TAX POLICY OPTIONS FOR FISCAL SUSTAINABILITY

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GENERAL PRINCIPLES

FAD

Standard tax principles continue to apply, but maybe with new twists:

Equity—Put a large part of the burden on better-off old?

Efficiency—A search for immobile tax bases; ease that constraint by further strengthening of international cooperation, including on climate policies?

Implementation—How fundamentally will new technologies change things (real-time transaction reporting; personalized pricing…)?

OPTIONS

Value Added Tax

- All G-20 have a VAT, except US and Saudi Arabia
  —in US, 13% VAT could raise 6% GDP
- About 20 percent of all revenue
- Has proved a relatively efficient revenue source
- Wide variations in rate (5-21 percent), number of rates (1 to 4) and base

As a broad indicator:

C-efficiency = VAT revenue/(rate x consumption)

= 100% if single rate, broad-based, perfectly enforced

In practice, averages 50% for advanced and emerging...

—though with big variation (69% in Japan, e.g.)

...suggesting scope to do more without raising rate

Decomposing failure into ‘policy’ and ‘compliance’ gaps, main weaknesses are:

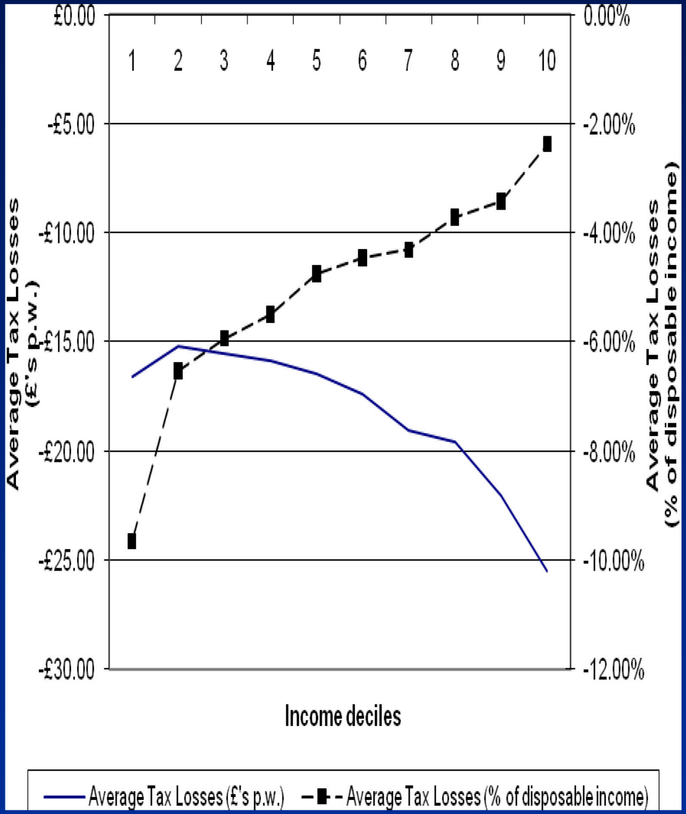
- Compliance in emerging economies

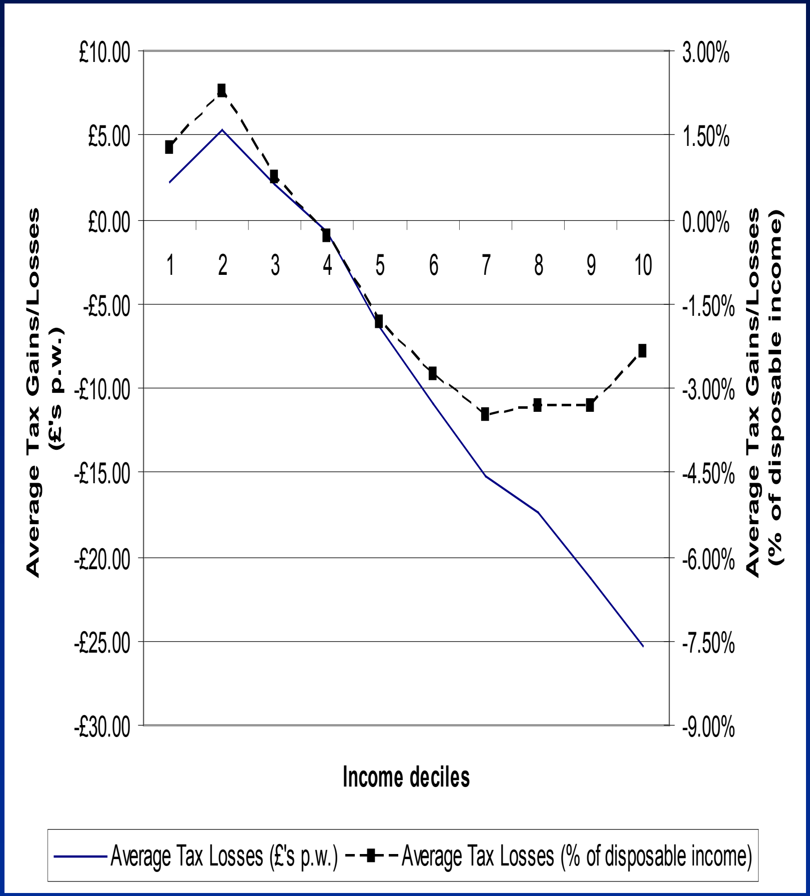
  —Latvia could raise 1.6% GDP by cutting compliance gap to that in France

- Policy in advanced countries: ‘old’ VATs have multiple rates and exemptions

  —Eg1: Italy could raise 3.1% GDP by halving policy gap

Eg2: Removing zero-rating in UK:





…would raise 0.79% GDP even after protecting poor

Personal income tax

Central for equity concerns, but behavioral impact—real and avoidance/evasion—matters

- Main labor supply effects are through participation

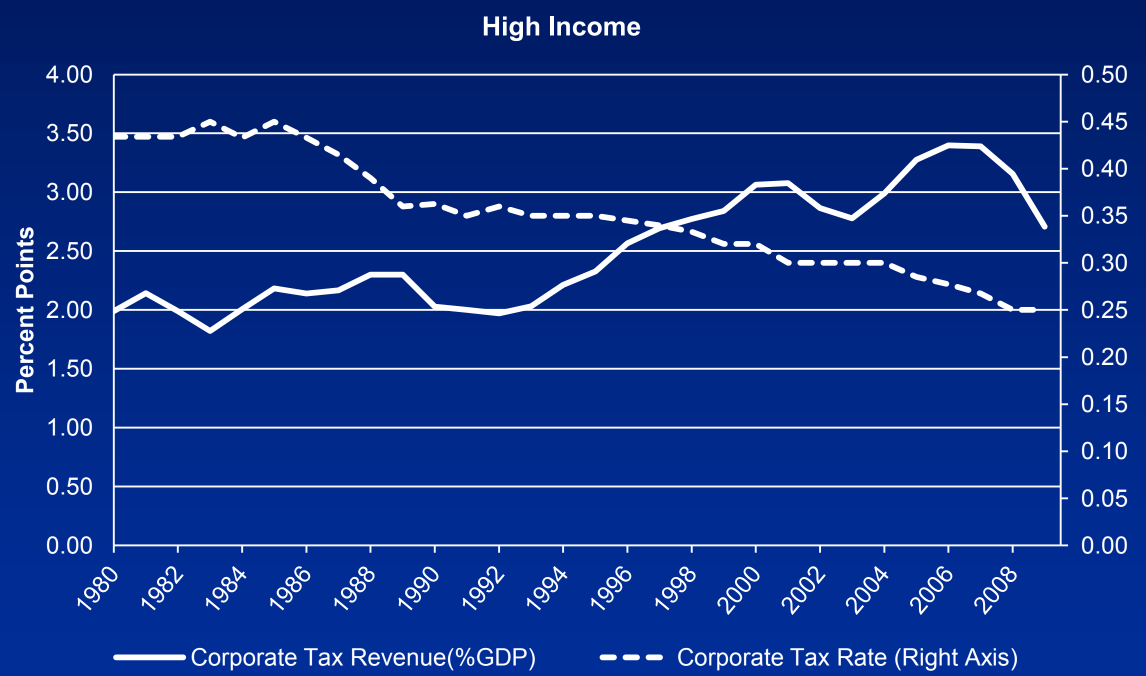
  —more scope to exploit these: e.g. lower rates on those near retirement (but consistent with intercohort equity?)

- Planning makes taxable income of richest responsive

  —current top rates may be close to revenue-maximizing

Corporate income tax

Rates have tumbled but revenue held up (pre-crisis…)



Possible explanations include strength of financial sector

- Substantial increase in revenue unlikely given:
  —Continued pressure on rates
  —Likely lower financial sector profits (and accumulated losses)
  —Past base broadening (though maybe scope for more—R&D tax credits?)

- International coordination, again beyond info. exchange (to minimum rates, bases, formula apportionment
  —has proved hard

Carbon pricing

…whether tax or cap-and-trade

- Substantial potential in principle…
  —$50-660 billion annually form efficient pricing
  —Proposals in US implied c. $100 billion annually
  …even after compensating measures

- Important not to dissipate by free allocation of rights…

- …and to include international aviation and maritime (and in indirect taxation more generally)

Real estate taxes

- Seem relatively growth-friendly (immobile, low current rates) fair, and suitable for lower-level govts.

- Under-used in some countries

  —3% percent GDP in Canada, US, UK, but under 1% in other G20

- But reform can take time

  —to develop cadastre and valuation techniques

CONCLUDING

- Nature (and extent) of policy measures country-specific
- Some new opportunities (carbon and congestion pricing, congestion…)
- But largely widening existing bases…
- …in ways that have proved politically difficult