Tax Policy after the Pandemic

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JOINT VIENNA INSTITUTE

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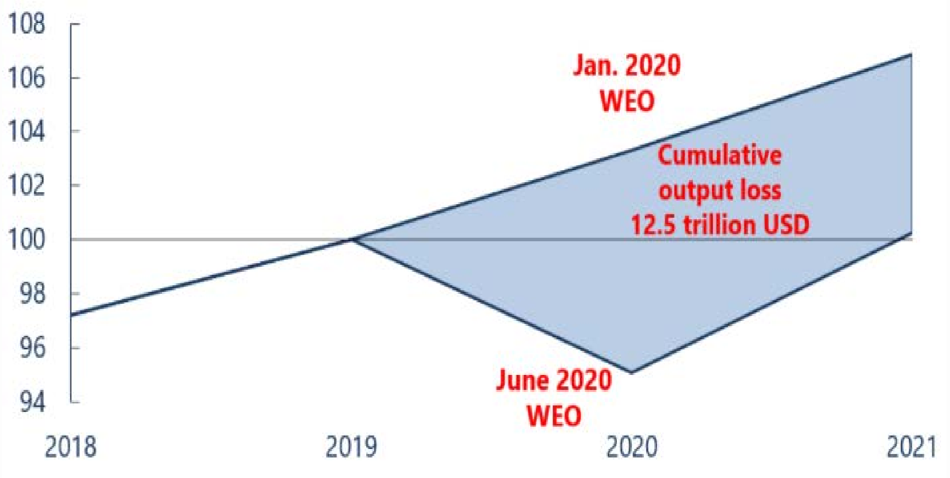
Economic impact of COVID

- **WEO update June 24**
  - Global output – 4.9%;
    - US –8; EU –10; EME –3; LICs – 1
    - Emerging Europe: –6
  - Commodity price slump
    - GDP Mexico – 11%; Nigeria – 5½%

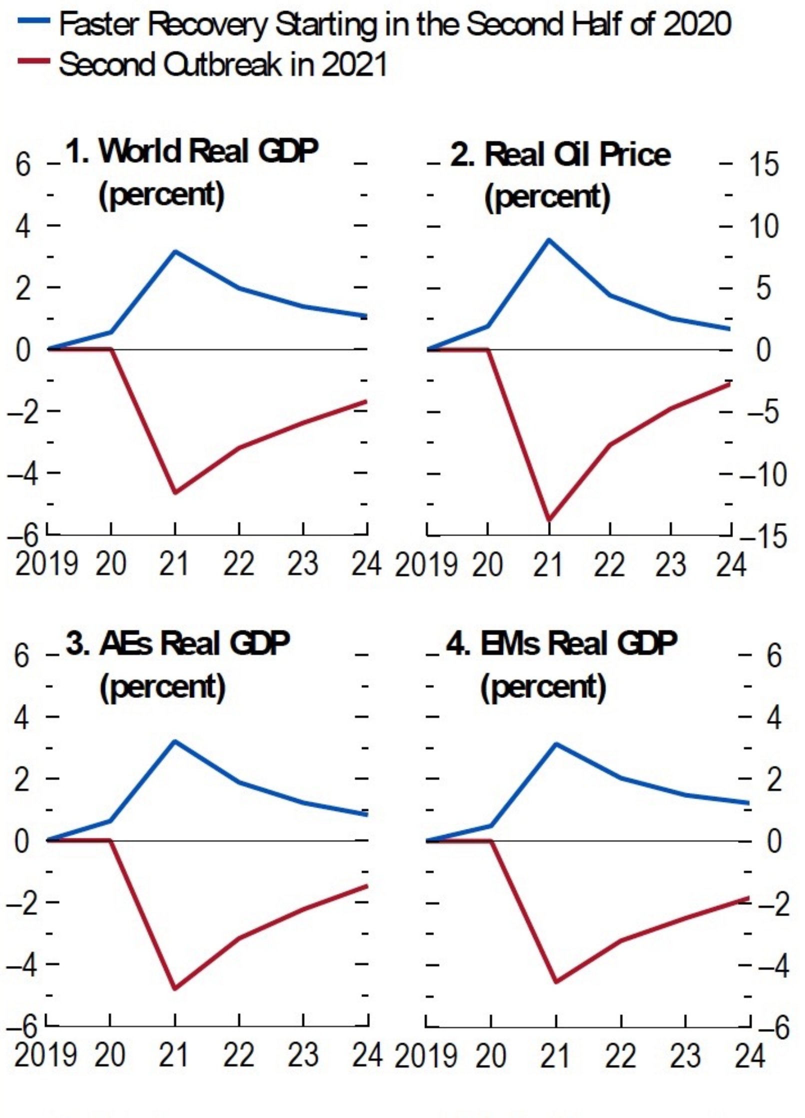


- **> 100 countries requested IMF support**
  - Emergency lending to 72 has been approved
  - Debt relief granted to 26 LICs
  - > $ 120 bln precautionary lending to EMEs

Specifics of the COVID crisis

- **'A crisis like no other'**
  - Started as a highly asymmetric supply shock
  - Subsequent dynamics in supply & demand, with demand slump being salient (precautionary savings)
  - Unlikely go 'back to trend'

- **Extreme uncertainty**
  - WEO update +5.4% in 2021 (baseline)
  - But 2 alternative scenarios – 2nd wave or vaccine?



‘A crisis like no other’

- ***It is a asymmetric in many dimensions***
  - The less affluent face higher incidence of job loss, income loss and exposure to COVID risk
  - Large sectoral differences
- ***Might create lasting transformations***
  - Air travel, tourism, retail, cash payments, digitalization
  - The way we work, commute, meet
- ***(Tax) policy can shape that transformation***

Fiscal policy response in 3 different phases

1: Immediate: 'whatever it takes'

- Health care spending
- Business continuity
- Protecting people

2: Stimulus: support reopening

- How to deal with uncertainty?

3: Recovery / consolidation

- How to steer the transformation?

Phase 1 – immediate response

Do “whatever it takes” …

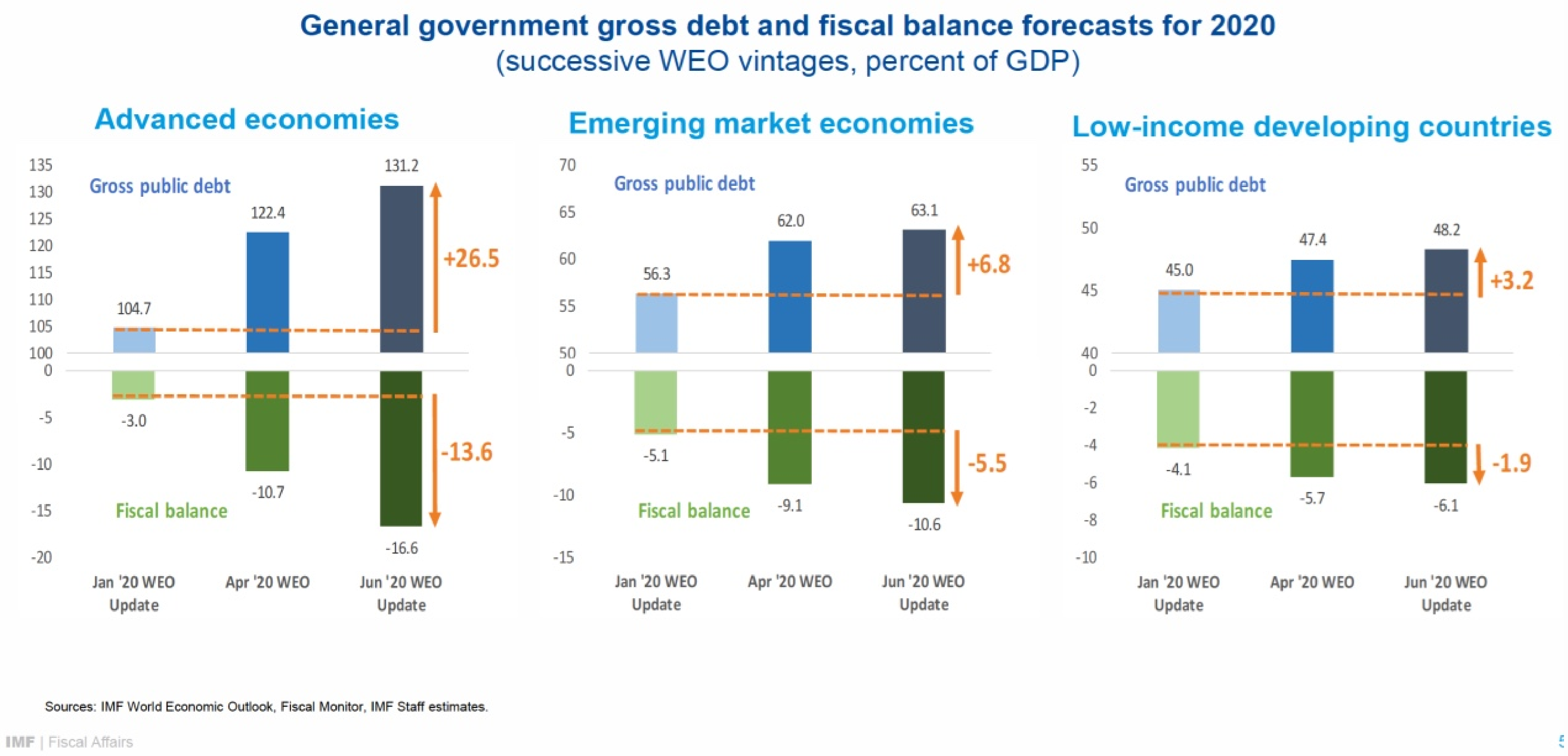
- Support health priorities, e.g. tariff reliefs, digital
- Secure survival of solvent enterprises: delay payments, adjust installments, loss carry backs
- Protect affected individuals: SSC relief, delay filing

… but some ‘do nots’

- Abolish tourism taxes or flight taxes during a lockdown
- Cut rates of PIT, CIT and VAT while domestic revenue essential

Impact Phase 1 – Fiscal Monitor (update June 24)

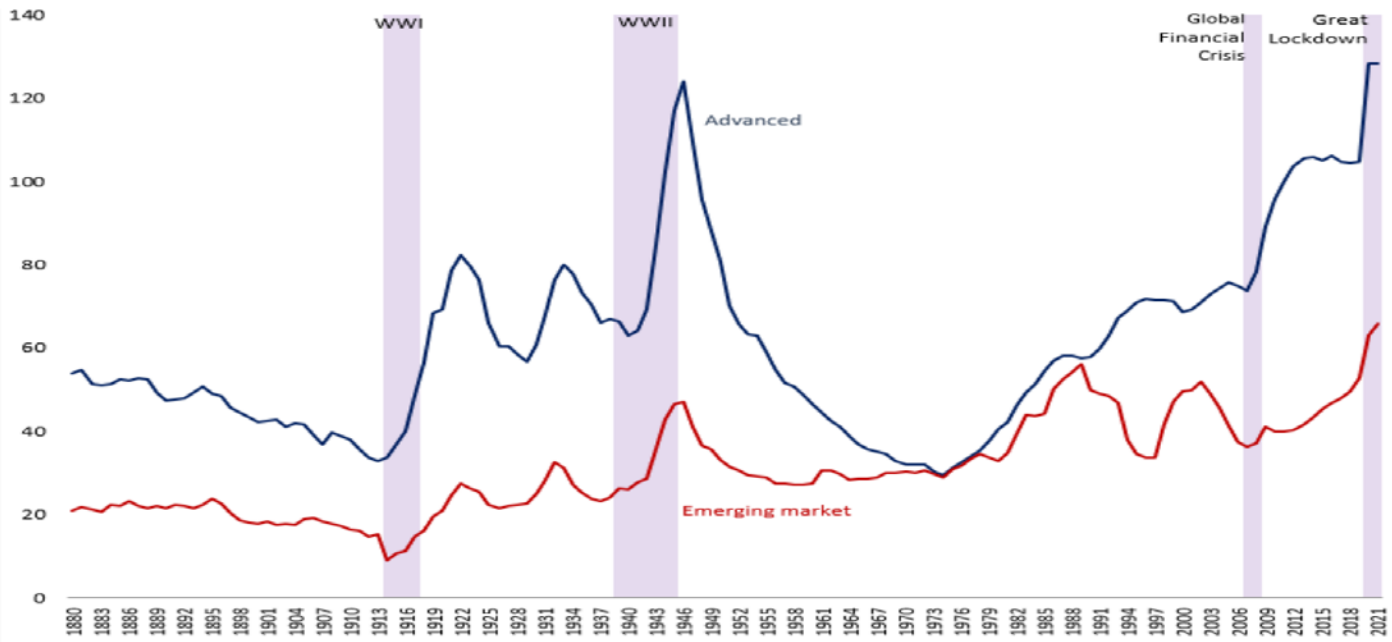
Fiscal support exceeds $11 tln – equally split above/below the line



Soaring public debt

Global public debt is projected to reach 101.5 percent of global GDP in 2020 – the highest level ever.

(percent of GDP)



Sources: Historical Public Debt Database, IMF WEO, Maddison Database Project; and IMF staff calculations.
Note: The aggregate public debt-to-GDP series for advanced and emerging market economies is based on debt-to-GDP data for a constant sample of 25 countries and 27 countries, respectively. The averages are calculated using weights derived from GDP in PPP terms.

INTERNATIONAL MONETARY FUND

Phase 2 – how to apply the 3 T's of stimulus?

- ***Timely – when does phase 2 start?***

  When to switch from containment support to stimulus -- given extreme uncertainty (e.g. 2nd wave)?

- ***Targeted – what does it mean?***

  When phase out support to affected sectors and households—to avoid supporting insolvent firms and redundant jobs?

  Fiscal stimulus with high multipliers: temporary VAT cut; payroll tax cut; bonus depreciation?

- ***Temporary?***

  When to end stimulus and turn to consolidation?

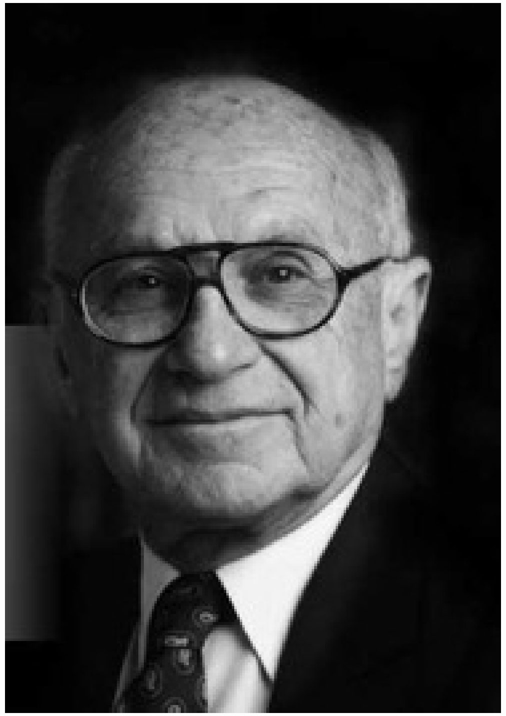
  Is growing public debt feasible and desirable?

  What's the right time for (temporary) 'solidarity levies'?

Phase 3: Higher taxes (likely) needed

- **Increased debt will need to be paid back through**
  - High (nominal) growth that exceeds interest rates – to reduce debt/GDP ratios if deficits are normalized
  - Cutting government spending
  - Raising (tax) revenues

- **Tax increases**
  - (Temporary) solidarity levies on income or wealth
  - Structural reform to support the transformation
    - Green recovery
    - Progressivity
    - Increased role of government



Milton Friedman

"*Nothing is so permanent as a temporary government program.*"

(1) Tax Policy and the Green Recovery

- **Several policies can steer a “green recovery”**
  - Green investment, -finance, -budgeting
  - Efficient carbon pricing can steer future investment

- **Meeting the Paris goals requires a carbon tax of $75 per ton** – while today’s global price is $2
  - Gasoline price rises <10%; electricity < 20% in Europe
  - Revenue of between 0.5 and 1% GDP in EU
  - Major domestic benefits (reduced mortality, congestion)

- **Overcome main obstacles**
  - Set a price floor (*Fiscal Monitor October 2019*)
  - Regressive impact → use funds for compensation
  - Competitiveness → border adjustment (*forthcoming SDN*)

(2) Solidarity: Income Tax Progression

- **(Temporary) surtax on the top rate of the personal income tax**
  - As in Germany (1991); Japan (2012)
  - Straightforward to implement

- **Surtax on capital income – e.g. capital gains, dividends**
  - Commonly lightly taxed
  - Enhance tax on inheritances and gifts
  - Surtax on the recurrent property tax, perhaps above a floor

Wealth Taxation – as a one-off levy

- **Efficient in theory …**
  - Does not distort behavior before imposing the tax (when unanticipated) or after (commitment not to repeat)

- **… but hardly implementable in practice**
  - Avoidance/evasion before implementation very large
  - If successful, not credibly one-off and distort investment
  - Legal obstacles – expropriation
  - Unsuccessful in the past (Austria, Germany, Italy after WWII)

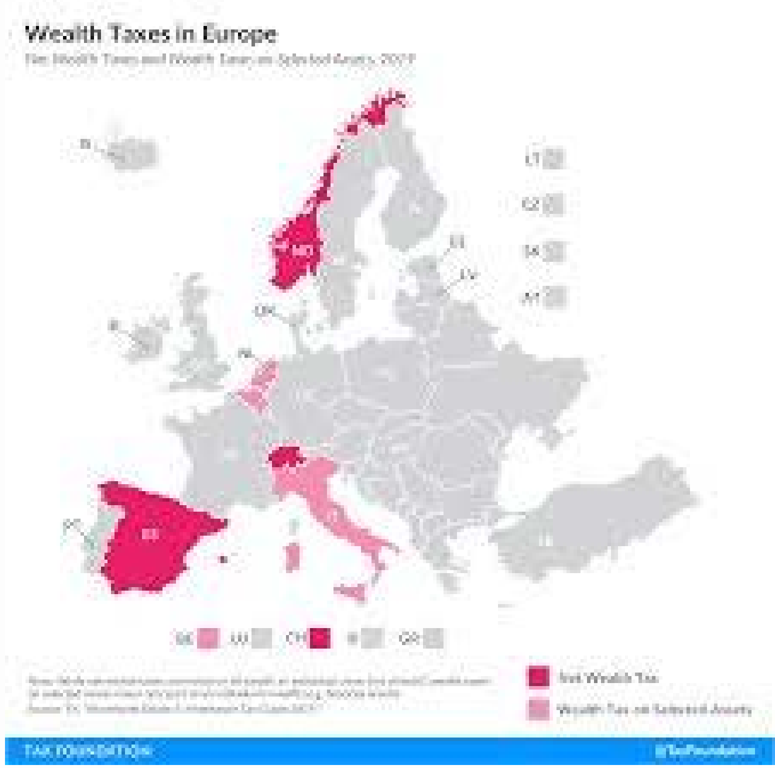
Wealth Taxation – as a recurring tax

- **Compared to a capital income tax …**
  - Distorts risk taking more
  - Generally less equitable
  - Harder to enforce

… but has a broader base by including non-income generating assets (immovable property; other valuables)

- **Several countries have repealed them …**
  - … although others kept or reinstated them
  - Switzerland raises the most, ≈ 1% GDP
  - Real property taxes more common

- **Enforcement challenges**
  - Some assets hard to value (SMEs; DB pensions; art)
  - Evasion/avoidance can be large (e.g. Switzerland – 43%)
  - Yet, AEOI may improve things in the future



(3) Business Tax Reform

- **BEPS 2.0 will shape the future international tax system**
  - *Pillar 1*: first step toward ‘destination’ and ‘formulary’ aspects
    - But: without agreement, risk proliferation of digital service taxes
  - *Pillar 2*: minimum tax will put a floor on tax competition
    - And will induce countries to reform – e.g. increase tax rates or eliminate tax incentives

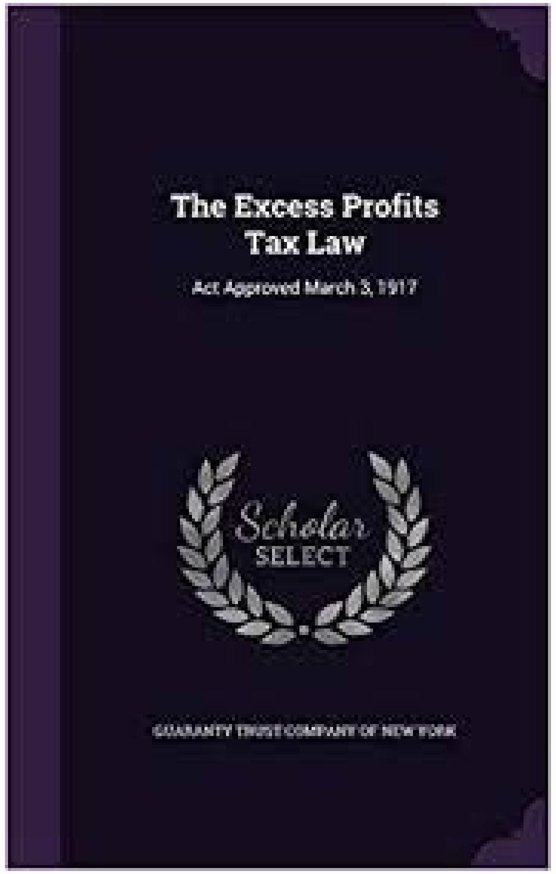
- **Talks about a (temporary) ‘solidarity surcharge’ on CIT**
  - Advantage that it only affects firms making profit
  - But CIT base known to be highly distortive (investment; debt bias)
  - And international coordination seems desirable (profit shifting; tax competition)

Toward an excess profit tax ?

- **Could be a (temporary) ‘solidarity surcharge’ on CIT**
  - Used during WW by e.g. US and UK

- **Base of the EPT starts from CIT base but:**
  - Replaces interest deduction by a capital deduction
  - Capital allowance is a policy parameter to determine what is ‘excess’
  - EPT does not distort investment if deduction = ‘normal return’
  - EPT does not induce debt bias - major topic during every crisis

- **Some similarities to Amount A in Pillar 1 of BEPS 2.0**
  - International coordination could help mitigate avoidance
  - Attribution could be ‘destination-based’ if on consolidated profit



(4) (Bigger) role of government?

- **Health systems**
  - Possible corrective tax on sources of pandemics?
  - Ensure equal access to vaccine

- **Safety nets**
  - Need for insurance – rather than precautionary saving
  - Supporting people, not jobs
  - Saving illiquid, not insolvent firms

- **Digital transformation – e.g. in tax administrations**
  - Next presentation

For more: see IMF special COVID Series:

https://www.imf.org/en/Publications/SPROLLs/covid19-special-notes

Thank You!