Priorities for Strengthening Key Revenue Sources in Asia

By

Sanjeev Gupta
Center for Global Development

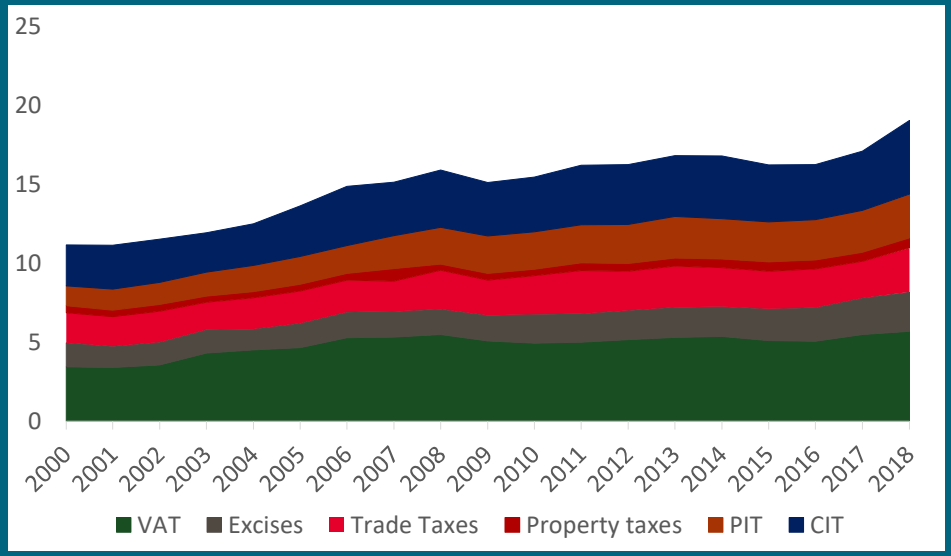
November 2, 2023

Economic Commission for Asia and Pacific, Bangkok

Introduction and Context

- Why focus on DRM:
- Financing additional SDG spending and climate transition, addressing fiscal consequences of COVID; and ensuring debt sustainability and supporting post-COVID fiscal consolidation in the face of rising debt to GDP ratios
- The region has done well since 2000 with tax-to-GDP ratio rising by 4 pp. of GDP, with one-half of the revenue coming from VAT
- Collections from other taxes, such as CIT and PIT also increased. PIT revenues, while increasing by a percentage point, remain substantially less than AE. Property taxes stagnated at about 0.5 percent of GDP
- However, the increase in indirect taxes has been higher than the increase in direct taxes, with implications for the progressivity of tax systems in the region

Figure 1: Tax revenues by type in developing Asia, 2000-2018 (as a share of GDP)

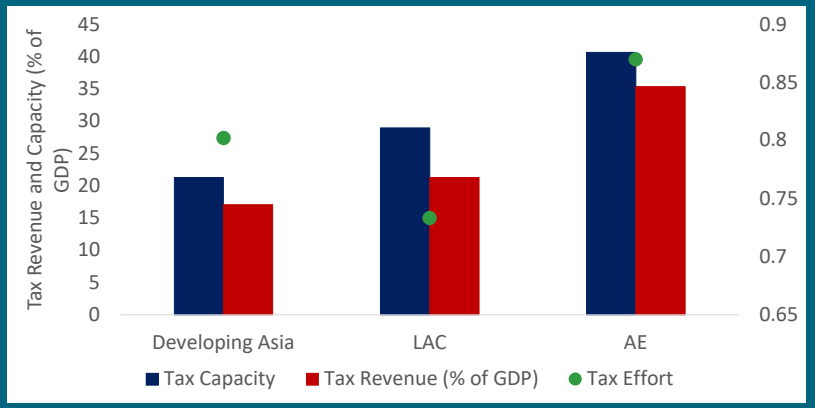


Tax Capacity and Tax Potential in Asia

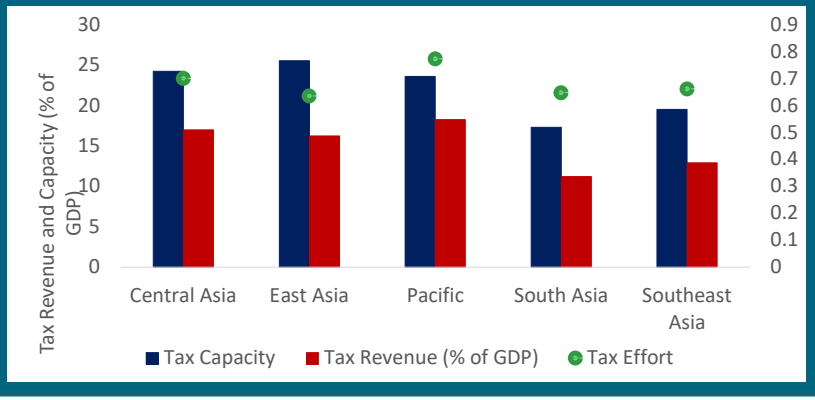
- Estimates of tax capacity, tax effort and tax potential over 1990-2019 show capacity to raise additional revenue of up to 4 percent of GDP, on average
- Tax capacity lower than in LAC; South Asia has the lowest tax capacity and actual tax collections; and Pacific has highest tax effort
- Singapore or Thailand have potential to raise revenues provided expanded role of the state is acceptable
- Essential to complement this analyis with detailed country analysis (case studies)

Figure 2. Tax effort

a. by country group, last available date



b. Developing Asia by region, last available date



Tax Burden

- Two indicators of tax burden using alternative measures (a la Frank and Bird)
- We find that while potential to raise taxes is high, the level of tax burden is also relatively high, suggesting caution in designing aggressive DRM strategies in the region
- The good news is that burden from taxation has been declining since 2000

Figure 4: Tax burden in developing Asia vs other regions, 2000-2017 average

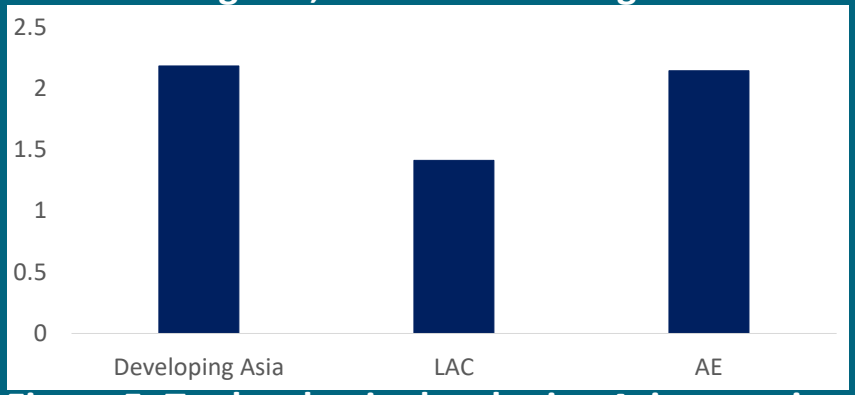
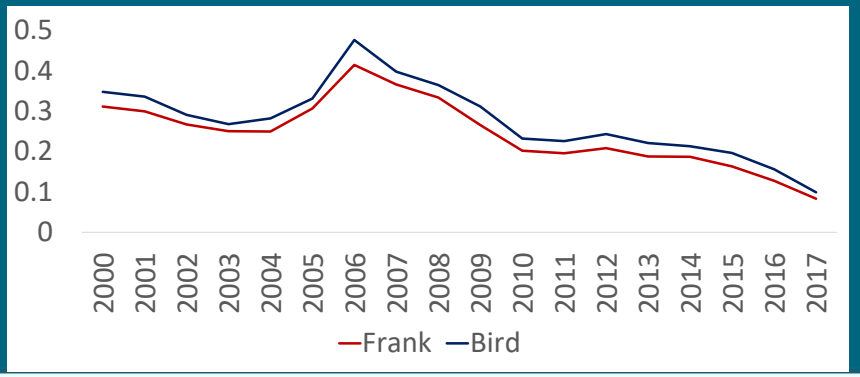


Figure 5: Tax burden in developing Asia over time, 2000-2017 median



Tax Productivity and Tax Efficiency I

- We looked at relative productivity of individual taxes to gauge tax system's performance
- PIT and CIT tax rates have declined over time while VAT rates have remained broadly unchanged
- VAT and PIT productivity similar to that of other regions, but there is much heterogeneity in PIT while CIT productivity is higher

Figure 6. Tax Rates in developing Asia

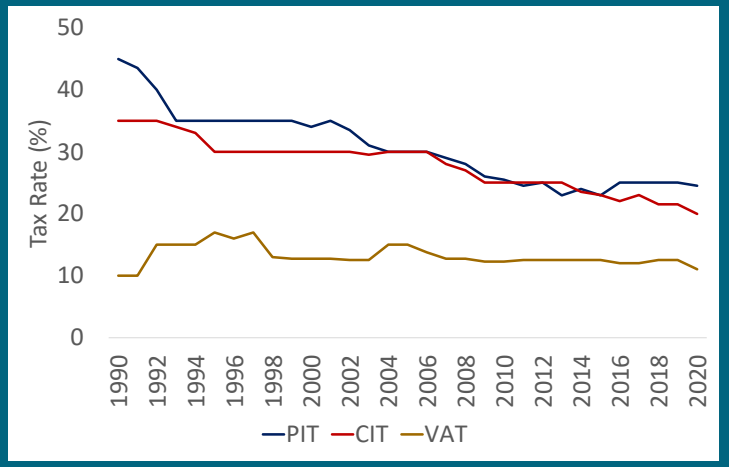
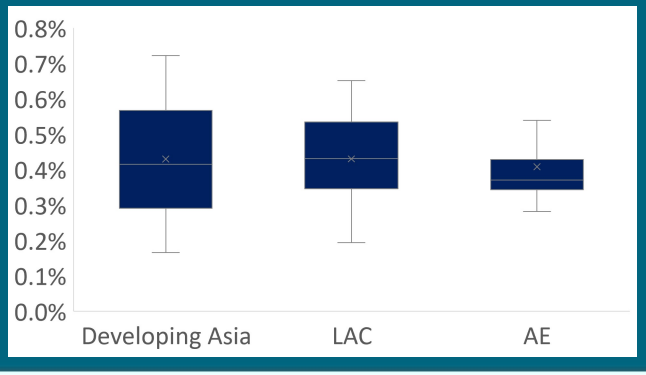
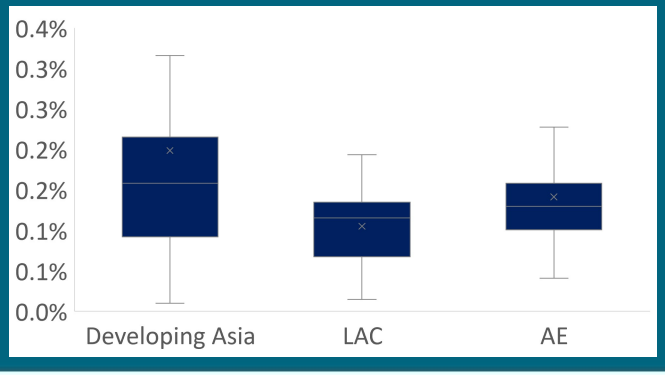


Figure 7. Tax productivity in developing Asia

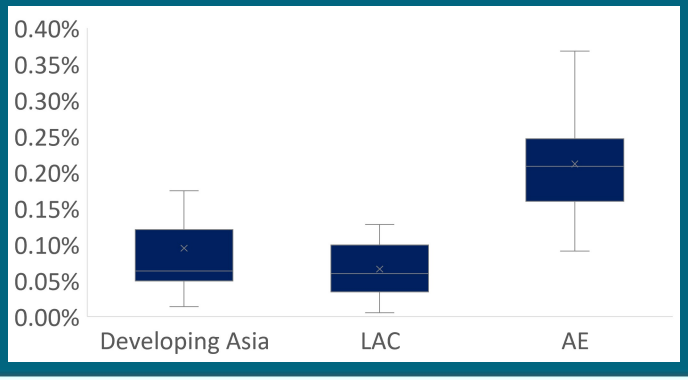
a. PIT rate in Asia



b. CIT rate in Asia



c. VAT rate in Asia



Tax Productivity and Tax Efficiency II

- C-efficiency of VAT—indicative of its performance and effectiveness—has risen over time in developing Asia (partly because of small island countries)
- The IMF's gap analysis shows a potential to raise VAT revenues by 2 percent (with highest in the Philippines and lowest in Sri Lanka and Thailand)
- The largest compliance gaps for the VAT are in construction and trade sectors

Figure 8: VAT C-efficiency, 2000-2018

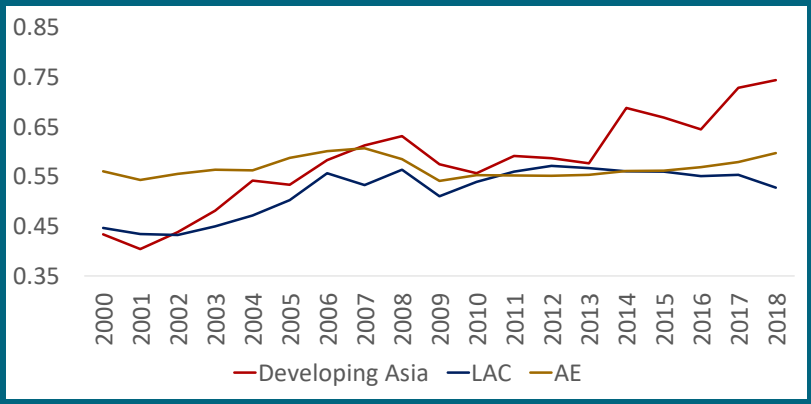
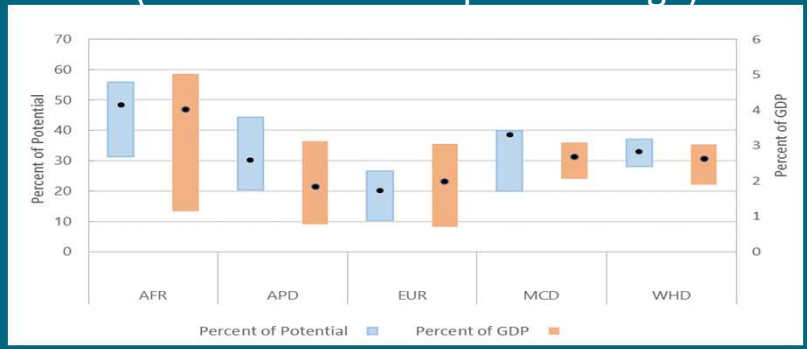


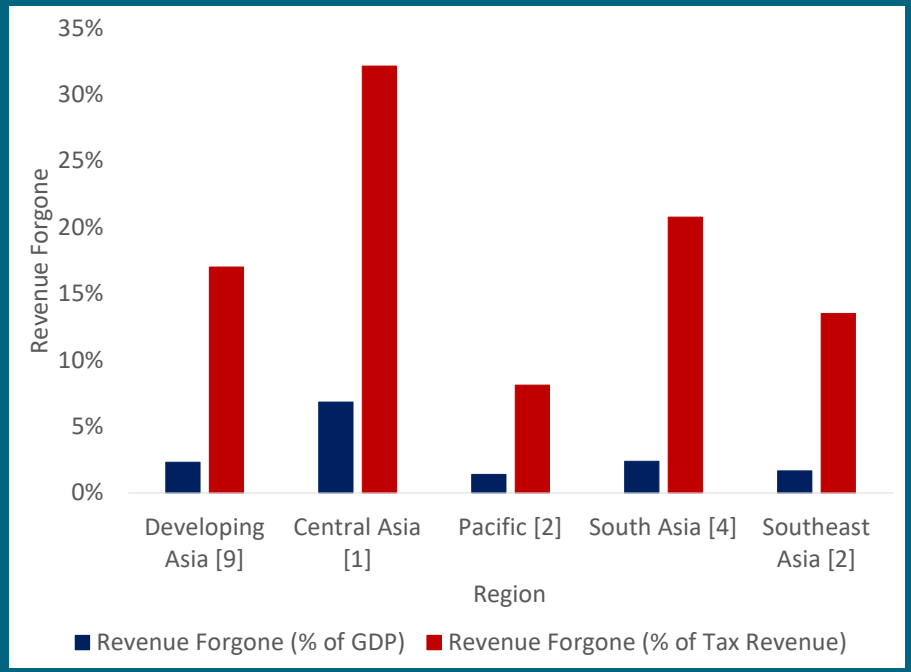
Figure 9: VAT compliance gaps by region (median and inter-quartile range)



Tax Expenditures I

- Tax expenditures (TE) are "benefits granted to specific sectors, activities or groups through preferential tax treatments such as exemptions, deductions, credits, deferrals and lower tax rates"
- Typically, they are nontransparent in comparison with other budgeted programs
- Data for only nine countries in the region and TE on average are one-half of the level found in sample of 99 countries

Figure 10: Average of countries reporting and revenue forgone by region in developing Asia



Tax Expenditures II

- TEs in developing Asia are not as elevated as in some advanced economies, but they nevertheless can amount to 30 percent of total taxes (e.g., Armenia)

- The bulk of TEs are granted on taxes on goods and services. This has implications for the tax which has most revenue potential going forward

Figure 11: Tax expenditure (percent of GDP) vs tax expenditure (percent of tax revenue)

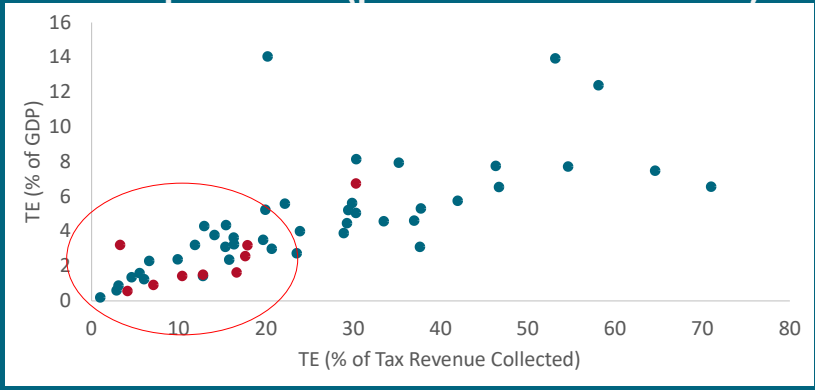
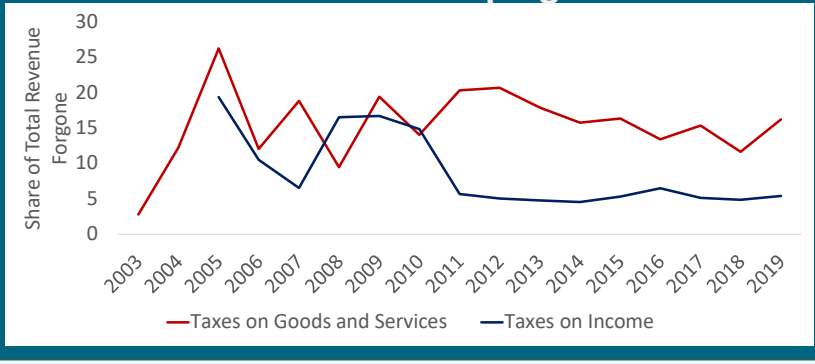


Figure 12: Tax expenditures in relation to the tax base in developing Asia



Key Takeaways and Policy Implications

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1. Developing Asia has improved its revenue performance since 2000 with 4 pp. increase in tax-to-GDP ratio, but comprehensive reforms needed to sustain the momentum
2. The region has potential to raise more revenues—of up to 4 percent of GDP—with the VAT holding the most potential and compliance by construction and trade sectors deserving greater attention for improving VAT yield
3. At the same time, strengthening of VAT must be accompanied by an expansion of progressive taxes to prevent tax systems from becoming even more regressive. Improved incidence of social and in-kind benefits would help offset regressivity of indirect taxes
4. TEs are an important source of leakage and inequity. In this regard, countries should be encouraged to estimate and publish TEs and the ADB should consider providing support to countries to estimate and rationalize tax expenditures. At present, limited data are available in developing Asia
5. Finally, policymakers in developing Asia must complement tax-enhancing efforts with those directed at improving the quality of public spending. It is possible to generate up to 3 percent of GDP in resources by focusing on improving the efficiency of existing budget allocations

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Thank you!