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Task Force 03

REFORMING THE INTERNATIONAL FINANCIAL ARCHITECTURE

Improving Tax Expenditure Reporting to Enhance Tax Expenditure Policy Making

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Abstract

Tax expenditures (TEs) are preferential tax treatments that lower government revenue and the tax liability of the beneficiary. Their impact is sizeable: according to the Global Tax Expenditures Database (GTED), the global average revenue forgone over the 1990-2022 period is 3.8 percent of GDP and 23.0 percent of tax revenue. Yet, despite the fact that TEs have similar effects on public budgets as direct spending, the lack of transparency is striking: according to the GTED, more than half of the 218 jurisdictions worldwide do not publish any reports on TEs. Moreover, even when information on TEs is published, the quality, regularity and scope of disclosure are very diverse, and in some cases the effectiveness and efficiency of TEs can hardly be assessed. The Global Tax Expenditures Transparency Index (GTETI) provides the first systematic and comparative account of worldwide TE reporting. Based on a normative approach, the GTETI allows to identify key areas of improvement in TE reporting, which is vital to increase transparency and accountability.

This policy brief presents four specific and actionable policy recommendations for the G20:

1. Agree on minimum standards for regular, comprehensive and detailed TE reports.
2. Improve the availability of good quality data, including revenue forgone estimates and results from the evaluation of TE provisions.
3. Incorporate TE analysis into the budget cycle.
4. Share TE information with stakeholders and the general public in a timely manner.

Keywords: Tax expenditure, revenue forgone, fiscal space, domestic resource mobilization

Diagnosis of the Issue

Improving TE reporting is key to increase transparency and accountability in fiscal policies. At the same time, good quality TE data can make a substantial contribution to better align governments' tax systems with their growth and development strategies. Yet, TE reporting is highly heterogeneous across regions but also across countries within regions.

Whereas 17 of the 19 G20 countries issue public TE reports, the quality of these reports differs widely – China and Saudi Arabia are non-reporting countries (Redonda et al., 2024). The GTETI provides a comprehensive and comparative assessment of worldwide TE reporting (Redonda et al. 2023b). South Korea, Canada, the Netherlands, Germany and France can be seen as frontrunners, obtaining scores above 70 out of a maximum of 100. Yet, several G20 countries, such as Türkiye (#78) and Japan (#104), rank strikingly low. Moreover, the median G20 member country – the UK – scores just 56,4, indicating that there is still significant room for improvement among G20 economies. The lowest average score is obtained in *Dimension 5. TE Assessment*, which confirms the striking lack of TE evaluations, even among best performing countries (Beer et al., 2022 and Redonda et al., 2023 and Redonda et al., 2023b).

The lack of transparency and consistency in TE reporting is not only an issue among G20 economies. Since the 80s, an increasing number of countries in LATAM have started to report on TEs. Figure 1 shows the evolution of reporting countries for CIAT (Inter-American Center of Tax Administrations) member countries. As Figure 1 shows, there is still a good number of countries that do not yet report on TEs.

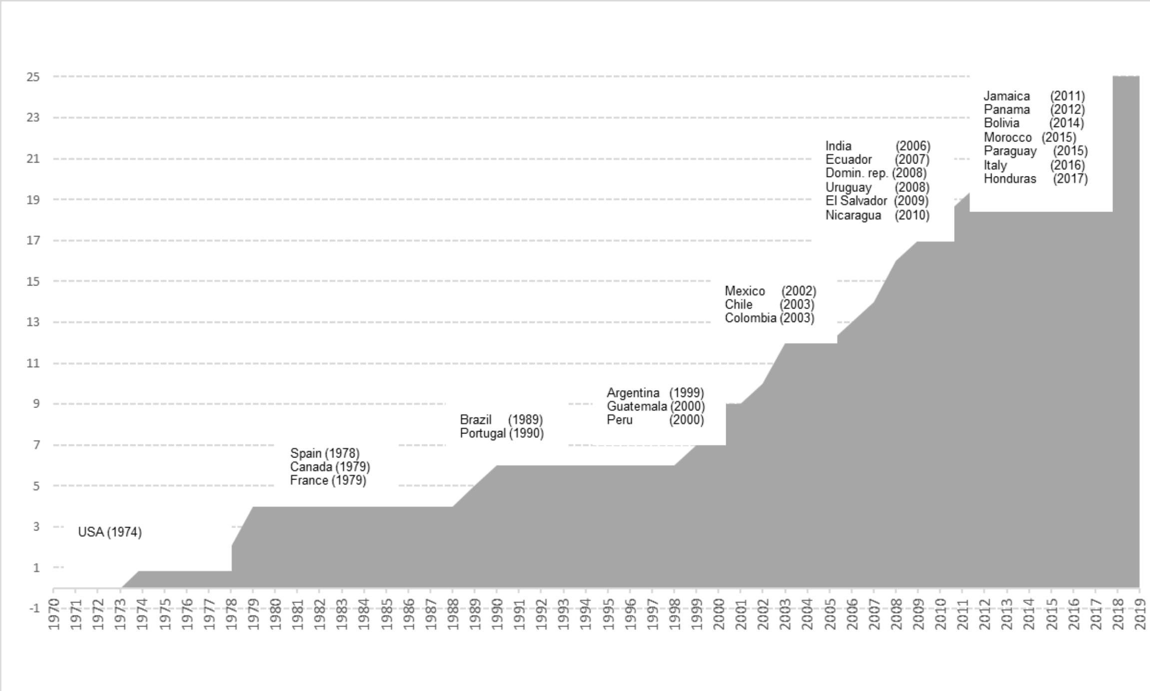

FIGURE 1. CIAT member countries that report on TEs

Source: Pelaez (2019).

A remarkable effort to standardize TE reporting has started in the region more than a decade ago, e.g. by creating working groups on TE estimation that resulted in the publication of CIAT´s Handbook of Best Practices on Tax Expenditure Measurements (CIAT, 2011). The [Tax Expenditure Database of Latin America and the Caribbean (TEDLAC)](), which makes a substantial contribution to the monitoring and analyzing of TEs in LATAM provides another example. Nowadays, most of the reports include a general definition of TEs, a description of the reference framework (benchmark) for each tax, a description of each TE, a reference to the legal provision through which the TE is generated, and revenue forgone estimates, including projections for future periods. Yet, there is still a lack of consistency concerning the elements that TE reports should include, triggering a certain level of heterogeneity in the quality and scope of TE reporting, as reflected in the dispersion of GTETI scores among LATAM economies (Redonda et al., 2023b).

Compared to LATAM, Africa has less of a tradition in TE analysis. African countries have started to report on TEs significantly later than LATAM ones. Between 2000 and 2019, only 20 African countries were publishing TE reports. Yet, according to the GTED, the number of African countries publishing TE reports has since increased to 31 (Redonda et al., 2024).

As in LATAM, the concerns regarding the quality and scope of the reports remain. While Tanzania provides aggregate estimates of revenue forgone and a list of the beneficiaries, Uganda provides more granular data, indicating revenue forgone estimates under each tax head and, in some instances, even sectors, but no information on the beneficiaries. Benin provides consistent high-quality reports classifying TEs not only by type of tax, but also by beneficiary, objective, and ministry. Benin ranks #8 in the GTETI, and shows the highest score (13.6/20) among all assessed countries in *Dimension 5. TE Assessment*, the dimension where countries show the weakest performance.

Two regional attempts at standardizing TE reports in Africa exist. Southern African Development Community (SADC) member states adopted the SADC Tax Expenditure Model in 2015 (reviewed in 2022). Yet, some countries, such as Zambia and Zimbabwe, are still non-reporting countries. Likewise, the Economic Community of West African States (ECOWAS) and the West African Economic and Monetary Union (WAEMU) launched a joint program to improve and harmonize efforts to report on TEs in 2018. A methodological guide, data collection grids and a common format for TE reporting have since been developed, and the implementation of these tools is being carried out, mainly focusing on indirect taxes.

Improving TE reporting should be a priority for G20 governments to enhance TE policymaking and rationalize the use of TEs. This would trigger a twofold positive effect by increasing tax revenues (and hence, boosting fiscal space) and, at the same time, better aligning TE regimes with governments' development and growth strategies (Dressler et al., 2022). The latter is particularly relevant for this year's G20 process as the priorities defined by the Brazilian presidency include the "fight against hunger, poverty and inequality" and "the three dimensions of sustainable development (economic, social and environmental)", all issues for which more and better TE analysis would be highly beneficial (Redonda, 2016).

Recommendations

Recommendation 1. Agree on minimum standards for TE reporting

G20 governments should agree on minimum standards for regular, comprehensive and detailed TE reporting, covering the following aspects:

- Reports should be published every year and contain up-to-date information.
- Reports should provide revenue forgone estimates at the individual provision level for all TEs in use.
- Reports should include a detailed description of every TE provision as well as information on the policy objective, the targeted beneficiaries, the legal basis and the timeframe of each TE provision.
- Reports should contain information about the benchmark tax system upon which each TE provision is being granted.

While good TE reporting is ultimately the responsibility of each government, agreeing on these minimum standards could greatly facilitate conversations about the use of TEs worldwide. For instance, it would help countries to protect their tax base in the context of the recent reforms of the international tax system (the "Two-Pillar Approach") developed by the OECD (OECD, 2021). Whereas the alignment of national tax regimes with the Two Pillar approach remains a sovereign decision, more and better data on TEs would allow those decisions to be better informed ones. Likewise, increasing transparency in the use of TEs that affect climate policy – either negatively (TEs supporting the production and consumption of fossil fuels or CO2 tax reliefs for energy-intensive sectors) or positively (green tax incentives) – would significantly contribute to lower CO2 emissions and accelerate climate action.

Recommendation 2. Enhance the availability of good quality data for TE analysis

To enhance the quality and availability of data for TE analysis, it is essential to implement a holistic approach that focuses on capacity building, transparency, and regular evaluation.

Data collection and reporting standards must be established to ensure consistency in TE classification. Data governance should be developed or adapted to include the collection and safe use of data for TE analysis. Training personnel in data management, quality assurance and analysis is essential to build capacity.

Access to TE data promotes transparency and stakeholder engagement. In the beginning, a few key datasets can be very valuable to assess TEs and, later, this could include a large collection of datasets.

Routine quality assurance checks ensure data quality, leading to more accurate TE estimates and improved policy decisions based on sound data analysis. Technology is a crucial tool to automate recurring processes and help identify potential inconsistencies.

Enhancing the availability of good quality TE data will foster increased public trust through transparent data practices and support informed decision-making in TEs. Whereas moving in this direction can be a challenging process, some countries have made substantial progress in this area. The Canadian TE report includes the so-called Gender-based Analysis Plus of the impacts of existing TEs based on key identity factors directly identifiable using tax return data, including gender, family status, age, income, ethnicity, sexual orientation and disability. The National Treasury Secure Data Facility and Uganda Research Lab are two examples of developing countries making their sensitive data available for TE analysis in a secure way.

Recommendation 3. Incorporate TE information into the budget cycle

TEs are a key policy instrument for governments and the revenue forgone stemming from TEs can be significant. It is, hence, vital that TE information is incorporated into the regular annual budget cycle. This includes both the overall assessment of revenue forgone, which affects the government's revenue generation potential, and a functional breakdown that allows for a full picture of sectoral resource allocation patterns. Ideally, such information should be included within or appended to budgetary documents, such as the budget proposal that the executive presents to the legislature, the medium-term fiscal strategy that governments often produce during the more strategic phase of budget formulation, and budget execution reports.

Budgetary documents should encompass revenue forgone estimations for each TE, accompanied by detailed descriptions of the provisions, and a classification according to government functions in line with the one used for budget purposes. This is critical to ensure that TE provisions are comparable to direct spending entitlements as appropriated by parliament.

Currently, such practices are not very widespread. The GTETI shows that in more than half of the countries covered, governments' budget proposals (when they are publicly available) do not include any TE-related information, and only about ten percent of countries provide comprehensive information. Even among G20 member countries, the picture is not very encouraging, with only about half of the countries promoting adequate linkages between TE policy and broader fiscal policy.

Recommendation 4. Share TE information with stakeholders and the general public in an appropriate and timely manner

For effective government accountability to citizens, TE reports need to be public and accessible in their presentation, language and format, but they also need to provide up-to-date information. Therefore, revenue forgone estimates should ideally cover the most recent financial year(s) and even provide projections for the medium term going forward. GTETI *Indicator 1.2 Timeliness* assesses whether, at the moment of publication (year t), TE reports contain the most up to date TE data, i.e. data for the previous year (year t-1). Whereas this indicator shows a relatively good performance with 74 percent of countries getting the highest possible score, the scores for 26 percent of the countries lie among the lowest possible options, i.e. the report provides data for the fiscal year before the most recent one (t-2), or older (Millan- Narotzky et al., 2023).

Publishing a good quality TE report allows for external scrutiny and debate, which can strengthen the quality of policymaking, whilst comparing TEs with other types of spending helps to identify trade-offs in the allocation of public funds across competing priorities.

Moreover, engaging civil society, media and other stakeholders in the early stages in the publication process can also be important in helping the public to understand and interpret the results, which can avoid common misconceptions about TEs. These misconceptions include assuming that all TEs are exemptions (as opposed to a spectrum of partial to full tax relief), suggesting that revenue forgone translates into an equal revenue gain if TE provisions were removed (i.e. not accounting for behaviour change), or assuming that all TEs represent wasteful leakages (Granger et al., 2022).

Scenario of Outcomes

The definition of TEs and benchmarks, the estimation of revenue forgone from TE use as well as the publication of TE reports have been considered the exclusive responsibility of individual governments. Whereas a few regional initiatives to standardize TE reporting as well as technical guidelines on TE management (Heady and Mansour, 2019), estimation (Caner, 2023) and evaluation (Beer et al., 2022) exist, they mostly address individual countries and do not aspire to trigger any collective responses to the issue.

Recent developments in international taxation, above all the introduction of the global minimum tax under the GLOBE project coordinated by the OECD, show that a more coordinated approach to TEs – at least, when it comes to those measures that seek to incentivise investment, is in order. The adoption of shared standards for TE reporting, data quality, budget integration and public access to information by the G20 would be an important step in this direction.

G20 member states would benefit from such a coordinated approach in multiple ways. First, transparency on the extent to which TEs are used and the conditions under which they are granted would be greatly enhanced, thus limiting those forms of international tax competition that are based on secrecy and beggar-thy-neighbour attitudes. Hence, G20 member states will find it easier to counteract approaches that seek to side-step the GLOBE rules by introducing new TEs or modifying existing ones. Second, shared standards and public access to information would also help to shed light on domestic TE regimes, facilitating reforms that seek to rationalise the use of TEs. Indeed, getting rid of ineffective or even harmful TEs would produce short-term benefits to fiscal space and domestic revenue mobilisation. Third, the coordinated approach outlined in this brief would also help to improve fiscal policies more generally, by fully integrating TEs into budget planning and medium-term fiscal strategies.

At the level of individual G20 members, embracing the recommendations made above might require some policy shifts and political efforts. Not all G20 members provide full public access to TE-related information. Also, not all G20 members have succeeded in fully integrating TEs into budget planning. TE reports published by G20 members do not always include all the information outlined above. Not least, a majority of G20 members do not yet subject their TEs to regular and thorough evaluations, including cost-benefit analyses, other types of impact assessments, as well as the assessment of spillover effects. However, even though some governments might consequently find it easier to avoid such reforms, it is evident that the short-term benefits of non-action would be greatly outweighed by the mid-to long-term benefits of improved TE reporting.

Finally, besides the benefits for their own economies and societies, by improving TE reporting, G20 countries would also be leading by the example and, hopefully, positively influencing non-G20 economies to move in the same direction.

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