource wealth could be managed successfully in developing countries; for instance by using the revenues from oil, gas and minerals for development

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