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# Tax Expenditures in Uruguay

Dirk Muir and Hector Perez Saiz

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IMF Selected Issues Papers are prepared by IMF staff as background documentation for periodic consultations with member countries. It is based on the information available at the time it was completed on October 6, 2025. This paper is also published separately as IMF Country Report No 25/288.

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**Tax Expenditures in Uruguay**  
**Prepared by Dirk Muir and Hector Perez-Saiz**

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**ABSTRACT:** With around 180 active tax expenditures and an estimated revenue foregone equivalent to about 6 percent of GDP in 2021, the third highest in Latin America, Uruguay offers a diverse array of tax breaks. This paper investigates the composition and trends of tax expenditures in Uruguay, benchmarking the results from a cross-country perspective. Since many of these incentives have endured for decades, previous literature suggest a detailed reevaluation of their costs and benefits would be beneficial. Macroeconomic simulations suggest that a relatively modest tax reform reducing tax expenditures could create additional space for productive public expenditure and enhance long-term growth.

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## SELECTED ISSUES PAPERS

# Tax Expenditures in Uruguay Uruguay

Prepared by Dirk Muir (RES) and Hector Perez-Saiz (WHD) <sup>1</sup>

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<sup>1</sup> The authors greatly appreciate the contributions from Ana Cebreiro (Fiscal Affairs Department) and Zamid Aligishiev (WHD), and research assistance from Roberta Guarnieri and Diego Gutierrez (both from WHD).



# URUGUAY

## SELECTED ISSUES

October 6, 2025

Approved By  
**Western Hemisphere  
Department**

Prepared by Hector Perez-Saiz (WHD) and Dirk Muir (RES).

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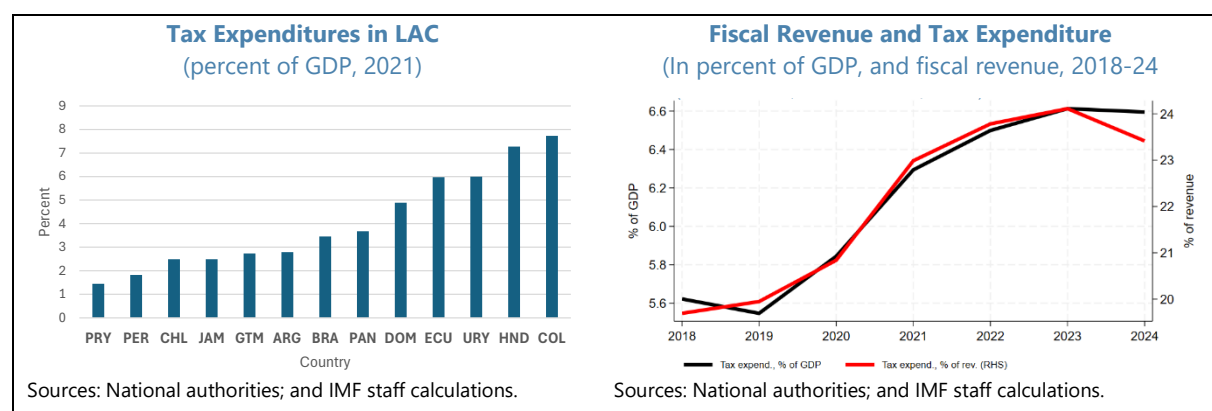
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# TAX EXPENDITURES IN URUGUAY<sup>1</sup>

With around 180 active tax expenditures and an estimated revenue foregone equivalent to about 6 percent of GDP in 2021, the third highest in Latin America, Uruguay offers a diverse array of tax breaks for both households and businesses. This Selected Issues Paper investigates the composition and trends of tax expenditures in Uruguay, benchmarking the results from a cross-country perspective. Since many of these incentives have endured for decades, previous results from the literature suggest that a detailed reevaluation of their costs and benefits would be beneficial. Macroeconomic simulations suggest that a relatively modest tax reform reducing tax expenditures could create additional space for productive public expenditure and enhance Uruguay's long-term growth.

## A. Introduction

1. **Tax expenditures, defined as a deviation of a benchmark tax system, can have a significant budgetary impact (IMF, 2022).** Tax expenditures are often aimed at encouraging investment and job creation. However, these incentives impose significant fiscal costs in terms of revenue foregone. Although there is some uncertainty on quantification, cross-country data indicates Uruguay has one of the highest levels of tax expenditures in Latin America, with foregone revenue equivalent to 6 percent of GDP in 2021, ranking third after Honduras and Colombia according to the Global Tax Expenditures Database. This extensive reliance on tax breaks<sup>2</sup> raises concerns about their efficiency and sustainability, particularly given their long-standing nature and lack of periodic reassessment.

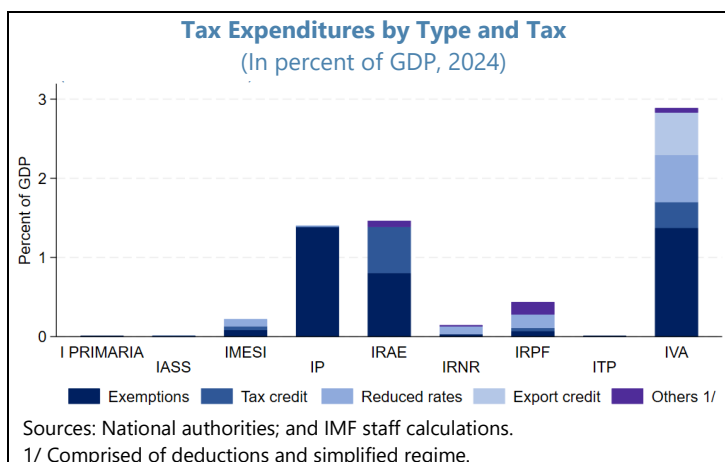


2. **Tax expenditures in Uruguay have increased over time, consistent with trends observed in many high-income countries.** This growth is not unexpected in countries with relatively high levels of institutional development, administrative capacity, and economic complexity.

<sup>1</sup> Prepared by Dirk Muir (Research Department) and Hector Perez Saiz (Western Hemisphere Department) with contributions from Ana Cebreiro (Fiscal Affairs Department) and Zamid Aligishiev (WHD). Research assistance of Roberta Guarnieri and Diego Gutierrez (both from the Western Hemisphere Department) is greatly appreciated.

<sup>2</sup> The terms 'tax expenditures,' 'tax incentives,' and 'tax breaks' are used interchangeably throughout this annex.

Indeed, advanced economies often use tax expenditures as a policy tool to promote investment, social inclusion, or regional development. But with a current level of around 180 active tax incentives, Uruguay's tax expenditure system is complex, with many measures remaining in place for decades. The most affected taxes in Uruguay's system are the Value-Added Tax (IVA) and the Corporate Income Tax (IRAE). A small subset of



measures—just ten—accounts for nearly half of all tax expenditures. While these tax breaks aim to promote private investment, sectoral development and reduce household vulnerabilities to income shocks, they also limit fiscal flexibility and reduce the potential for reallocating resources toward productive public investment, infrastructure, and social programs.

**3. This Selected Issues Paper aims to analyze the framework of tax incentives in Uruguay and to contribute to the discussion of possible reforms.** The paper provides a detailed empirical analysis of tax incentives in Uruguay, comparing them with international good practices to assess their relative scale and effectiveness. The empirical analysis based on cross-country panel regressions reveals that Uruguay's level of tax expenditures is significantly higher than what would be empirically predicted given its institutional quality, governance indicators, and economic structure. These results suggest a structural divergence between Uruguay's actual fiscal practices and those of peer countries with similar characteristics.

**4. Building on this analysis, the paper conducts a macroeconomic simulation using the Global Integrated Monetary and Fiscal (GIMF) model to evaluate the impact of reducing cost-inefficient tax incentives.** The extensive use of tax incentives highlights the country's reliance on these reliefs as a tool for economic policy but also raises concerns about efficiency and fiscal sustainability. Redirecting additional fiscal resources from streamlining them toward high-priority areas such as education, infrastructure, and innovation could help boosting private investment, productivity and long-term growth potential. Our simulations show that this reform has a potential to increase tax revenues by 0.4 percentage points of GDP could lead to a long-term increase in annual real GDP growth of about 0.5 percent. These simulation results suggest that a future tax reform should be carefully designed to balance fiscal sustainability with economic competitiveness, ensuring that tax incentives support strategic development goals while avoiding undue fiscal pressures.

**5. Finally, the paper concludes discussing several recommendations from the literature (World Bank, 2020; IMF, 2022; World Bank, 2024), considering also potential obstacles for its implementation.** Given the high inertia in tax incentives across the world, conducting regularly cost-benefit analysis would be beneficial to assess their value and consider phasing out obsolete or

inefficient measures. A comprehensive benchmark tax system could be necessary to improve transparency and provide a consistent framework for evaluating tax expenditures. Regularly conducting in-depth cost-benefit analysis, based on detailed micro-level data and robust econometric methods, would improve the understanding of behavioral effects of tax incentives and assess whether they are achieving their objective. This would allow the identification of which measures incentivize productive investment and which ones primarily benefit specific sectors without broader economic gains. Leveraging recent international country experience in the region could also be useful to better understand the behavioral response to these incentives.

**Table 1. Uruguay: Type of Tax Expenditures**

<b>Measure</b>	<b>Definition</b>	<b>Examples</b>
<i>Exoneraciones</i> (exemptions)	Exemptions or exonerations are situations explicitly provided for in tax regulations that exempt certain economic events which, having met all the conditions to verify the taxable event, would be subject to tax.	Incomes exempt from both corporate and personal income tax  Transactions of goods specifically released from tax obligations.
<i>Alicuotas reducidas</i> (reduced rates)	While the tax regime identifies a nominal rate for the generality of the economic events it applies to, it exceptionally establishes lower rates for specific cases	Reduced rate in the Value Added Tax.
<i>Deducciones Especiales</i> (special deductions)	Amounts that are subtracted from the taxable base beyond the reference framework (e.g. beyond the cost of inputs, salaries, social security contributions, plant or equipment leases, depreciation of fixed assets that are subtracted from gross income)	Increased deductions in corporate income (e.g. deductions that are greater than actual expenditure) to enhance quality of national production (expenses in R&D, staff training, etc)
<i>Creditos</i> (credits)	Amounts that can be reduced from the determined tax liability, or from the tax quota (note the difference with deductions, which apply on the taxable amount)	Tax credits for investment promotions in corporate income tax
<i>Regímenes simplificados</i> (simplified regimes)	Provisions that encompass one or more taxes, typically operating on small taxpayers, as well as in geographical areas with comparative disadvantages compared to the rest of the country or in specific economic sectors	Fixed-sum (or turnover based) taxes for microenterprises that completely or partially replace taxation that generally apply to the rest of taxpayers

Source: IMF staff elaboration based on standard literature of tax expenditures.



**Table 2. Uruguay: Tax Expenditures in International Perspective (I)**

	Uruguay	LAC	Emerging & developing	Advanced economies
<b>Total foregone revenue</b>				
As percent of tax revenues	32.3	28.7	17.6	21.9
As percent of GDP	6.0	4.1	3.1	5.5
<b>HHI index of measures</b>	421.9	1342.2	1993.3	1437.2
<b>Number measures</b>	186.0	103.6	91.7	142.3
<b>Type of tax (shares of each category in percent)</b>				
Goods and services	48.2	62.8	69.2	34.4
Income	30.8	33.9	26.2	60.7
Property	21.0	3.1	1.9	3.4
Multiple	0.0	0.2	0.2	0.4
Not stated	0.0	0.0	2.3	1.0
Other	0.0	0.0	0.1	0.0
<b>Type of tax expenditure (shares of each category in percent)</b>				
Exemption	59.5	51.7	44.4	29.7
Reduced rate	13.3	6.5	6.4	24.8
Tax credits, rebates and refunds	11.6	5.5	3.5	13.3
Other	9.6	3.9	1.5	1.8
Deduction	3.6	2.7	8.8	17.4
Not stated/unclear	2.4	15.9	14.3	5.4
Deferral	0.0	1.5	0.2	1.9
Multiple	0.0	7.3	15.5	4.0
Zero-rated	0.0	5.1	5.4	1.9
<b>Type of beneficiary (shares of each category in percent)</b>				
Businesses	39.7	30.8	29.5	26.1
Households	31.3	19.1	19.3	50.2
Other	16.9	3.0	1.7	1.3
Non-profit organizations/NGOs/Philantropi	5.9	2.7	1.2	0.1
Not stated/unclear	3.8	33.8	34.0	12.9
Multiple	2.2	9.4	12.6	9.1
Public sector	0.1	0.8	1.3	0.3
Churches/religious organizations	0.0	0.2	0.1	0.0
International/Regional/Multilateral organiz	0.0	0.2	0.3	0.1

Note: Statistics for countries across regions. The database includes data for 27 advanced economies, 51 emerging & developing economies, and 13 countries in Latin America and the Caribbean (including Uruguay). HHI concentration index is estimated using revenue foregone per measure. Sources: GTED database on tax expenditures for 2021, *Rendicion de Cuentas* from Uruguay, and IMF staff calculations.

## B. Tax Expenditures in International Perspective

### 6. The Global Tax Expenditures Database (GTED) is a comprehensive resource that compiles and standardizes information on tax expenditures across countries and regions.<sup>3</sup>

Developed to improve transparency and accountability, GTED tracks various forms of tax exemptions, deductions, credits, and preferential rates, allowing analysts to assess their impact on public finances (see Table 1 for a description of various types of tax expenditures). By offering detailed, cross-country comparable data, the database intends to help assess the effectiveness of tax

<sup>3</sup> Developed and maintained by the Council on Economic Policies (CEP) in collaboration with the German Institute of Development and Sustainability (IDOS), the GTED provides comprehensive data on tax expenditures across countries. It compiles information from government reports and other official sources, offering a global perspective on tax expenditure policies.

expenditures, identify trends, and support evidence-based policy reforms aimed at enhancing fiscal sustainability and economic efficiency.<sup>4</sup>

**7. Tax expenditures vary significantly across regions.** Table 2 highlights significant differences in tax expenditure patterns across advanced economies, emerging and developing economies, Latin America and the Caribbean (LAC), and Uruguay. In terms of revenue foregone (RF), advanced economies and emerging markets forgo around 22 percent and 18 percent of tax revenues, respectively, while LAC and Uruguay report notably higher shares at 29 percent and 32 percent. When measured as a percentage of GDP, advanced economies forgo 5.5 percent, while emerging markets report 3.1 percent, with LAC and Uruguay at 4.1 percent and 6.0 percent, respectively. The Herfindahl-Hirschman Index (HHI) of concentration is highest in emerging and developing economies, indicating that the cost of tax expenditure is more concentrated on a few tax incentives in such countries, whereas Uruguay has a relatively low HHI, suggesting a more evenly distributed application of tax incentives. Interestingly, Uruguay's number of tax expenditure measures stands out compared to emerging markets or LAC.

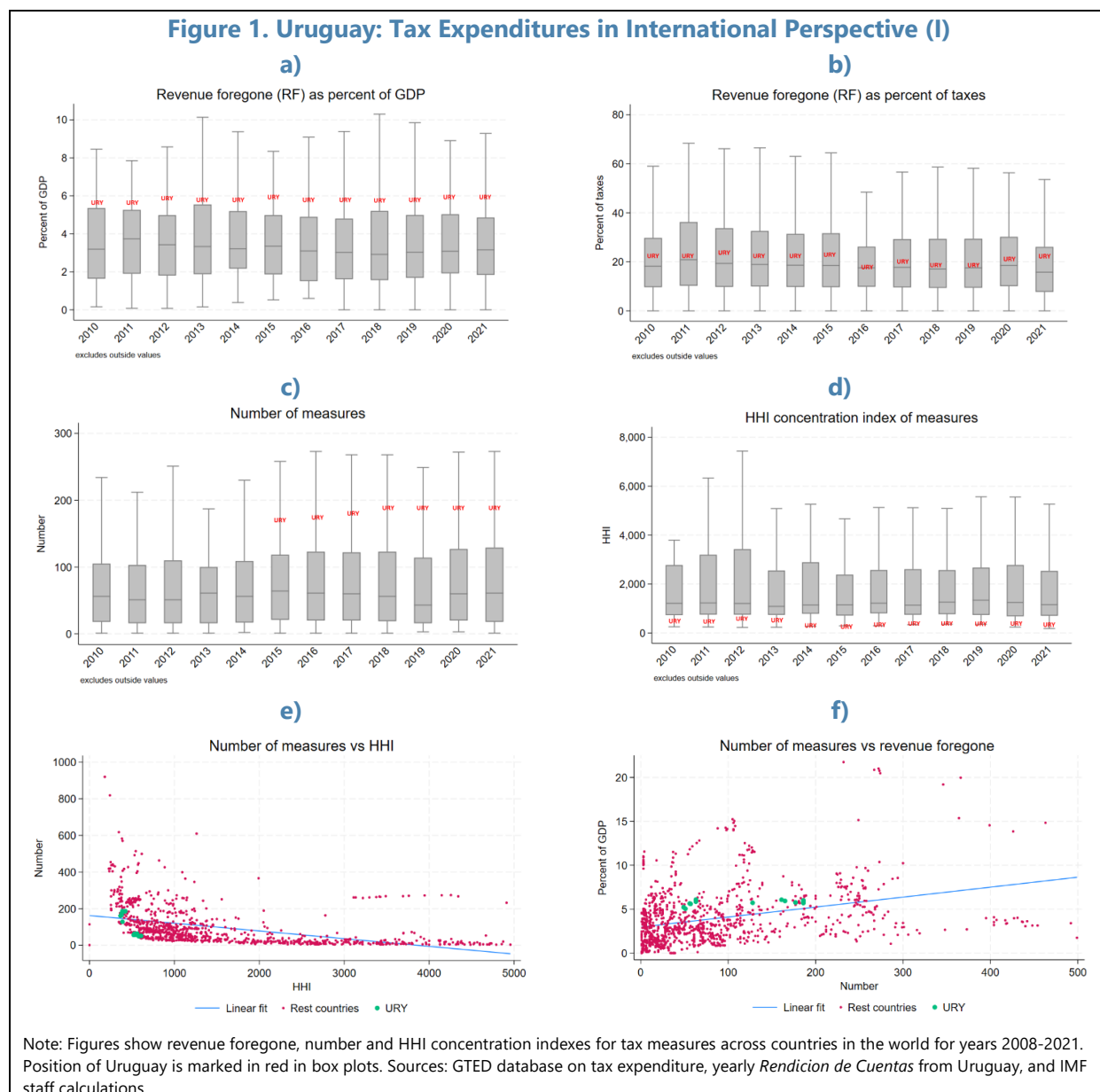
**8. The composition of tax expenditures also varies substantially across regions.** In emerging markets and LAC, tax expenditures are predominantly associated with taxes on goods and services, while in advanced economies, they are mainly linked to income taxes.<sup>5</sup> In Uruguay, however, the cost of tax deductions on property taxes is significantly higher than other regions. Regarding the type of tax expenditure, exemptions are the most prevalent mechanism across all regions, particularly in LAC and Uruguay. Finally, in terms of beneficiaries, households benefit from the largest share of tax expenditures in advanced economies, whereas in Uruguay, businesses receive the largest share.

**9. Figure 1 illustrates key patterns in tax expenditures across countries, focusing on revenue foregone, the number of tax measures, and their concentration.** The first set of charts (Figure 1a and 1b) shows RF as a percentage of total tax revenues and GDP, highlighting substantial variation across countries. Uruguay, with tax expenditures totaling about 6 percent of GDP and more than 30 percent over total revenues in 2021, is consistently positioned in the top quartile of countries. Moreover, Uruguay has increased the revenue foregone, both in terms of percent of GDP or as percent of revenues. Uruguay has also consistently stood out among countries for the number of tax measures over the years (Figure 1c). The scatter plot depicting the number of tax measures versus revenue foregone shows a positive correlation (Figure 1.f), suggesting that countries with more tax expenditure measures tend to forgo a larger share of GDP. However, there is significant dispersion, implying that some countries experience high RF with relatively fewer measures, potentially due to broad-based or high-value tax incentives. In terms of concentration of revenue foregone across measures, Uruguay shows relatively low values compared to other countries, with

<sup>4</sup> While this source is highly valuable due to its detailed cross-country data over time, it does not apply a standardized benchmark for tax expenditures, limiting comparability. As a result, empirical analysis drawn from the data should be interpreted with caution.

<sup>5</sup> In emerging markets and LAC, exemptions are the most common type of tax expenditure for goods and services taxes. In advanced economies, exemptions are also the most common type of tax expenditure for income taxes.

values well below the first quartile threshold.<sup>6</sup> Overall, these charts emphasize Uruguay's increasing reliance of tax expenditures over time, its broad distribution of measures, and the strong link between the scale of tax expenditures and the revenue impact across countries.



<sup>6</sup> We also find that the number of tax expenditure measures and the HHI index of concentration exhibit an inverse relationship, with more measures leading to lower concentration levels. The findings imply that a higher number of tax measures is generally associated with lower concentration of their fiscal impact (relative to GDP), suggesting that systems with numerous measures may need more comprehensive reform efforts to achieve significant reductions in tax expenditures.

**Table 3. Uruguay: Tax Expenditures in International Perspective (II)**

Variable	(1) RF (log)	(2) RF (log)	(3) RF (log)	(4) RF (log)	(5) RF (log)	(6) RF (log)
Government efficiency	-0.0352 (0.0298)					-0.0465 (0.0320)
Legal/property rights		0.0730** (0.0321)				0.0387 (0.0389)
Sound macroeconomics			0.122*** (0.0205)			0.0960*** (0.0326)
Free trade				0.153*** (0.0419)		0.0918 (0.0603)
Regulation					0.0844** (0.0390)	-0.0482 (0.0584)
GDP per capita (log)	0.273*** (0.0318)	0.184*** (0.0560)	0.195*** (0.0327)	0.162*** (0.0466)	0.231*** (0.0408)	0.103 (0.0700)
Constant	-1.271*** (0.476)	-1.171*** (0.385)	-1.792*** (0.296)	-1.686*** (0.297)	-1.698*** (0.298)	-1.098** (0.540)
Observations	1,240	1,240	1,240	1,227	1,240	1,227
R-squared	0.105	0.109	0.121	0.116	0.108	0.127
Year fixed effects	YES	YES	YES	YES	YES	YES
Country fixed effects	NO	NO	NO	NO	NO	NO

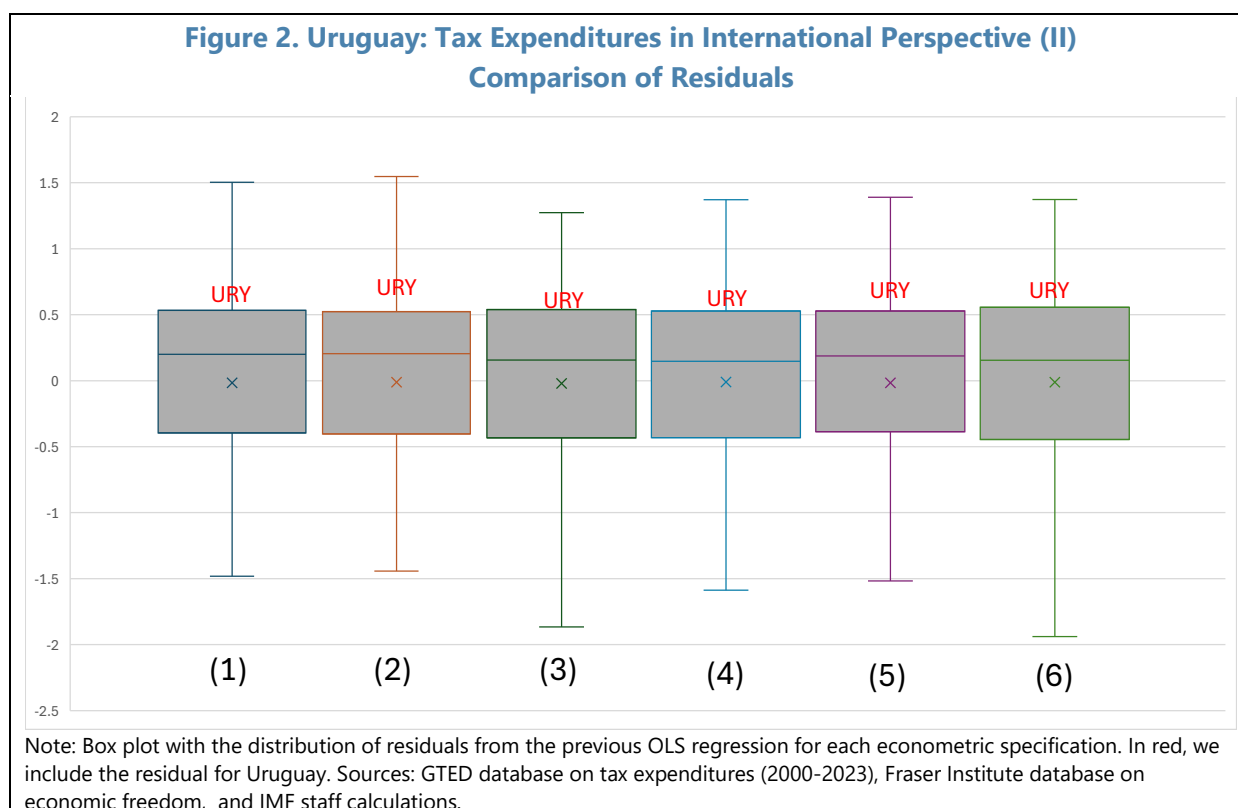
Note: OLS regression where an observation is a country-year for years 2000-2023. We include as regressors economic freedom indicators provided by the Fraser Institute. These indicators of government efficiency, legal/property rights, sound macroeconomics, free trade and regulation are higher if the country performs better in that dimension: A higher value in government efficiency means a smaller government, with lower government spending, fewer state-owned enterprises, and lower taxation, whereas a lower value suggests a more interventionist state, with higher public expenditures and taxation; A higher value in legal System & Property Rights indicates a stronger rule of law, better protection of property rights, and more efficient judicial processes, whereas a lower value suggests weak legal institutions, insecure property rights, and potential corruption or government interference in contracts. A higher value in sound macroeconomics means the country has low inflation, independent central banking, and a stable monetary environment, whereas a lower value suggests high inflation, excessive monetary intervention, or an unstable financial system. A higher value in free trade indicates fewer trade barriers, lower tariffs, and fewer restrictions on international investment and capital flows, whereas a lower value suggests protectionist policies, high tariffs, and limitations on trade. Finally, a higher value in regulation implies a less restrictive regulatory environment, meaning businesses, labor markets, and credit markets face fewer bureaucratic barriers and state controls, whereas a lower value means heavy regulation, labor market rigidity, and more government intervention in private sector activities. Robust standard errors in parentheses and levels of significance are \*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.1$ .

Sources: GTED database on tax expenditures (2000-2023), Fraser Institute database on economic freedom, and IMF staff calculations.

**10. Countries with stable macroeconomic policies, open trade, and strong legal frameworks tend to forgo more revenue through tax expenditures.** Table 3 shows regression results of revenue foregone on economic freedom indicators provided by the Fraser Institute. Countries with higher GDP per capita are consistently and significantly associated with higher foregone revenues from tax expenditures. Moreover, most economic freedom indicators, on legal rights, sound macroeconomics, regulation and free trade, show a strong positive association with revenue foregone. In contrast, government size does not show a statistically significant relationship with revenue foregone. Overall, the results highlight that higher-income countries and those with

more open and stable economic policies tend to forgo more revenue through tax expenditures, possibly as part of their broader fiscal and economic strategies.

**11. Empirical evidence suggests that the level of tax expenditures in Uruguay may lay above countries with similar economic and institutional characteristics.** An analysis of the residuals from the previous regression (see Figure 2) reveals that Uruguay (URY) lies systematically above the predicted values, given its governance, institutional quality, and economic indicators. In other words, based on the country's structural characteristics, this empirical model would predict lower levels of tax expenditures. The positive residuals indicate that Uruguay's actual tax expenditures exceed what is typical for countries with similar profiles. This suggests there may be room to streamline or rationalize existing tax incentives.



**12. Tax expenditures vary significantly across regions, with Latin America exhibiting a distinct profile marked by higher reliance on exemptions and non-traditional beneficiaries.** Table 4 is derived from regression results at the tax measure level and complements the statistics presented in Table 2. It illustrates that the revenue foregone related to taxes on goods and services, or income—or whether through deductions or exemptions—is generally lower in advanced economies compared to other country groupings. In contrast, emerging and developing economies exhibit a relatively larger revenue foregone associated with other taxes, exemptions, and tax credits/refunds. Specifically, in Latin America and the Caribbean (LAC), the revenue foregone is lesser for taxes on goods and services, as well as other taxes, but higher for tax exemptions and

deductions. Furthermore, tax benefits aimed at "other" beneficiaries, distinct from businesses or households, are more substantial in LAC. These findings underscore the regional disparities in the fiscal costs of tax incentives across regions.

**Table 4. Uruguay: Tax Expenditures in International Perspective (III)**

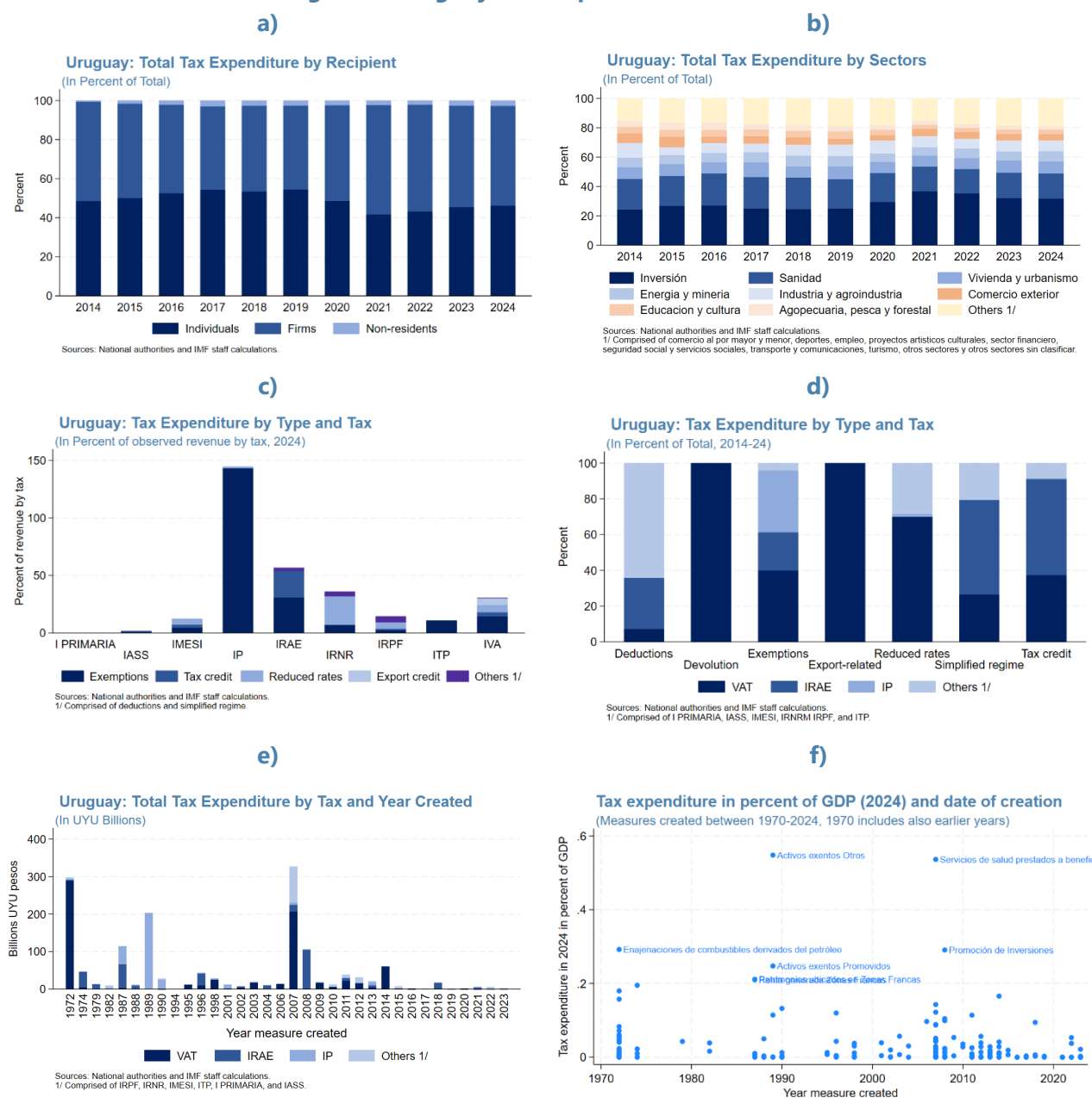
	Advanced Economies	Emerging & developing	LAC
<b>Type of tax</b>			
Goods and services	-0.785***	-0.0871	-0.539***
Income	-0.579***		
Other taxes		1.663***	-1.433***
<b>Type of tax expenditure</b>			
Deduction	-0.627***	0.0383	0.413***
Exemption	-0.528***	0.489***	0.473***
Reduced rate	-0.250		0.368**
tax credit/refund		1.083***	
Other	-1.507***	-0.459***	0.186
<b>Type of beneficiary</b>			
Businesses			
Households	0.0399	-0.0845	
Other			0.737***

Note: We show estimates of interaction terms in a OLS regression of revenue foregone as percent of GDP (in logs) on GTED indicators for type of taxes, type of tax expenditures and type of beneficiary. One observation in this regression is a tax measure in a country and year (a total of 98,905 observations). In the table we only show the interaction terms for each world region. The regression includes year fixed effects, country fixed effects, and region fixed effects. Robust standard errors in parentheses and levels of singificance are \*\*\* p<0.01, \*\* p<0.05, \* p<0.1.

Sources: GTED database on tax expenditures (2000-2023), and IMF staff calculations.

## C. Tax Expenditures in Uruguay

**13. Uruguay's tax expenditures, approximately 180 active measures, were estimated to cost 6 percent of GDP in 2024, making it one of the largest in the Latin American region.** There are many longstanding measures—some dating back to the 1970s and 1980s—accounting for a significant share of revenue foregone, highlighting the large inertia within the tax system. The cost also gradually increased over the years, and it was estimated at only 4 percent of GDP (or 19 percent of tax revenues) in 2005. Expenditures are approximately equally distributed between individuals and firms, with little variation across years (Figure 3). A very small fraction of revenue foregone corresponds to non-residents. The sectoral breakdown indicates that tax expenditures are heavily concentrated in investment-related activities, followed by health, industry, energy, and housing.

**Figure 3. Uruguay: Tax Expenditures in Detail**

Sources: Budget execution reports (Rendición de Cuentas) covering the period from 2014 to 2024.

**14. The most affected taxes in Uruguay are the Value-Added Tax (IVA) and the Corporate Income Tax (IRAE).** Both represent more than 60 percent of the total revenue foregone.

Exemptions account for the largest share of revenue foregone, estimated at about 60 percent, followed by tax credits, representing around 20 percent. A relatively small subset of measures—just

ten—accounts for nearly half of all tax expenditures<sup>7</sup>. Relative to the revenue collected, property tax expenditures in the form of exemptions represent the highest proportion of foregone revenue, representing about 150 percent of the property tax collected. The construction, healthcare, housing and energy sectors benefit the most from these tax expenditures, making them potential targets for reforms.

**15. Exemptions dominate as the primary form of tax expenditure.** They are particularly relevant within corporate income tax (IRAE), property tax (IP), and VAT (IVA). For IRAE, tax expenditures in the form of exemptions and tax credit are equally split. For IVA, reduced rates and tax credits are also relevant. Overall, these findings suggest that Uruguay's tax expenditure system is highly persistent, concentrated in investment-related incentives, and increasingly significant as a share of public revenue, raising important questions about fiscal sustainability and policy efficiency.

## D. Effects of a Tax Reform That Would Reduce Fiscal Expenditures in Uruguay

**16. A tax reform aiming at reducing inefficient tax expenditures in Uruguay could create additional fiscal space.** Long-term growth could rise as productive public expenditure strengthens the foundations for sustained economic expansion. This section presents policy simulations of the effect of a reduction in tax expenditures on growth.

**17. An illustrative tax reform is assumed to increase tax revenues by 0.4 percent of GDP.** Such a tax reform can be seen as modest compared to the size of tax expenditure in Uruguay. Its burden is assumed to fall on consumption in the theoretical model used (GIMF, see Box 1), but its actual macroeconomic impact will crucially depend on the behavioral response of taxpayers and how elastic their demand is for consumption and investment of goods vis-a-vis changes to the tax code. This response should be properly calibrated ex-ante by the tax authorities using appropriate empirical analysis.

**18. It is assumed that the increase in revenues resulting from the proposed tax reform translates into an increase in productive public expenditure, preserving the fiscal balance.** For instance, public investment, when efficiently allocated and converted into productive public capital—such as roads, energy infrastructure, and communication networks—contributes to increases in private sector productivity, reduces production costs, and fosters economic growth. Gupta et al. (2014) or Abiad et al. (2015) show that in economies with high public investment efficiency, government spending has stronger growth multipliers, as productive infrastructure supports private sector activity.

<sup>7</sup> While this finding could be interpreted as evidence of high concentration in Uruguay, the preceding country-level analysis indicates that tax incentives are, in fact, more evenly distributed in Uruguay compared to other regions.



### Box 1. The GIMF Model, Public Investment Efficiency and the Evaluation of Fiscal Reforms

**The Global Integrated Monetary and Fiscal (GIMF) model is a Dynamic Stochastic General Equilibrium (DSGE) model developed by the IMF.** It is used to analyze the effects of monetary, fiscal, and structural policies on the global economy, incorporating nominal rigidities, real frictions, and an overlapping generations (OLG) framework to capture the short- and medium-term macroeconomic effects of policy changes. It includes forward-looking (OLG) households and rule-of-thumb (hand-to-mouth) households, ensuring realistic consumption and savings behavior. Firms operate under monopolistic competition, face sticky prices and wages, and interact across economies through trade and financial linkages. The model also accounts for fiscal policy through various spending and taxation instruments, and public debt dynamics, making it particularly useful for evaluating fiscal sustainability.<sup>1</sup>

**A key feature of GIMF is its monetary policy framework, typically modeled using Taylor-type inflation-forecast-based interest rate rules, where central banks adjust interest rates in response to inflation deviations.** Given its structure, GIMF is widely used for scenario analysis and policy simulations, enabling policymakers to assess the macroeconomic effects of fiscal consolidation, monetary stimulus, or external shocks on growth, inflation, and debt sustainability.

**GIMF has been extensively applied to evaluate fiscal reforms, particularly in analyzing the effects of tax changes, government spending adjustments, and debt reduction strategies.** For example, it has been used to assess the impact of tax reforms (such as shifts from labor to consumption taxation) on economic growth and fiscal sustainability. It has also been employed to study the long-term effects of fiscal consolidation, showing how reducing public debt through expenditure cuts or tax increases affects output and private consumption. Additionally, the model is useful for evaluating infrastructure investment policies, demonstrating how government spending on infrastructure can crowd in private investment and boost productivity. These applications make GIMF a powerful tool for designing evidence-based fiscal policies in both advanced and developing economies.<sup>2</sup>

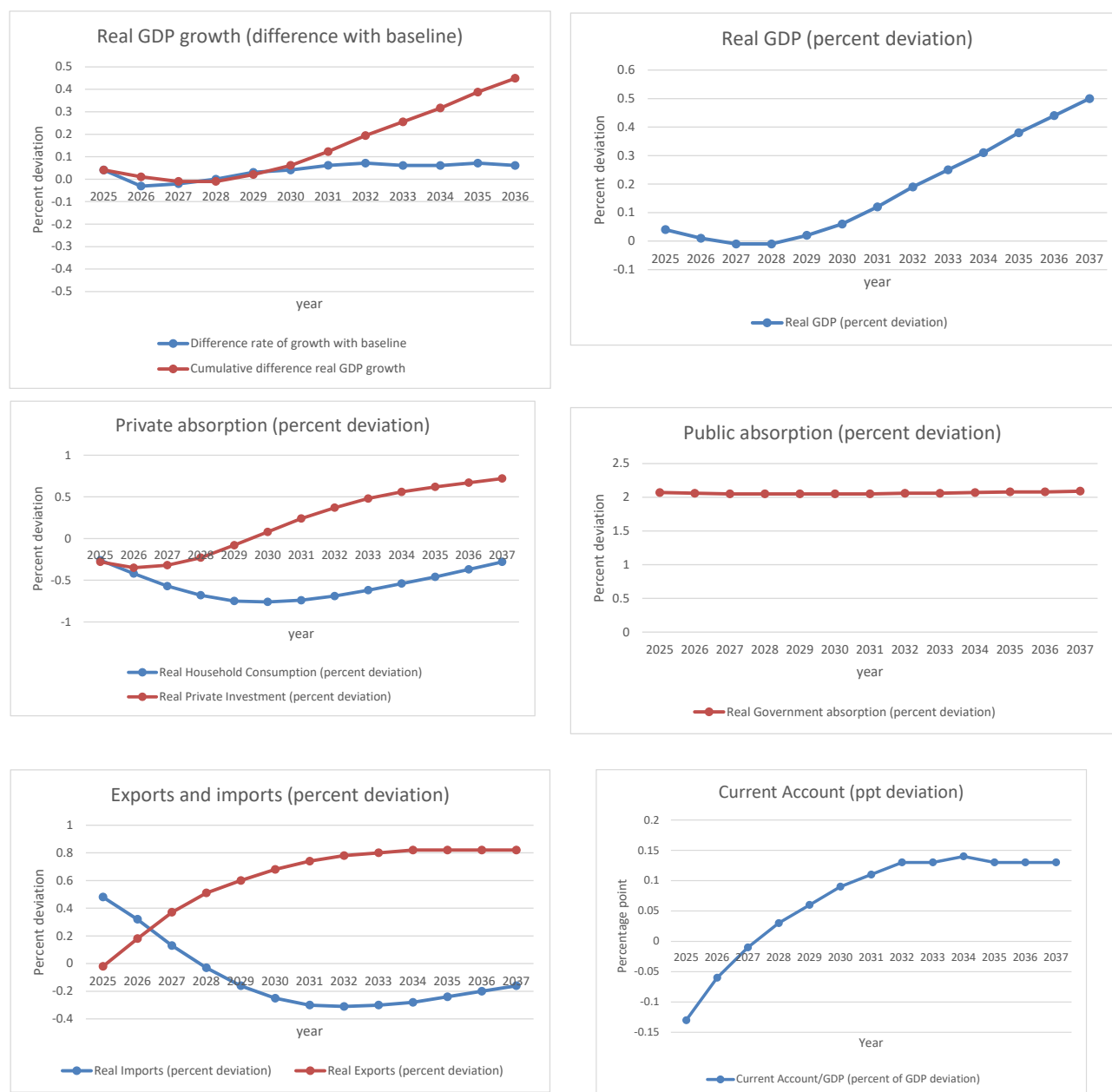
**The GIMF model also incorporates assumptions on the efficiency of public investment.** This refers to the extent to which government spending on investment goods translates into productive assets that contribute to economic growth. In many economies, inefficiencies—stemming from poor project selection, corruption, bureaucratic delays, and weak institutional capacity—mean that only a fraction of public investment effectively increases the public capital stock (see Pritchett, 2000; Abiad et al., 2015). This concept is explicitly incorporated in GIMF through an efficiency parameter ( $\xi$ ), which determines how much of each unit of public investment actually contributes to capital accumulation. Thus, the evolution of public capital  $K_t^G$  can be expressed as

$$K_t^G = (1 - \delta^G)K_{t-1}^G + \xi I_t^G$$

where  $I_t^G$  is public investment, and  $\xi$  captures investment efficiency. A higher  $\xi$  implies more productive public investment, leading to stronger growth and fiscal multipliers, while a lower  $\xi$  reflects waste and inefficiency, reducing the effectiveness of government spending in fostering economic development. Given the good quality of public investment management in Uruguay,  $\xi$  was calibrated to 80 percent.

<sup>1/</sup> See also Kumhof et al. (2010) and Anderson et al. (2013).

<sup>2/</sup> See Elekdag and Muir (2014), Carton et al. (2017), IMF (2019a), Hannan et al. (2022) and IMF (2023) for country applications.

**Figure 5. Uruguay: Tax Reform Simulations Using GIMF (I)**

Sources: IMF staff simulations using GIMF. Macroeconomic variables deviations are with respect to the baseline.

**19. Alternatively, additional tax revenues from the proposed reform could also be allocated for other purposes.** The fiscal authorities could consider maintaining current public expenditure levels to reduce the fiscal deficit. Yet, it is essential to properly calibrate ex-ante behavioral responses of households and firms, as economic activity may be quite responsive to the removal of specific incentives. Depending on a reform's specific design, it could potentially lead to short-term economic losses that must be weighed against anticipated long-term benefits. Therefore, a thoughtfully designed and more comprehensive tax reform should be accurately calibrated to

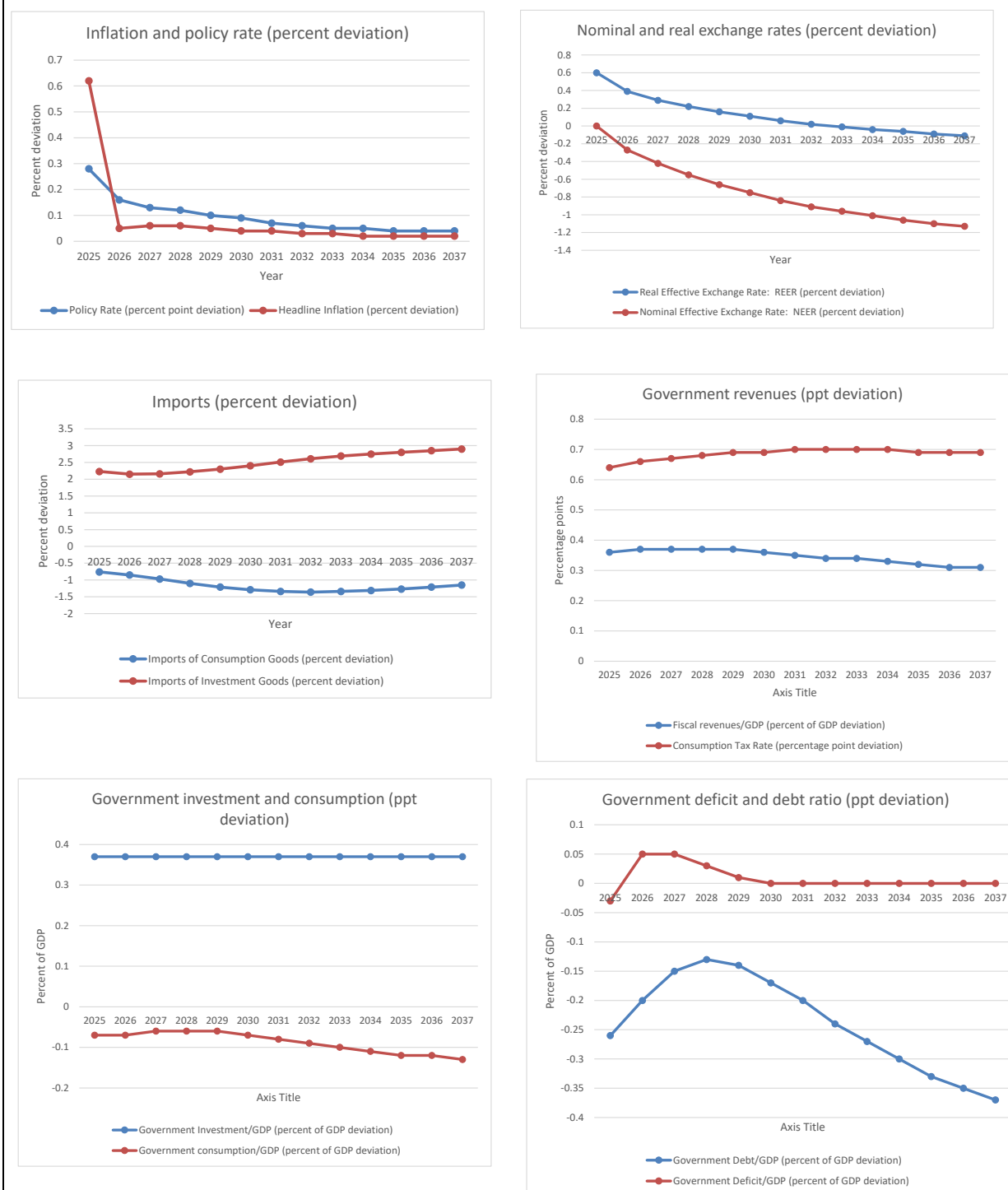
account for behavioral reactions to various tax incentives and should effectively weigh economic trade-offs.

**20. The Global Integrated Monetary and Fiscal (GIMF) model from the IMF is used to simulate the effects of this illustrative reform (see Box 1).** The relatively modest reduction in tax expenditures increases revenues over time which are devoted to productive public expenditure (about 0.4 percent of GDP, over 2 percent higher for government absorption). This pushes up productivity in the economy, gradually encouraging higher private investment (which initially falls due to the reduction in tax expenditures). Increased investment and productivity leads to higher labor demand and production. By contrast, the higher taxes decrease household consumption. However, they recover over the medium term, due to higher labor income related to the increase in productive capacity. Overall, these elements translate into a positive impact on real GDP over time. Initially, the difference in GDP growth compared to baseline remains close to zero but starts increasing from 2029 onward, reaching a cumulative increase of 0.5 percent compared to baseline by 2037.

**21. The reduction in tax expenditures has notable effects on external and domestic prices and monetary policy.** As taxes increase, inflation experiences a slight initial increase but stabilizes over time. The nominal effective exchange rate (NEER) depreciates consistently—by about -1.2 percent lower compared to baseline in 2037—making domestic goods more competitive internationally. In contrast, the real effective exchange rate (REER) initially appreciates but then stabilizes, suggesting that price adjustments partly offset nominal depreciation. Headline inflation spikes on impact due to the one-off change in the VAT, but inflation is rapidly contained, due to the reaction of monetary policy, and the fact that there is a disinflationary productivity shock in the economy. Therefore in the monetary policy rate (and real interest rate) only increase slightly in the short term.

**22. The current account and trade flows adjust dynamically in response to the proposed tax reform.** Real exports increase steadily, with an increase of about 0.8 percent above baseline by 2037, driven by the currency depreciation and improved competitiveness. On the other hand, real imports initially rise but start declining from 2028 onwards, reflecting the depreciation of the currency, weaker domestic consumption and the shift toward greater reliance on domestic production. A notable decline in the imports of consumption goods suggests that household spending cuts are affecting demand for foreign products. However, imports of investment goods increase significantly, reaching almost 3 percent above baseline by 2037, driven by higher investment. Overall, the deviation in the current account balance improves over time, turning positive from 2028 onwards in line with the depreciated exchange rate and reduced household consumption.

Figure 6. Uruguay: Tax Reform Simulations Using GIMF (II)



Sources: IMF staff simulations using GIMF. Macroeconomic variables deviations are with respect to the baseline model.

## E. Conclusion

**23. An illustrative scenario assumes that a reform of tax expenditure could increase total government revenues-to-GDP by about 0.35 percentage points over the period.** Even with increased government expenditures, simulations show that the government would be able to eliminate early on the small initial government deficit, stabilizing at near-zero levels. Public debt-to-GDP declines steadily, improving by 0.4 percentage points by 2037 due to higher economic growth. Government spending as a share of GDP increases. These fiscal effects highlight the long-term benefits of lowering inefficient tax expenditures, as this helps consolidate public finances, reduce debt burdens, and create space for productive public spending without excessive crowding out of private sector activity.

**24. The World Bank (2024) suggests that efficiencies could be achieved with the revision and modernization of tax incentives.** The elimination of ineffective or obsolete tax expenditures would ensure that fiscal resources are directed toward policies that generate meaningful economic impact. This requires a systematic review of existing tax incentives to assess their contribution to investment, employment, and productivity (World Bank, 2024).

**25. The literature also suggests that a data-driven approach is essential for improving tax policy design.** Conducting cost-benefit analysis, well-grounded on detailed micro-level data and robust econometric methods, would help understand the behavioral effects of tax incentives, identifying which measures drive productive investment and which primarily benefit specific sectors without broader economic gains (World Bank, 2020; IMF, 2022). A clear benchmark tax system should also be defined (IMF (2019b), providing greater transparency and consistency in evaluating tax expenditures, and also serving as a standardized reference for international comparison.

**26. The World Bank (2024) also recommends that the impact of the incentives should be properly measured on relevant outcomes, such as job creation, innovation, or regional development.** This approach would ensure that fiscal benefits translate into tangible economic improvements. Also, effectiveness of tax incentives should be evaluated regularly and phase out those that do not contribute to sustainable and inclusive economic growth. Recent initiatives in other countries that have reformed tax incentives, such as in Chile in 2024, could provide valuable lessons.<sup>8</sup>

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<sup>8</sup> See Ley N° 21.420 published in 2022 and Ley N° 21.713 published in 2024.

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