Tax Policy Options for Aging Societies

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Outline of Presentation

I. Trends in Revenue Mobilization

II. Growth Friendly Tax Policy

III. Importance of Revenue Administration
I. Trends in Revenue Mobilization

Trends in Overall Revenues - Median tax ratios to GDP by income group

Government Revenue

- Low income
- Lower middle income
- Upper middle income
- High income
I. Trends in Revenue Mobilization

### VAT Revenues

- **Low income**
- **Lower middle income**
- **Upper middle income**
- **High income**

### CIT Revenues

- **Low income**
- **Lower middle income**
- **Upper middle income**
- **High income**

### PIT Revenues

- **Low income**
- **Lower middle income**
- **Upper middle income**
- **High income**

### Trade Tax Revenues

- **Low income**
- **Lower middle income**
- **Upper middle income**
- **High income**
I. Trends in Revenue Mobilization

VAT has spread out…
I. Trends in Revenue Mobilization

Low Income Countries

Lower Middle Income Countries

Upper Middle Income Countries

High Income Countries

CIT revenue (% of GDP)  CIT rate (right axis)
I. Trends in Revenue Mobilization

Tax Systems Have Become Less Progressive…

Top Marginal Personal Income Tax Rate, 1980 and 2012 (Percent)

Ratio of Direct to Indirect Tax Revenue

I. Trends in Revenue Mobilization

Median tax ratios to GDP by low and lower-middle income group

Developing Asia (WEO)  
Latin America and Caribbean  
Middle East and North Africa (WEO)  
Sub-Saharan Africa (WEO)
II. Growth Friendly Tax Policy

• In the least harmful way for growth...

  - Growth friendly tax policy
    • By shifting tax composition to the least distortionary taxes (taxes on consumption, excises, taxes on property), and broadening tax base
II. Growth Friendly Tax Policy

- **VAT**
  - Replacing inefficient production or sales taxes by a simple VAT
  - Levying a VAT on a broad base, with a high threshold and avoiding multiple rates

- **CIT**
  - Building CITs that are simple and sufficiently broad-based to allow statutory rates competitive by international standards

- **PIT**
  - Extending the coverage of the PIT (particularly through inclusion of smaller businesses and professionals)
  - Establishing coherent taxation of capital income
  - With effective rate structure consistent with the authorities’ distributional preferences
II. Growth Friendly Tax Policy

• Specific tax policies helping growth
  – Labor participation
    • Reduce ‘tax wedge’ by PIT and social contribution
    • Incentives for elderly/women/low skilled?
  – Physical capital
    • Taxing rents or excess returns
    • Incentives for specific capital formation?
  – Productivity
    • Incentives for R&D?
II. Growth Friendly Tax Policy

Relationship Between the Tax Wedge and Employment Rate

1. Advanced economies

\[ y = -0.7877x + 81.033 \]
\[ R^2 = 0.2888 \]

2. Developing economies

\[ y = 0.0336x + 32.415 \]
\[ R^2 = 0.0005 \]

Sources: Institute for the Study of Labor; Organisation for Economic Co-operation and Development; and IMF staff estimates.

Note: Line shows an ordinary least squares (OLS) regression line.

II. Growth Friendly Tax Policy

• Social contribution
  – Widely adopted in advanced countries as a source of social spending (pension / healthcare), because…
    • ‘earmarked’ revenues to specific spending
    • by design (grouping), easy to understand closer relationship between ‘burden’ and ‘benefit’
    • easy to keep compliance by withholding labor wages
II. Growth Friendly Tax Policy

• **Social contribution**
  – Can we continue (start) to rely on it, considering…
    • function as labor wedge
    • declining working age population
    • less flexibility for designing system (especially, after fixing a system for social groups)
II. Growth Friendly Tax Policy

• Taxation on wealth/property
  – Less adopted, because…
    • affecting incentives for (domestic) saving
    • not easy to keep compliance
II. Growth Friendly Tax Policy

Taxes on wealth / property

- Taxes on financial and capital transactions
- Estate, inheritance and gift taxes
- Recurrent taxes on net wealth
- Recurrent taxes on immovable property

Source: OECD Revenue Statistics
III. Importance of Revenue Administration

‘Compliance gap’ and ‘Policy gap’

- Compliance Gap
- Actual Collections
- Policy Gap

Potential Collections

Administrative Effectiveness

Current Effectiveness

Current Structure

Normative Structure

Tax Structure

100%
III. Importance of Revenue Administration

Revenue Gain from Closing Half of Compliance Gap and Policy Gap (percent of GDP)

III. Importance of Revenue Administration

Trend in Compliance gap

III. Importance of Revenue Administration

• Effective revenue administrations
  – making proper use of withholding and third-party information, implementing voluntary compliance and self-assessment
  
  – limiting opportunities for rent seeking by designing and applying forceful and efficient strategies to deal with non-compliance
III. Importance of Revenue Administration

Diagnostic tools

RA-GAP: Potential vs. Actual

<table>
<thead>
<tr>
<th>Year</th>
<th>Potential VAT</th>
<th>Accrued Collection</th>
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<tbody>
<tr>
<td>2007</td>
<td>10%</td>
<td>8%</td>
</tr>
<tr>
<td>2008</td>
<td>10%</td>
<td>8%</td>
</tr>
<tr>
<td>2009</td>
<td>10%</td>
<td>8%</td>
</tr>
<tr>
<td>2010</td>
<td>10%</td>
<td>8%</td>
</tr>
<tr>
<td>2011</td>
<td>10%</td>
<td>8%</td>
</tr>
<tr>
<td>2012</td>
<td>10%</td>
<td>8%</td>
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</table>

Compliance Gap

<table>
<thead>
<tr>
<th>Year</th>
<th>% of Potential VAT</th>
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<tbody>
<tr>
<td>2007</td>
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<tr>
<td>2008</td>
<td>5%</td>
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<tr>
<td>2011</td>
<td>25%</td>
</tr>
<tr>
<td>2012</td>
<td>30%</td>
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</table>

RA-FIT: Collects RA data and establish baselines/benchmarks

TADAT: Assessment tool

III. Importance of Revenue Administration

Performance Outcome Areas

- Accountability and Transparency
- Assessment and Mitigation
- Supporting Voluntary Compliance
- Filing of Tax Returns
- Payment of Obligations
- Ensuring Accuracy of Reporting
- Tax Dispute Resolution
- Operational Efficiency and Effectiveness
- Integrity of the Registered Taxpayer Base
Concluding Remarks

• Global trends in shifting to tax base with less distortion – while causing concerns for equity issues

• Design of ‘each’ revenue components still matters – VAT, CIT, PIT, SC, WT

• Strengthening institutional capacity could be an important element for efficient revenue mobilization
Reference

IMF(2011) Revenue Mobilization in Developing Countries
