

TE Evaluation for Parliamentarians

Follow-up Technical Meeting on Tax Expenditures

Accra, 18-20 September 2023

Agustin Redonda

Background

- Tendency to adopt policies developed elsewhere or “one size fits all” type of solutions
 - Reduces relevance & effectiveness in addressing specific needs
- Poorly implemented policies carry a high opportunity cost, hinder development and sometimes can even negatively impact economies through undesired effects
- Policy making often prioritize ideological beliefs, political opinion or theory, intuition, ad hoc case studies, and political expediency
- Increasing recognition of the need for **evidence-based tax policymaking (EBTPM)**
 - Provide data and evidence to effectively design and implement tax policy
 - [UNDP Tax for SDGs Initiative](#): currently developing a course on EBTPM to “*equip officials with the necessary skills and knowledge to make evidence-based tax policies that contribute to a better alignment of tax systems with the SDGs*”

Evidence Based Tax Policy Making

Why Evidence Based Tax Policy Making (EBTPM)?

1. Relies on factual information, credible evidence and research to support tax policy
2. Bridges the research-practice gap in tax policy design, implementation and evaluation
 - Uses data and research to inform tax policy decisions
3. Crucial role in achieving better development outcomes in developing countries
 - Identifying areas of greatest need and high-impact interventions
 - Ensuring efficient utilization of limited resources
4. Offers insights into feasibility, potential barriers and necessary conditions for success
 - Tailors tax policy to specific contexts, higher relevance and likelihood of effectiveness
5. Facilitates continuous learning from policy outcomes
6. Enhances transparency and accountability

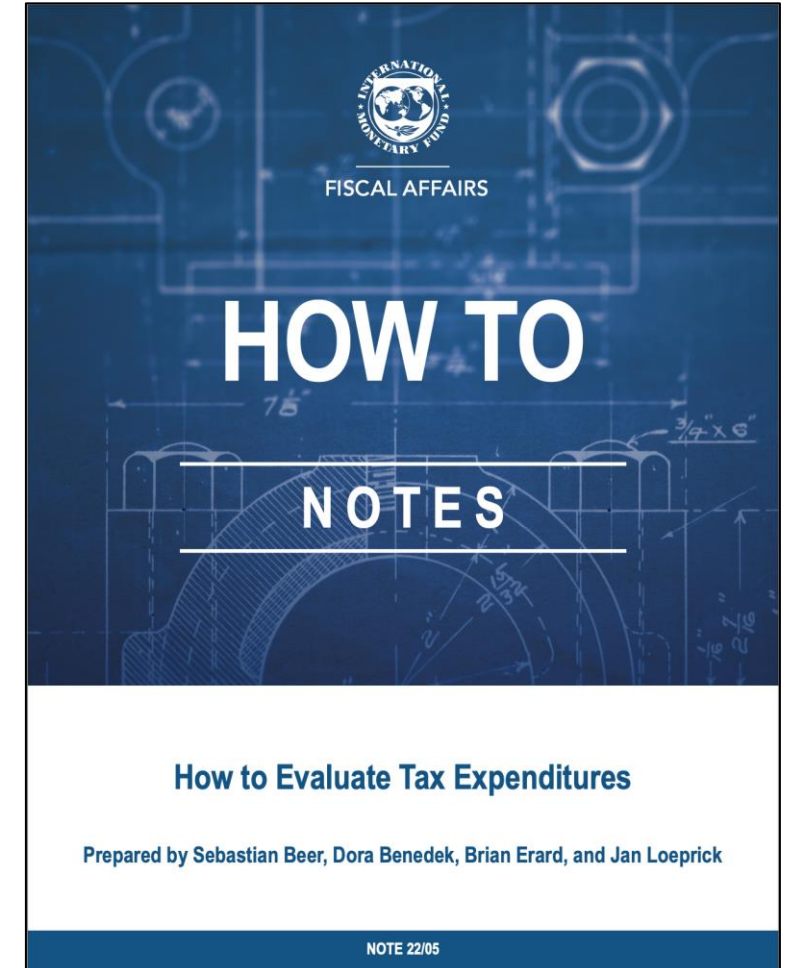
1. Financial and resources constraints (e.g. under-staffing)
 - Team-up with academic and research institutions (e.g. SA-TIED, TaxDev)
2. Access to high-quality research
 - Establishing open policy dialogues between government officials, research community, and evidence-to-policy organizations to promote the use of evidence in tax policy making
3. **TE Evaluation** is crucial for EBTPM
 - Skills gap – capacity building
4. Political economy
 - **What role for the parliament?**

Tax Expenditure Evaluation

- **Why** to evaluate? Identify existence and magnitude of (**causal**) effect
- **What** to evaluate? Research question/policy objective clearly identified
- **When** to evaluate?
 - Monitoring: real time policy making
 - Ex ante assessments
 - Ex-post evaluation: time-specific, informs current and future policy making
- **Who** evaluates? Internal (which agency) vs external
- **How** to evaluate? Data requirements & Different methods
- **Impact** of evaluations?
 - Needs to feed TE policy making process (MoF, line ministries, Parliament, etc)
 - Communication and dissemination

- A positive change in the outcome of interest is not enough to claim that a TE seeking to affect that outcome was effective...other things might have played a role as well
- Impact evaluations are used to identify causal relationships between the TE and changes in outcomes of interest:
 - *What is the impact (causal effect) of the TE on the outcome of interest?*
- Causality implies that:
 - We can attribute observed changes in the outcome of interest to the TE
 - In the absence of the TE, such changes in the outcome of interest would not have been observed

- Beer *et al.* (2022) provide some guidance on TE evaluation
- *“a process that seeks to systematically inform policymakers on the desirability of introducing or maintaining specific tax benefits by gathering and analysing available quantitative and qualitative information on their effects”*
- Only a handful of countries carry out systematic evaluation of TE
- **Germany:** every TE evaluated at least once per decade.
- **Ireland:** aims to evaluate TE every five years.

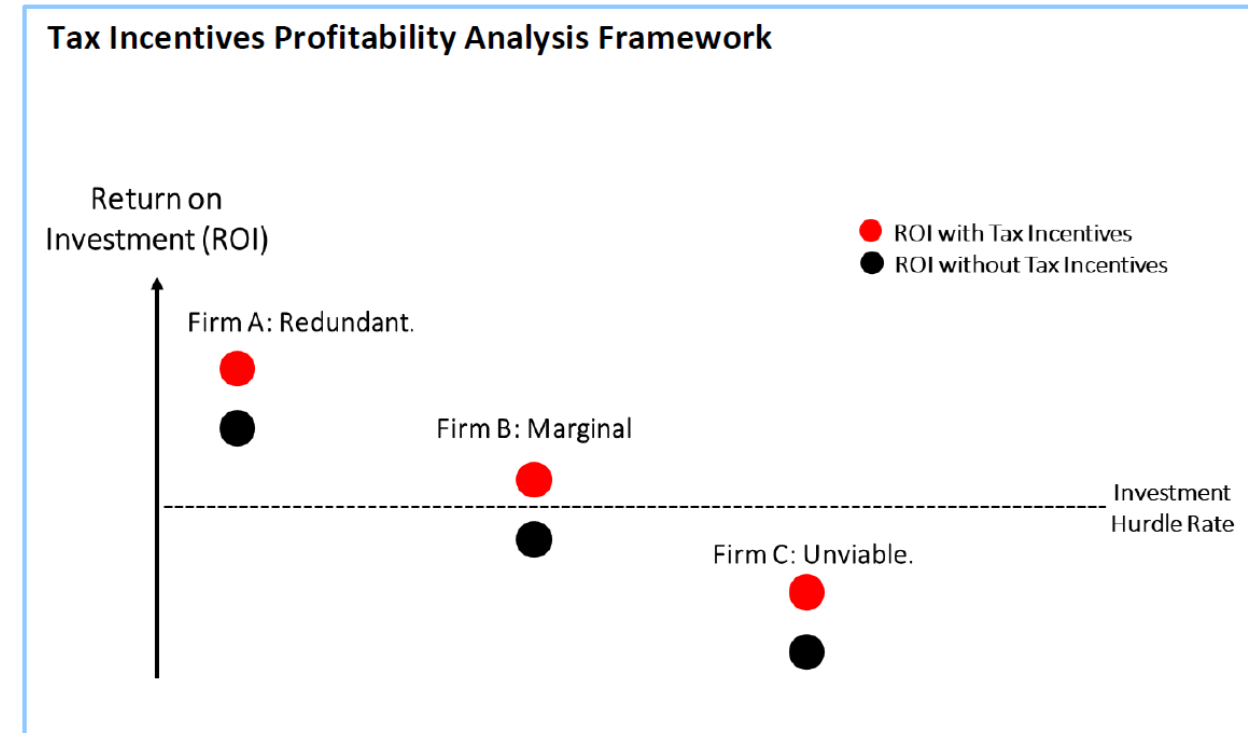


Examples of Ex-Post Evaluations

WB (2022): Trade Competitiveness Diagnostic and State Aid Effectiveness Report

3-step approach:

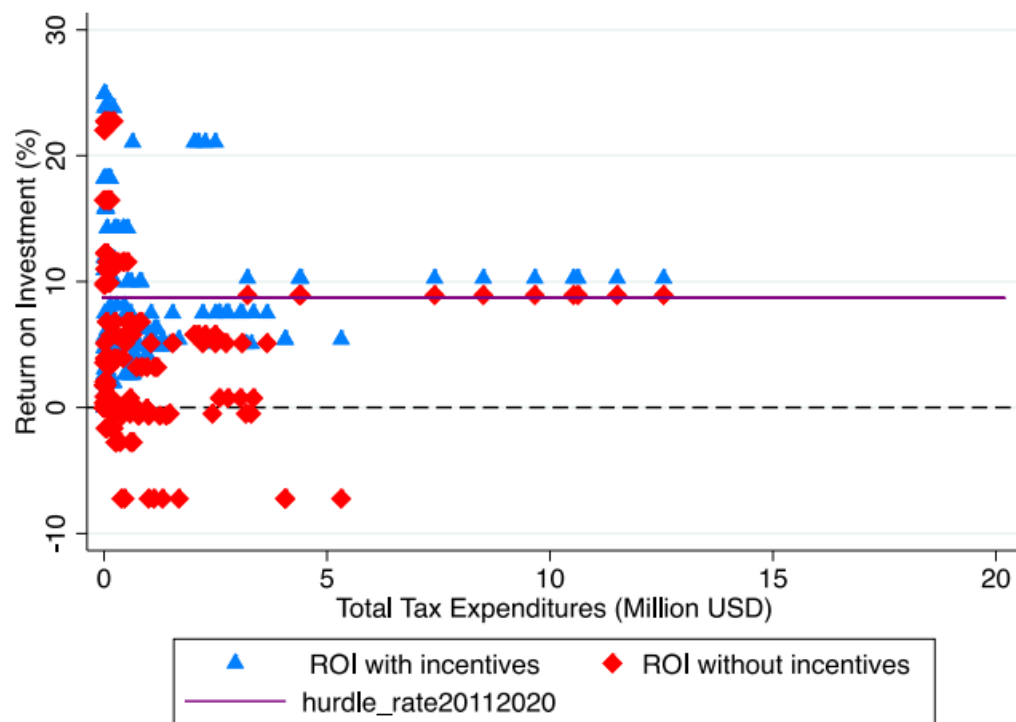
1. Micro-simulation to estimate effect of incentives on firms' tax liability over time
2. Linked info on TEs directly to firm performance (jobs, exports, investment)
 - Only firms that are profitable **with** incentives, but **would not** be profitable without incentives are considered as “**marginal**”
3. Cost-Benefit (TE per job)



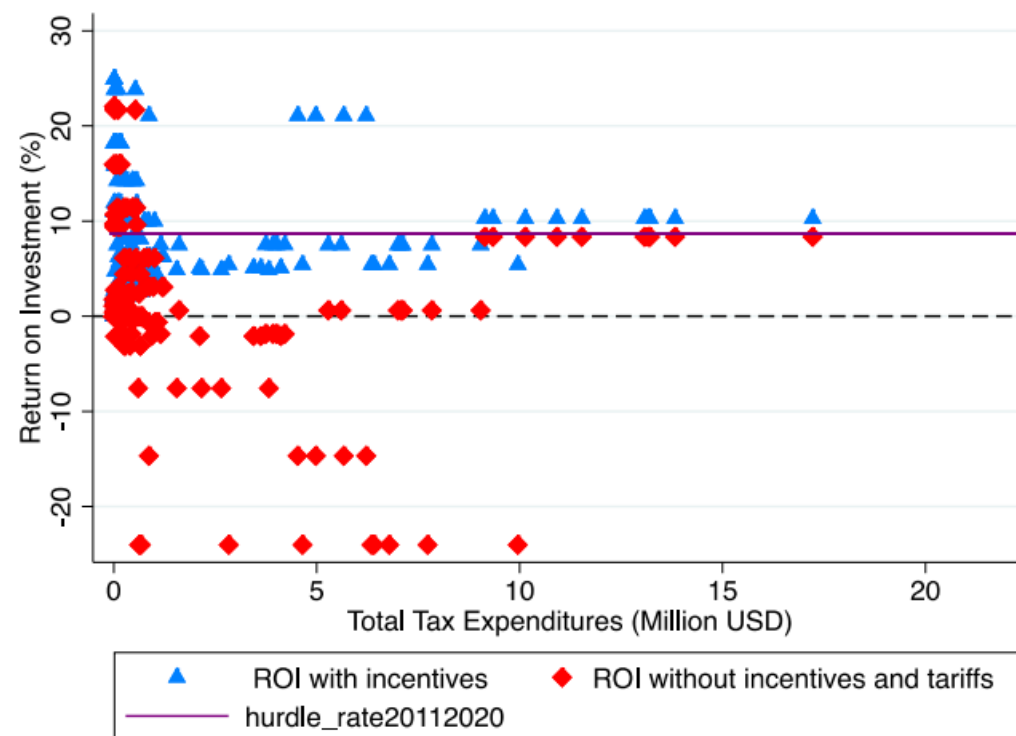
Tax incentives impact firms' ROI, but only a few firms reached a return above what the market is offering...

Figure 50: ROI for Firms in TIDZs—with and without tax incentives

A. Scenario 1 (CIT, PIT and SSC Exemptions)



B. Scenario 2 (CIT, PIT, SSC and CD Exemptions)



The incentives' impact on firms return on investment is positive, but final results are mixed

- Only 16% of firms in the TIDZs have turned from losses to profits thanks to tax incentives (**marginal**)
 - 59% are still in low return zone even with tax incentives (**unviable**), and
 - 25% became more profitable with the tax incentives (**redundant**)
- Compared to similar firms, companies moving into the TIDZs are associated with higher performance in exports & investment in assets, but no effect on sales, wages, employment & imports
 - Also...no behavioral impact (no change in their own trends on these variables)
- Based on cost-benefit, TE per job-year created stands at \$17,000
 - Relatively costly: about 3 times the price of an annual manufacturing wage

Distributional analysis can be very useful, and relatively “easy” to be conducted if administrative tax data is available

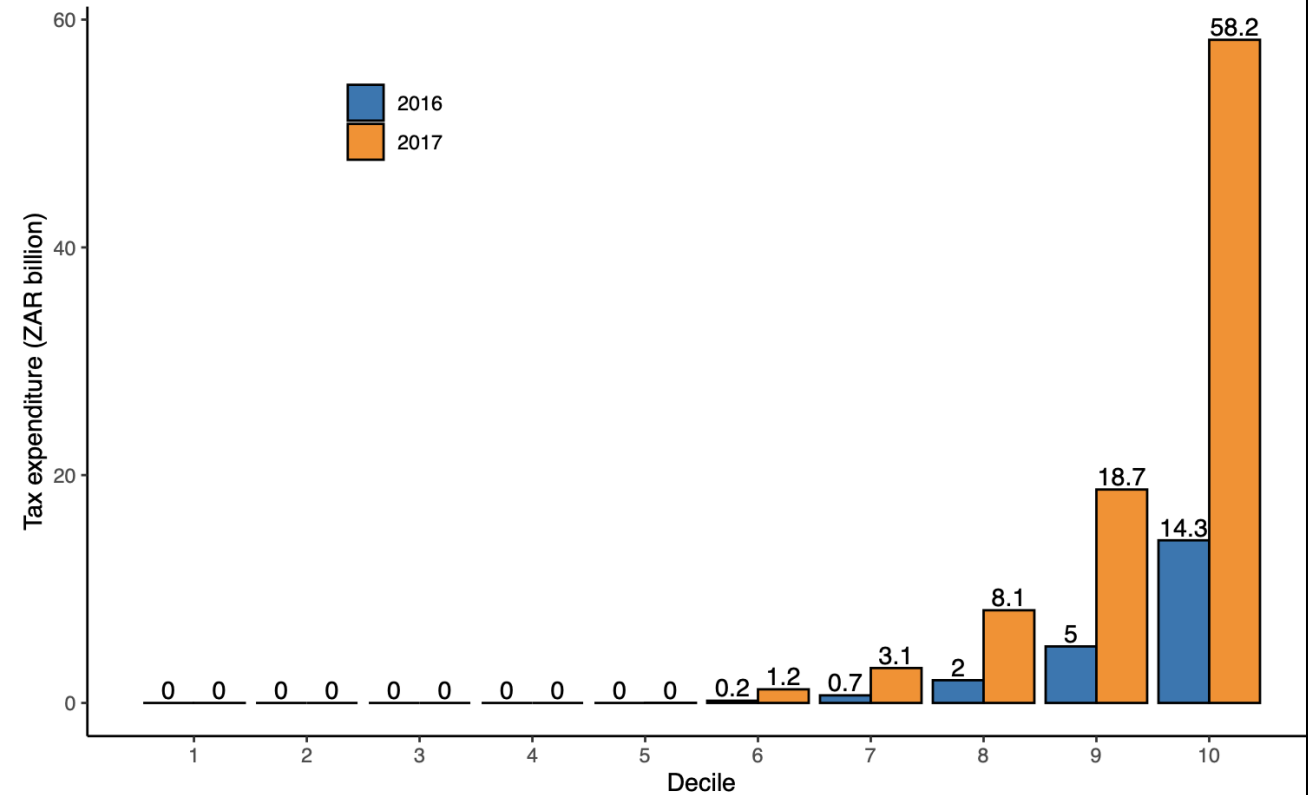
- VAT exemption on basic foodstuffs
 - do they benefit consumers or restaurant owners?
 - If they benefit consumers, which ones?
- Tax-benefit microsimulation models are very useful
- For PIT expenditures, one can use PAYE returns
- For CIT expenditures, one can use CIT returns (firm size, sector)

Axelsson & Redonda (2021):

Examine distributional effects of pension-related TEs in South Africa.

- The 2016 reform exacerbated the regressive impact of one of the most expensive TEs in South Africa

Figure 7: Total tax expenditure by taxable income decile



Source: authors' elaboration based on National Treasury and UNU-WIDER (2019).

The Role of Parliaments

As for tax policy in general, parliaments should play a key role in TE policy making

Setting up TEs:

- The role of the Parliament is vital in the approval, modification, and elimination of TEs
- Also, to incorporate TE information into broader fiscal policy instruments, e.g. the budget and MTRSs

Estimation & Reporting: Whereas the role of the parliaments is more passive, it is crucial that the TE report is communicated in a timely manner to the Parliament

Evaluation

- Ex-ante assessments need to be shared with the parliament so that MPs can make informed decisions
- Whereas there is no need for MPs to conduct evaluations, it is crucial that they are able to understand the main findings and potential policy implications
- Evaluations (or, at least, non-technical summaries) should be shared with the Parliament in timely manner

Reform

- Tax policy making is a complex process involving diverse actors:
 - Different institutions and agencies within the government
 - Pressure and lobbying groups
 - Media and social media
- The rationalisation of TEs requires several technical aspects to be in place, but also an understanding of the considerations behind their governance and the political economy in the TE field
- Rationalising the use of TEs to better align the tax system with governments development strategies is a task that necessarily needs the engagement of Parliaments

Thank you!

Contact details:

- Email: ar@cepweb.org