

Tax Policies for a Post-Crisis World

Stephen Matthews
(Stephen.Matthews@oecd.org)

Chief Tax Economist

**Centre for Tax Policy & Administration,
OECD**

General Tax Reform Principles

- **Fairness**
 - Similar treatment for similarly placed individuals (horizontal equity)
 - Effective compliance – prevention of tax fraud and evasion
 - Capable of redistributing incomes to share tax burden fairly (vertical equity)
- **Economic efficiency and growth**
 - Minimise tax-induced distortions of behaviour
 - Foster flexible markets, entrepreneurship, innovation, etc
- **A well-run system**
 - Low compliance costs for taxpayers and administrative costs for government
 - Clear and predictable regime
- **Addresses environmental issues effectively**
- **Shares powers between levels of government**
 - Equitable and stable regime that supports fiscal discipline and overall tax policy

Tax Policy Before the Crisis

- Revenue mix
 - Increase in (OECD average) share of SSCs and fall in PIT share
 - Rise in share of VAT, fall in share of specific consumption taxes
 - Slight fall in share of environmentally-related taxes in past decade
- Corporate Income Tax
 - Fall in statutory rates, some base broadening
 - Increased use of R&D tax credits
- Personal Income Tax
 - Reductions in top rates and simplifications of rate structures
 - More integration of in-work income-related benefits into tax regime
- Value Added Tax
 - Increases in standard rate but little change to scope of reduced rates and exemptions

Tax Policy in 2008/2009

- Temporary tax cuts to boost investment and consumer spending
- Support for business liquidity
- Personal income tax cuts and improvements to in-work tax credits
- Sectoral support, e.g. for property market
- Implementation of planned structural reforms, but perhaps on revenue-losing basis

Medium-Term Challenges for Tax Policy

- **Financial stability**
 - How to support improvements to financial regulation to ensure capital adequacy of banks and to strengthen financial stability

- **Sound public finances**
 - Stabilisation / reduction in public debt ratios to maintain sustainable public finances

- **Globalisation and restoring economic growth**
 - Adaptation to the challenges/ taking advantage of the opportunities of globalisation and technical progress
 - Encouraging entrepreneurship, innovation, investment
 - Achieving a high level of employment

- **Climate change**
 - Key part of taxes and/ or tradable permits in reducing emissions of greenhouse gases at least resource cost

The public finances

General govt budget balances and debt ratios (OECD average)

	2007	2008	2009	2010	2011
Budget balance	- 1.3	-3.5	- 6.2	- 8.3	- 7.6
Gross financial liabilities	73	78	90	97	103

Source: OECD Economic Outlook, December 2009

Fiscal Consolidation

- Fragile recovery makes timing tricky
- Reversal of crisis tax measures and cyclical recovery in receipts unlikely to be enough in many countries
- Tax reforms with significant losers challenging
- Importance of restoring growth of potential output in stabilising debt ratios

“Pro-Growth” Tax Reforms

Low rates and broadening of tax bases, plus good taxpayer service and compliance

- Rebalancing the revenue mix
 - Raise more from recurrent taxes on residential property
 - Shift toward taxes on consumption
 - More environmentally-related taxes

- Avoid raising top PIT rates but reduce tax breaks for pensions, capital gains, etc for better off

- Broadening of PIT, CIT and VAT bases

What taxes to raise/ reduce?

Increase property taxes? But

- How far will higher taxes be capitalised into prices?
- Is aftermath of a boom propitious timing?
- A Sub-Central Govt tax

Increase taxes on consumption? Yes, but how?

- Can perceptions about effects of raising reduced rates be overcome?

Cut Income taxes and SCS? But

- Scale of fiscal consolidation needed in some countries: PIT and SSC raise some 50% of revenues
- Fairness
- Attractions of allowing fiscal drag to generate revenues

Administrative Reform

- **Globalisation and other challenges for tax administration**
 - Easier to move profits between jurisdictions, e.g. growth in importance of intangibles
 - Abuse of tax shelters and tax havens
 - Attitudes to compliance
 - Raised expectations on standard of service
- **Policy response**
 - Application of OECD standards on transparency and exchange of tax information – breakthrough in 2009
- **Tax administration response**
 - More withholding at source and information reporting by third parties
 - Improved risk management (by segment)
 - Use of new technology

Environmental taxes

- Challenge of climate change far outweighs any other environmental concern in scale and global dimension
- Required reductions in emissions to stabilise temperature rise at acceptable levels likely to imply much higher carbon prices
- Achieving this through carbon taxes and/or auctioning of permits under a cap-and-trade regime a big potential revenue source
- Will be losers (especially among poorer households) from higher energy prices, but governments will have more scope to compensate if they auction rather than give permits away

Some conclusions

- Low rates and broadening tax bases, plus good taxpayer service and compliance remains a good recipe
- Hard to achieve necessary scale of fiscal consolidation without discretionary tax rises
- Use opportunity to scale back tax expenditures that favour particular interest groups
- Vital to get acceptance of much higher rates of carbon taxes/ permit prices if GHG reduction targets to be met