



ด่วนที่สุด

บันทึกข้อความ

ส่วนราชการ สำนักงานประมาณ ศูนย์ยุทธศาสตร์การงบประมาณ โทร. 0 2273 9384

ที่ นร.0701 / 4103 วันที่ 14 มกราคม 2551

เรื่อง รายงานผลการประชุมเชิงปฏิบัติการทางวิชาการด้านการงบประมาณ : OECD Asian Senior Budget Officials Meeting ครั้งที่ 4

กราบเรียน นายกรัฐมนตรี

ผ่าน รองนายกรัฐมนตรี (นายโสมสิต ปันเปี่ยมรัษฎ์) ๘๘/๑/๕๖

ตามที่นายกรัฐมนตรีได้อนุมัติให้สำนักงานประมาณเป็นเจ้าภาพร่วมกับองค์การเพื่อความร่วมมือทางเศรษฐกิจและการพัฒนา (Organization for Economic Co-operation and Development : OECD) จัดการประชุม OECD Asian Senior Budget Officials Meeting ครั้งที่ 4 ระหว่างวันที่ 10 - 11 มกราคม 2551 ที่กรุงเทพมหานคร ซึ่งการประชุมครั้งนี้เป็นผลมาจากการที่รองนายกรัฐมนตรี (นายโสมสิต ปันเปี่ยมรัษฎ์) และนายวุฒิพันธุ์ วิชัยรัตน์ ผู้อำนวยการสำนักงานประมาณ ได้เข้าเยี่ยมชมพบผู้บริหาร OECD ณ ประเทศฝรั่งเศส เมื่อเดือนตุลาคม 2550 ที่ผ่านมานั้น

สำนักงานประมาณ ขอเรียนว่า การประชุมครั้งนี้ ได้จัด ณ ห้องดุสิตธานีฮอลล์ โรงแรมดุสิตธานี กรุงเทพมหานคร และประสบความสำเร็จอย่างดียิ่ง บรรลุตามวัตถุประสงค์และเป้าหมายที่กำหนด โดยมีผู้บริหารระดับสูงด้านการงบประมาณของประเทศต่างๆ เข้าร่วมประชุม 18 ประเทศ อาทิ ออสเตรเลีย ตุรกี ญี่ปุ่น เกาหลีใต้ จีน อินเดีย และสิงคโปร์ รวมทั้งผู้เชี่ยวชาญด้านการงบประมาณ เช่น Prof. Allen Schick จาก University of Maryland, USA และ Prof. Paul Posner จาก George Mason University, USA โดยในการประชุมครั้งนี้ มีนายวุฒิพันธุ์ วิชัยรัตน์ ผู้อำนวยการสำนักงานประมาณ และ Mr. Ian Watt, Permanent Secretary, Department of Finance, Australia เป็นประธานร่วมในที่ประชุม สรุปประเด็นสำคัญในการประชุมได้ดังนี้

1. Recent Budgeting Developments in Asia ผู้แทนแต่ละประเทศได้รายงานให้ที่ประชุมทราบระบบงบประมาณและแนวทางในการพัฒนาระบบงบประมาณไปสู่ระบบงบประมาณแบบมุ่งเน้นผลงาน (Performance-based Budgeting) การจัดทำประมาณการงบประมาณรายจ่ายระยะปานกลาง และกำหนดเป้าหมายทางการคลังอย่างเป็นรูปธรรม ในโอกาสนี้ สำนักงานประมาณได้นำเสนอความก้าวหน้าการดำเนินการการบริหารจัดการรายจ่ายภาคสาธารณะ (Public Expenditure Management : PEM)

2. Developing Fiscal Space : Overcoming Rigidities in the Structure of Expenditures

Prof. Allen Schick, University of Maryland, USA ได้นำเสนอผลการศึกษเกี่ยวกับแนวทางการนำ Fiscal Space หรือวงเงินงบประมาณรายจ่ายคงเหลือที่ภาครัฐมีในแต่ละปีที่สามารถนำมาดำเนินงาน/โครงการภายใต้นโยบายใหม่ หลังจากหักงบประมาณรายจ่ายตามภาระงบประมาณแล้ว และแนวทางการเพิ่ม Fiscal Space เช่น การให้เอกชนเข้าร่วมดำเนินงานกับรัฐ (Public Private Partnerships : PPP) การขายทรัพย์สินของรัฐ และการแปรรูปรัฐวิสาหกิจ เป็นต้น

3. PPP's and Outsourcing: Implications for Budgeting and Accountability

Prof. Paul Posner, George Mason University, USA ได้นำเสนอผลการศึกษเกี่ยวกับการร่วมทุนระหว่างภาคเอกชนกับภาครัฐ (Public Private Partnerships : PPP) และการให้ภาคเอกชนเข้ามาดำเนินงานของภาครัฐ (Outsourcing) โดยมุ่งเน้นการลดภาระงบประมาณ และเพิ่มประสิทธิภาพในการดำเนินโครงการ ตลอดจนปัจจัยสำคัญที่จะนำไปสู่ความสำเร็จ ซึ่งครอบคลุมในเรื่องของกฎหมาย สัญญา การจัดซื้อจัดจ้าง และการกระจายความเสี่ยง เป็นต้น

4. Integrating Tax Expenditures into the Budget Process ที่งานของ OECD ได้

นำเสนอรายงานการศึกษผลกระทบที่เกิดจากการดำเนินนโยบายรายจ่ายภาษี (Tax Expenditure) ของภาครัฐ เช่น การลดหย่อนภาษี การยกเว้นภาษี และการคืนภาษี ที่มีต่อกระบวนการจัดทำงบประมาณ โดยเฉพาะการพิจารณาของฝ่ายนิติบัญญัติ เพื่อแสดงถึงความโปร่งใสทางการคลัง

5. Fiscal Relations with Lower Levels of Government ที่งานของ OECD ได้

นำเสนอรายงานการศึกษเกี่ยวกับรูปแบบการจัดสรรเงินอุดหนุนและแนวทางปฏิบัติของส่วนภูมิภาค หรือท้องถิ่นในรูปแบบต่างๆ

ในการนี้ สำนักงานงบประมาณพิจารณาแล้ว เห็นว่า เพื่อให้มีการนำองค์ความรู้ที่ได้จากการประชุม มาประยุกต์ใช้กับกระบวนการจัดทำงบประมาณ การบริหารจัดการด้านการเงินและการคลังของประเทศไทยให้เกิดประโยชน์สูงสุด จึงขอกราบเรียนเสนอความเห็นดังต่อไปนี้

1. ในการจัดทำงบประมาณรายจ่ายประจำปี สำนักงานงบประมาณได้เน้นการจัดลำดับความสำคัญของแผนงบประมาณ งาน/โครงการ และดำเนินการทบทวน ปรับลดงบประมาณรายจ่ายตามกระบวนการจัดทำงบประมาณแบบมุ่งเน้นผลงาน เพื่อให้มีวงเงินงบประมาณคงเหลือ (Fiscal Space) เพิ่มขึ้น มาโดยตลอด เพื่อการจัดสรรงบประมาณให้กับงาน/โครงการที่เป็นนโยบายเร่งด่วน ตลอดจนได้จัดทำกรอบงบประมาณรายจ่ายระยะปานกลาง (MTEF) ทั้งจากระดับบนสู่ล่าง (Top-down) และจากระดับล่างสู่บน (Bottom up) เพื่อแสดงถึงการรักษาความยั่งยืนและวินัยทางด้านการงบประมาณและการคลัง

2. ในการดำเนินการรายจ่ายภาษี (Tax Expenditure) อาทิ การลดหย่อนภาษี การยกเว้นภาษี และการคืนภาษี ควรมีการศึกษาโดยละเอียดเกี่ยวกับ ความยุติธรรม ความโปร่งใส และผลกระทบจากการดำเนินการต่อผู้มีส่วนได้ส่วนเสีย (Stakeholders) ทั้งโดยตรงและโดยอ้อม มีการประเมินความคุ้มค่าจากการใช้จ่ายรายจ่ายภาษี อีกทั้ง ควรมีการพิจารณาและตรวจสอบจากฝ่ายนิติบัญญัติตามกระบวนการงบประมาณรายจ่ายประจำปี

สำหรับประโยชน์ที่ประเทศไทยได้รับจากการจัดประชุมเชิงปฏิบัติการทางวิชาการด้านการงบประมาณ : OECD Asian Senior Budget Officials Meeting ในครั้งนี้ ประกอบด้วย

1. มีการแลกเปลี่ยนองค์ความรู้ ประสบการณ์การทำงาน และนวัตกรรมใหม่ ๆ ด้านการจัดการงบประมาณในระดับนานาชาติ เช่น Fiscal Space, Public Private Partnership (PPP), Tax Expenditure และการจัดสรรงบประมาณให้กับรัฐบาลท้องถิ่น

2. เป็นการส่งเสริมภาพลักษณ์และศักยภาพของประเทศไทยให้เป็นที่ประจักษ์และยอมรับในระดับนานาชาติ จากผลงานการจัดประชุม OECD Asian Senior Budget Officials Meeting จำนวน 4 ครั้งที่ผ่านมา ในปี พ.ศ. 2545 2548 2549 และ 2551

3. เป็นการเสริมสร้างความสัมพันธ์ระหว่างผู้บริหารสำนักงานงบประมาณในภูมิภาคเอเชียและ OECD เพื่อให้เกิดความร่วมมือในการแลกเปลี่ยนองค์ความรู้ และทำงานร่วมกันในอนาคต

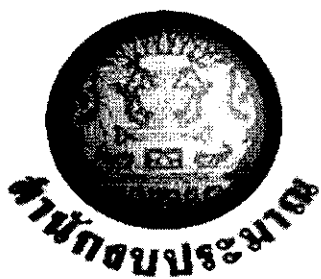
4. เป็นการพัฒนาศักยภาพบุคลากรของสำนักงานงบประมาณและหน่วยงานที่เกี่ยวข้องทางด้านการเงินและการคลังของประเทศไทย โดยบุคลากรได้มีโอกาสเพิ่มองค์ความรู้ นวัตกรรมทางด้านการเงิน การคลัง และการงบประมาณ จากการเข้าร่วมการประชุม

จึงกราบเรียนมาเพื่อโปรดทราบรายงานผลการประชุมเชิงปฏิบัติการทางวิชาการด้านการงบประมาณ : OECD Asian Senior Budget Officials Meeting ครั้งที่ 4 และขอได้โปรดนำเสนอคณะรัฐมนตรีทราบรายงานผลการประชุมดังกล่าวต่อไปด้วย พร้อมนี้ ได้จัดส่ง การบริหารจัดการรายจ่ายภาคสาธารณะของประเทศไทย (เอกสารแนบ 1) สรุปสาระสำคัญด้านวิชาการ (เอกสารแนบ 2) และเอกสารประกอบการประชุม (เอกสารแนบ 3) มาด้วยแล้ว



(นายวุฒิพันธุ์ วิชัยรัตน์)

ผู้อำนวยการสำนักงานงบประมาณ



การบริหารจัดการรายจ่ายภาคสาธารณะ ของประเทศไทย

(Public Expenditure Management/Review : PEM/R)

1

ประเด็นนำเสนอ

การบริหารจัดการรายจ่ายภาคสาธารณะของประเทศไทย

1. การดำเนินงานที่ผ่านมา
 - 1.1 การดำเนินงานในปี 2005
 - 1.2 การดำเนินงานในปี 2006
2. การดำเนินงานในปี 2007
3. การดำเนินงานในระยะต่อไป

2

1. การดำเนินงานที่ผ่านมา (ปี 2005 – ปี 2006)

3

1.1 การดำเนินงานเพื่อพัฒนา การบริหารจัดการรายจ่ายภาคสาธารณะ ของประเทศไทย : ปี 2005

โครงการจ้างที่ปรึกษาเพื่อกำหนดกรอบแนวคิดในการประเมินผลรายจ่ายภาคสาธารณะ (Public Expenditure Review) ของประเทศไทย และนำเสนอผลที่ได้ในการประชุมเชิงปฏิบัติการทางวิชาการด้านการงบประมาณ : OECD Asian Senior Budget Officials Meeting ปี 2005

❖ Thai PEM Framework

- Strategic Performance based Budget System
- Decree on Good Governance and National Administration Plan
- OECD Best Practices for Budget Transparency
- IMF Code of Good Practices on Fiscal Transparency

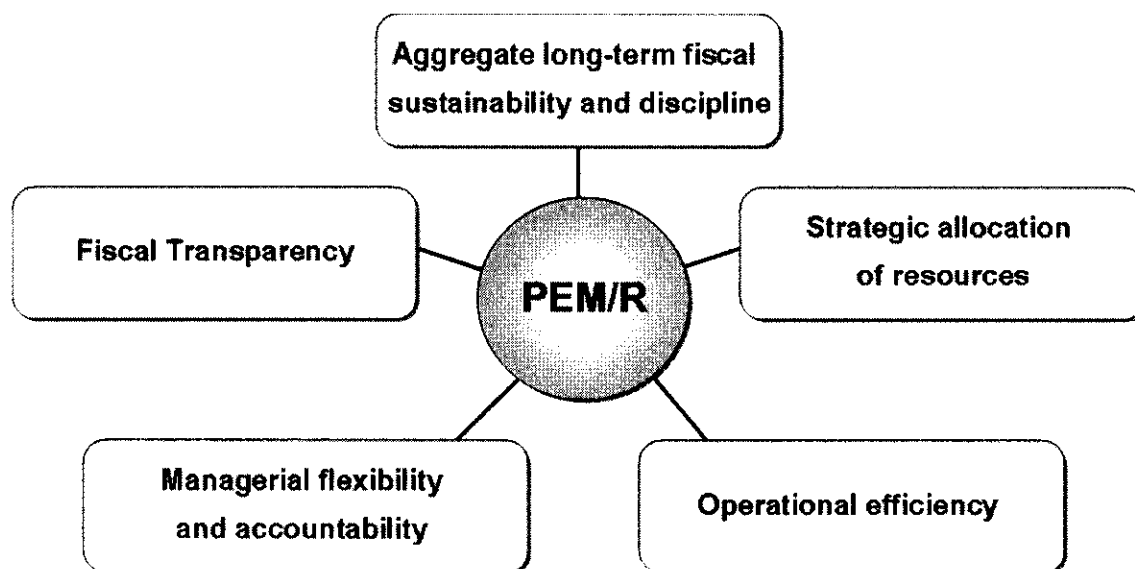
❖ Thai PEM Main Focus

- Linkage between national priorities and budgeting within the framework of sustainability
- Legal framework and Institutional arrangements for public spending

4

1.1 การดำเนินงานเพื่อพัฒนา การบริหารจัดการรายจ่ายภาคสาธารณะ ของประเทศไทย : ปี 2005 (ต่อ)

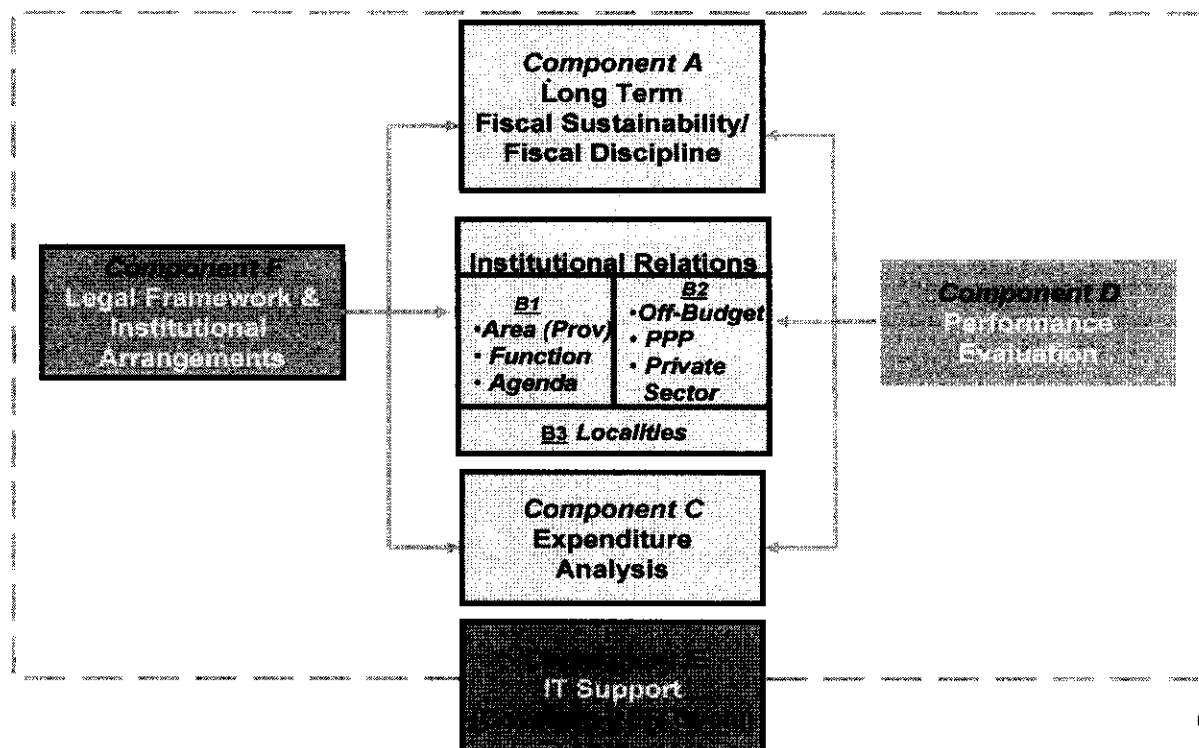
❖ PEM/R Fundamental Principles



5

1.1 การดำเนินงานเพื่อพัฒนา การบริหารจัดการรายจ่ายภาคสาธารณะ ของประเทศไทย : ปี 2005 (ต่อ)

❖ Thai PEM/R Components

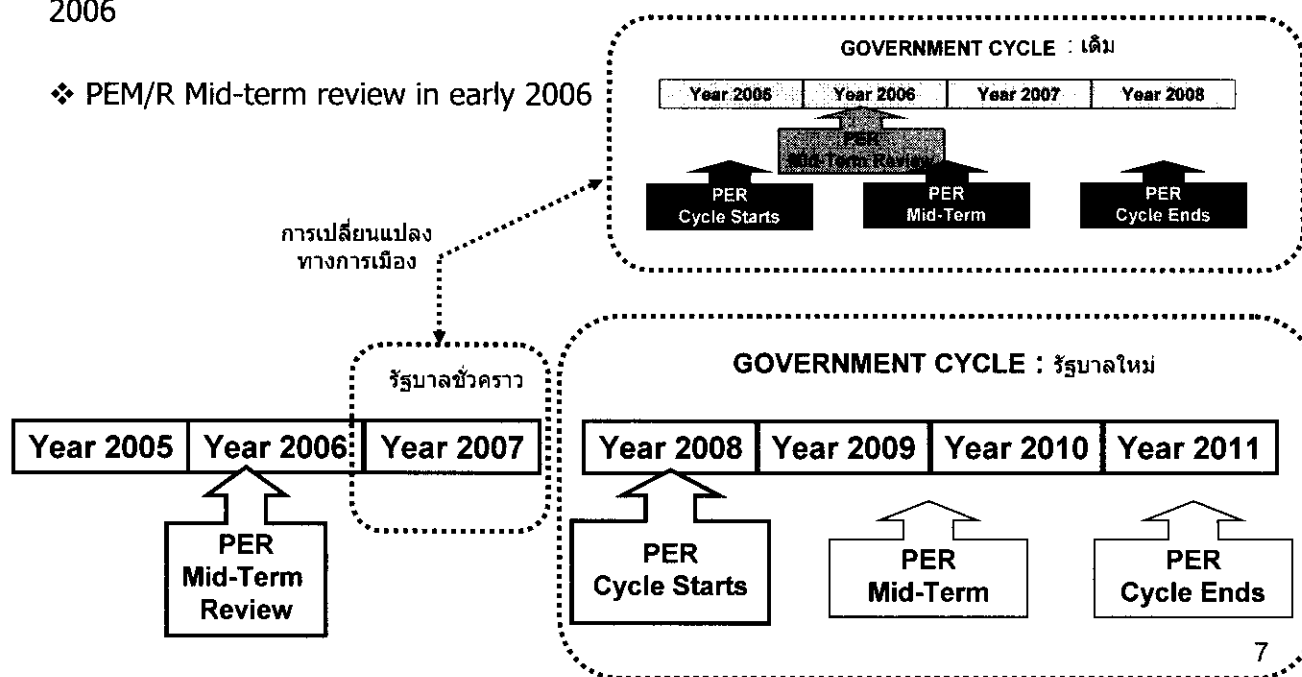


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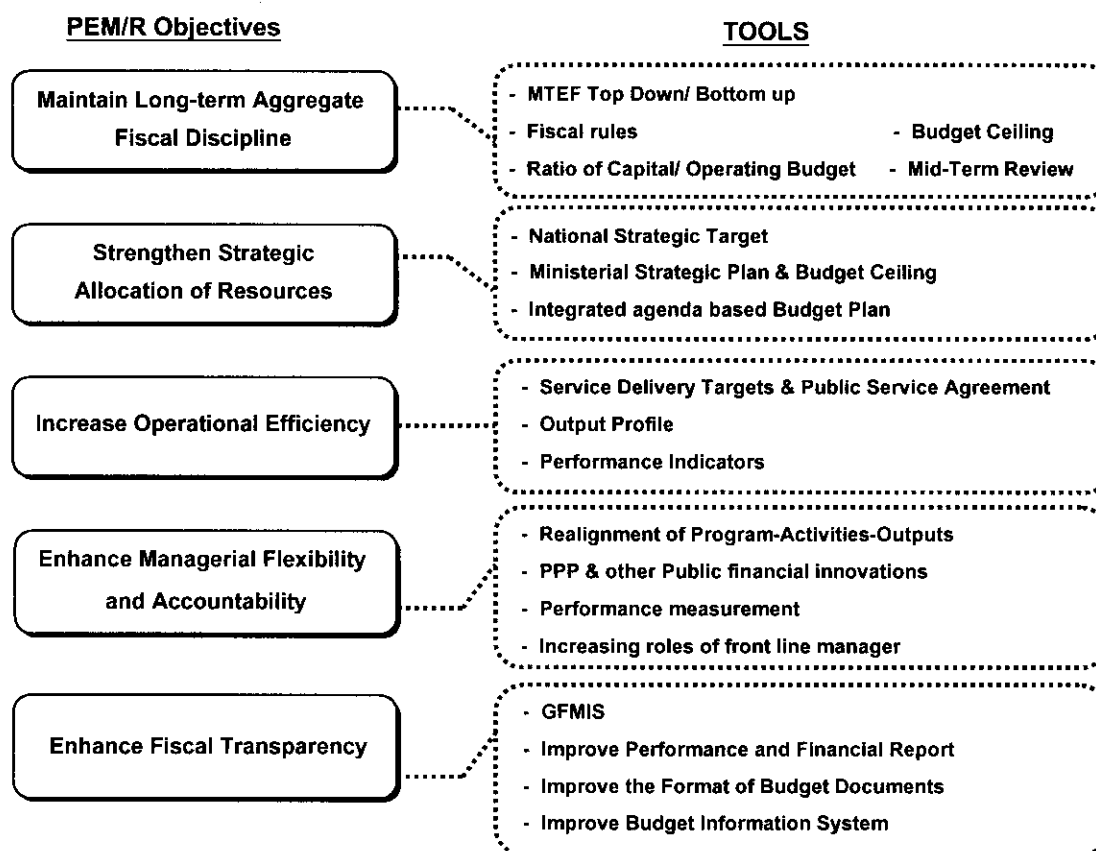
1.2 การดำเนินงานเพื่อพัฒนา การบริหารจัดการรายจ่ายภาคสาธารณะ ของประเทศไทย : ปี 2006

โครงการประเมินผลรายจ่ายภาคสาธารณะ (Public Expenditure Review : PER) ด้านความยั่งยืน
และวินัยทางการคลัง (Fiscal Discipline and Sustainability) และนำเสนอผลที่ได้ในการประชุมเชิง
ปฏิบัติการทางวิชาการด้านการงบประมาณ : OECD Asian Senior Budget Officials Meeting ปี
2006

❖ PEM/R Mid-term review in early 2006



1.2 การดำเนินงานเพื่อพัฒนา การบริหารจัดการรายจ่ายภาคสาธารณะ ของประเทศไทย : ปี 2006 (ต่อ)



2. การดำเนินงานในปี 2007

9

กรอบการประเมินผลรายจ่ายภาคสาธารณะของประเทศไทย

การประเมินผลรายจ่ายภาคสาธารณะของประเทศไทย มีองค์ประกอบ 6 ส่วน ซึ่งประเทศไทยได้เคยนำเสนอผลงานการวิเคราะห์และประเมินความสัมพันธ์ระหว่างองค์ประกอบทั้งหมดไปแล้ว ในคราวการประชุมเชิงปฏิบัติการทางวิชาการด้านการงบประมาณ Asian OECD Senior Budget Officials Meeting ปี 2005 และ ปี 2006

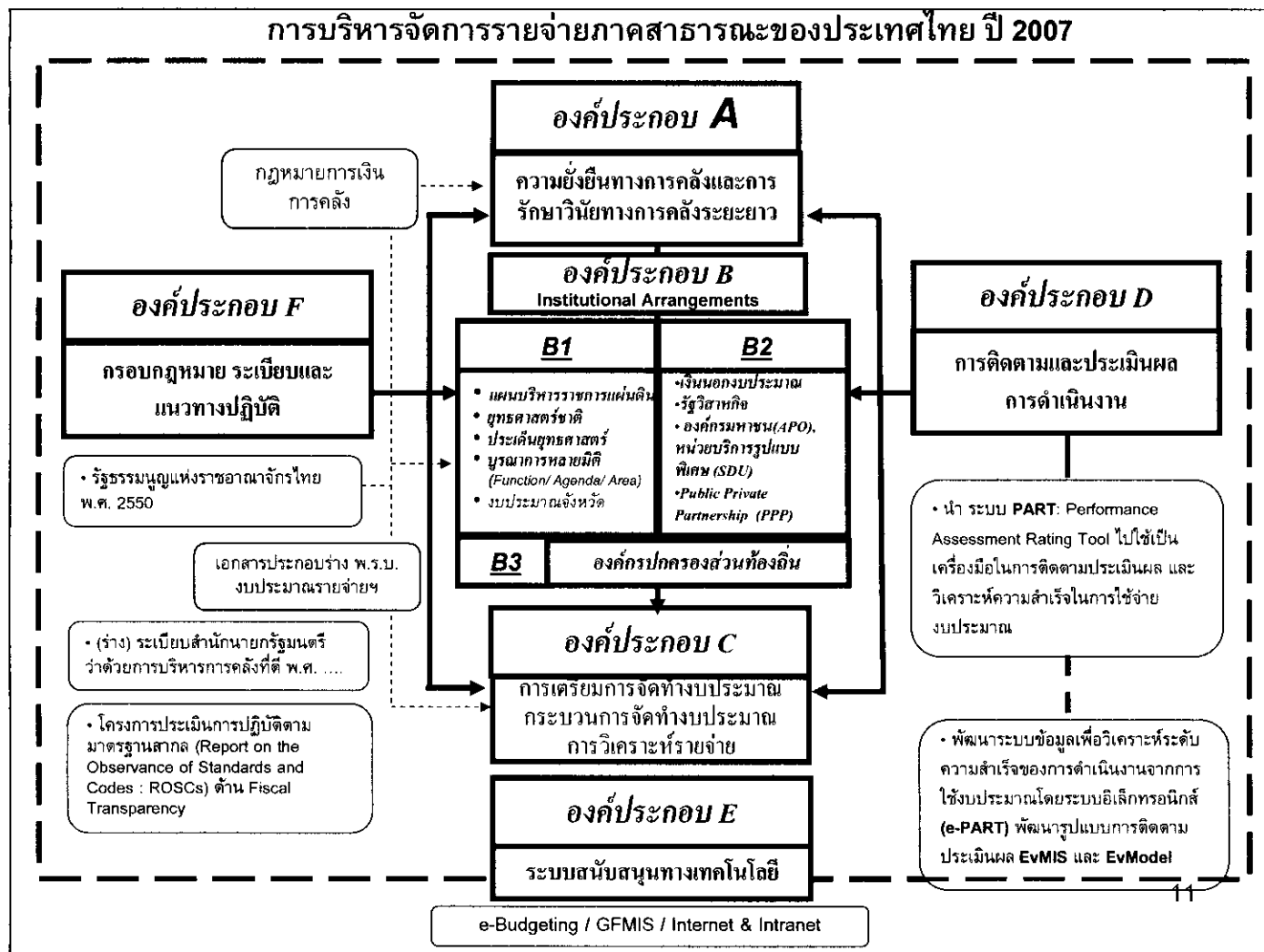
สำหรับการประชุม Asian OECD Senior Budget Officials Meeting ในปี 2007 นี้ จะได้นำเสนอความก้าวหน้าในด้านรายจ่ายภาคสาธารณะของไทย โดยจะมุ่งเน้นในเรื่อง

- ❖ กรอบกฎหมายและระเบียบ PER (ส่วนประกอบ F)
- ❖ การติดตามและระบบการประเมินผลการดำเนินงาน (ส่วนประกอบ D)
- ❖ การประเมินระบบเทคโนโลยีสารสนเทศที่สนับสนุนการดำเนินงาน (ส่วนประกอบ E)

เนื่องจากเป็นองค์ประกอบที่มีการเปลี่ยนแปลงอย่างชัดเจนเมื่อเปรียบเทียบกับปีที่ผ่านมา

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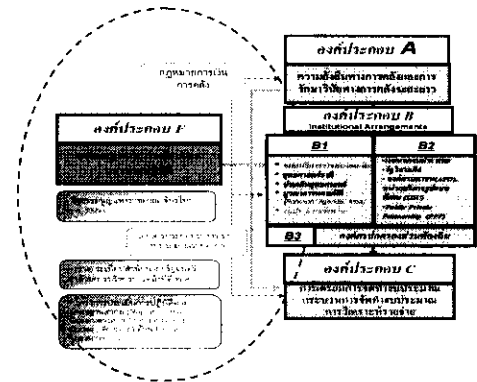
การบริหารจัดการรายจ่ายภาคสาธารณะของประเทศไทย ปี 2007



**การดำเนินงานเพื่อพัฒนา การบริหารจัดการรายจ่ายภาคสาธารณะ
ของประเทศไทย : ปี 2007**

PEM/R Components	กิจกรรม	ผู้รับผิดชอบ
F (Legal Framework & Institutional Arrangements)	1. กำหนดบทบัญญัติเกี่ยวกับการเงิน การคลัง และงบประมาณ ไว้ในหมวดที่ 8 มาตรา 166 ถึง มาตรา 170 ของรัฐธรรมนูญ แห่งราชอาณาจักรไทย พ.ศ. 2550 โดยที่ มาตรา 167 เป็นมาตราสำคัญเกี่ยวข้องกับการบริหาร จัดการรายจ่ายภาคสาธารณะโดยตรง ซึ่งมีสาระสำคัญเกี่ยวกับการ การกำหนดเอกสารประกอบร่างพระราชบัญญัติงบประมาณ รายจ่ายประจำปี และการจัดทำกฎหมายการเงินการคลัง	สภาร่างรัฐธรรมนูญ และ สภานิติบัญญัติ
	2. จัดทำ (ร่าง) ระเบียบสำนักนายกรัฐมนตรี ว่าด้วยการบริหารการ คลังที่ดี พ.ศ. ...	อนุกรรมการพัฒนาระบบ ราชการเกี่ยวกับการ ปรับปรุงระบบการเงิน และงบประมาณ
	3. โครงการประเมินการปฏิบัติตามมาตรฐานสากล (Report on the Observance of Standards and Codes : ROSCs) ด้าน Fiscal Transparency - เริ่มดำเนินการครั้งแรกในปี 2003 เพื่อเตรียมความพร้อมใน การประเมินสถานภาพทางการคลังเบื้องต้นของประเทศไทย ตามข้อกำหนดของ International Monetary Fund : IMF - ในปี 2007 หน่วยงานที่เกี่ยวข้องร่วมกันจัดทำข้อมูลส่งให้ IMF เพื่อเข้าสู่ขั้นตอนของการเข้ารับการประเมินความโปร่งใส ทางการคลัง	กระทรวงการคลัง ธนาคารแห่งประเทศไทย สำนักงานงบประมาณ สำนักงานการตรวจเงิน แผ่นดิน

PEM/R Component F : กรอบกฎหมาย ระเบียบ และแนวทางปฏิบัติ



- รัฐธรรมนูญแห่งราชอาณาจักรไทย พ.ศ. 2550 มาตรา 167

เอกสารประกอบร่าง พ.ร.บ.งบประมาณรายจ่ายฯ	กฎหมายการเงิน การคลัง
มาตรา 167 วรรค 1 กำหนดให้มีเอกสารประกอบการนำเสนอร่างพระราชบัญญัติงบประมาณรายจ่ายประจำปีฯ ดังนี้ 1. ประมาณการรายรับ 2. ในแต่ละรายการของรายจ่าย ให้มีวัตถุประสงค์ กิจกรรม แผนงาน โครงการ 3. แสดงฐานะการเงินการคลังของประเทศ - ภาพรวมของภาวะเศรษฐกิจที่เกิดจากรายจ่าย และการจัดหารายได้ - ประโยชน์ และการขาดรายได้จากการยกเว้นภาษีเฉพาะราย 4. ความจำเป็นในการตั้งงบประมาณผูกพันข้ามปี 5. ภาระหนี้ และการก่อหนี้ของรัฐ 6. ฐานะการเงินของรัฐวิสาหกิจ	มาตรา 167 วรรค 3 ให้มีกฎหมายการเงินการคลังของรัฐประกอบด้วย 1. หลักเกณฑ์เกี่ยวกับการวางแผนการเงินระยะปานกลาง 2. การจัดหารายได้ 3. การกำหนดแนวทางในการจัดทำงบประมาณรายจ่าย 4. การบริหารการเงิน และทรัพย์สิน 5. การบัญชี 6. กองทุนสาธารณะ 7. การก่อหนี้ หรือการดำเนินการที่ผูกพันทรัพย์สิน หรือภาระทางการเงินของรัฐ 8. หลักเกณฑ์การกำหนดวงเงินสำรองจ่ายเพื่อกรณีฉุกเฉินหรือจำเป็น

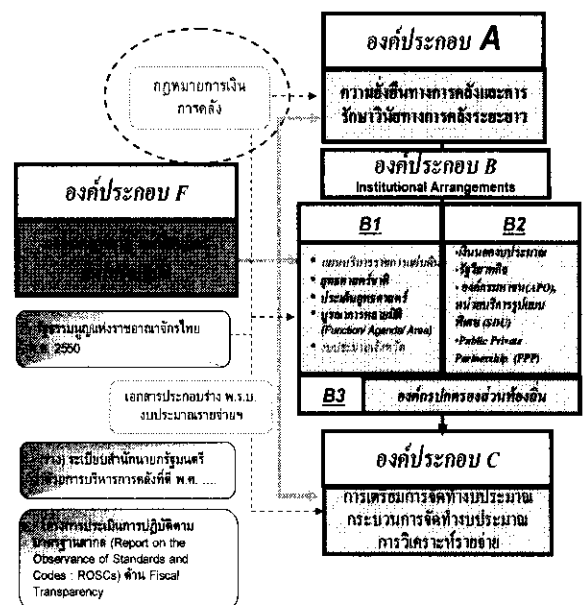
- (ร่าง) ระเบียบสำนักนายกรัฐมนตรีว่าด้วยการบริหารการคลังที่ดี พ.ศ.

- โครงการประเมินการปฏิบัติตามมาตรฐานสากล (Report on the Observance of Standards and Codes : ROSCs) ด้าน Fiscal Transparency

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การรองรับการจัดทำกฎหมายการเงิน การคลัง

- 24 สิงหาคม 2550 รัฐธรรมนูญแห่งราชอาณาจักรไทย พ.ศ. 2550 มาตรา 167 วรรค 3 ได้บัญญัติหลักการให้มีกฎหมายการเงินการคลังของรัฐภายใน 2 ปี
- 2 ตุลาคม 2550 คณะรัฐมนตรีมีมติให้กระทรวงการคลังและธนาคารแห่งประเทศไทยเป็นหน่วยงานรับผิดชอบหลักในการออกกฎหมายว่าด้วยการเงินการคลังของรัฐ โดยมีส่วนราชการที่เกี่ยวข้อง เช่น สำนักงบประมาณ สำนักงานคณะกรรมการพัฒนาการเศรษฐกิจและสังคมแห่งชาติ สำนักงานคณะกรรมการพัฒนาระบบราชการ เป็นหน่วยงานรับผิดชอบร่วม
- สำนักงบประมาณได้แต่งตั้งคณะกรรมการพิจารณาดำเนินการเกี่ยวกับร่างกฎหมายการเงินการคลังของรัฐ โดยนำกรอบแนวคิด และประเด็นที่หน่วยงานกลางร่วมกันพิจารณา และประเด็นที่เกี่ยวข้องกับสำนักงบประมาณโดยตรง รวม 15 ประเด็น เพื่อใช้ประกอบการยกร่างกฎหมายการเงินการคลัง ดังนี้



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ประเด็นต่าง ๆที่จะใช้ประกอบการจัดทำกฎหมายการเงิน การคลัง

1. หลักการ "วินัยการเงินการคลัง"
2. หลักเกณฑ์เกี่ยวกับการวางแผนการเงินระยะปานกลาง
3. หลักเกณฑ์เกี่ยวกับการจัดหารายได้
4. หลักเกณฑ์เกี่ยวกับการกำหนดแนวทางในการจัดท่างบประมาณรายจ่ายของแผ่นดิน
5. หลักเกณฑ์เกี่ยวกับการบริหารการเงินและทรัพย์สิน
6. หลักเกณฑ์เกี่ยวกับการบัญชี
7. หลักเกณฑ์เกี่ยวกับการจัดตั้งกองทุนสาธารณะ
8. หลักเกณฑ์เกี่ยวกับกระบวนการชี้แจงงบประมาณของส่วนราชการเจ้าของงบประมาณในชั้นกรรมาธิการพิจารณางบประมาณ
9. หลักเกณฑ์เกี่ยวกับการกำหนดดัชนีตัวชี้วัดปัจจัยเสี่ยงทางการเงินการคลัง
10. กำหนดให้กระทรวงการคลังหรือหน่วยงานหนึ่งรับผิดชอบในการจัดทำบัญชีรายรับรายจ่ายรวมของภาครัฐ
11. หลักเกณฑ์เกี่ยวกับการลงทุนโครงการภาครัฐ
12. หลักเกณฑ์เกี่ยวกับการนำบทบัญญัติของกฎหมายการเงินการคลังไปใช้โดยอนุโลมกับรัฐวิสาหกิจและองค์กรปกครองส่วนท้องถิ่น
13. หลักเกณฑ์เกี่ยวกับการก่อหนี้ หรือการดำเนินการที่ผูกพันทรัพย์สินหรือภาระทางการเงินของรัฐ
14. หลักเกณฑ์เกี่ยวกับการกำหนดวงเงินสำรองจ่ายเพื่อกรณีฉุกเฉินหรือจำเป็น
15. บทกำหนดโทษ

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การดำเนินงานเพื่อพัฒนา การบริหารจัดการรายจ่ายภาคสาธารณะ ของประเทศไทย : ปี 2007 (ต่อ)

PEM/R Components	กิจกรรม	ผู้รับผิดชอบ
D (Performance Evaluation)	1. เสนอความเห็นคณะรัฐมนตรี เพื่อให้ส่วนราชการนำ ระบบ PART: Performance Assessment Rating Tool ไปใช้เป็นเครื่องมือในการติดตามประเมินผล และวิเคราะห์ความสำเร็จในการใช้จ่ายงบประมาณ และคณะรัฐมนตรีมีมติเห็นชอบ เมื่อวันที่ 4 ธันวาคม 2550	สำนักงานงบประมาณ
	2. โครงการพัฒนาระบบข้อมูลเพื่อการวิเคราะห์ระดับความสำเร็จของการดำเนินงานจากการใช้จ่ายงบประมาณด้วยระบบอิเล็กทรอนิกส์ (e-PART)	สำนักงานงบประมาณ

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PEM/R Component D :

การติดตาม และระบบการประเมินผลการดำเนินงาน

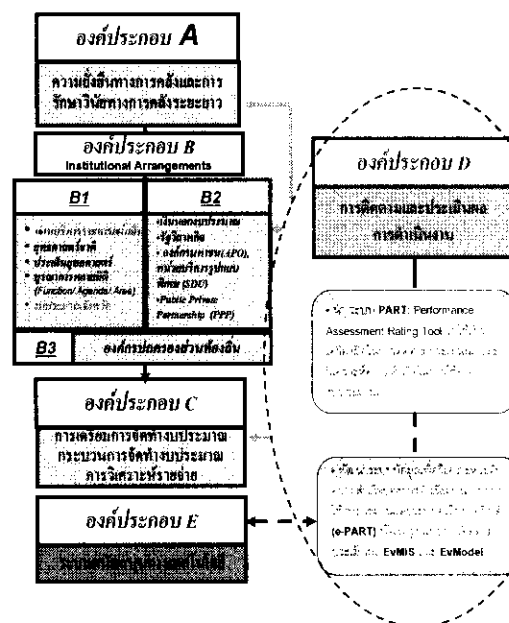
การใช้เครื่องมือวิเคราะห์ระดับความสำเร็จของ
การดำเนินงานจากการใช้จ่ายงบประมาณ

(PART : Performance Assessment Rating Tool)

• PART เป็นเครื่องมือวิเคราะห์ความเชื่อมโยงแผนของ
หน่วยงานกับความสอดคล้องกับยุทธศาสตร์ชาติ และวิเคราะห์
ความสัมพันธ์ของผลลัพธ์-ผลผลิต-กิจกรรม-งบประมาณ
อย่างเป็นระบบ

• การวิเคราะห์ผลการดำเนินงานจากการใช้จ่ายงบประมาณ
ของหน่วยงานภาครัฐจะเป็นเครื่องมือในกระบวนการจัดการ
งบประมาณที่ช่วยให้รัฐบาล หน่วยงาน และผู้เกี่ยวข้องมีข้อมูล
เพื่อใช้ประกอบการตัดสินใจในกระบวนการงบประมาณ เพื่อ
ให้การจัดสรรงบประมาณมีประสิทธิภาพ ประสิทธิผล คุ่มค่า
เกิดประโยชน์ต่อประชาชนอย่างแท้จริง

• e-PART เป็นการอำนวยความสะดวกในการนำ PART
ไปใช้งาน และปัจจุบันมีการเชื่อมต่อเข้ากับระบบ e-Budgeting

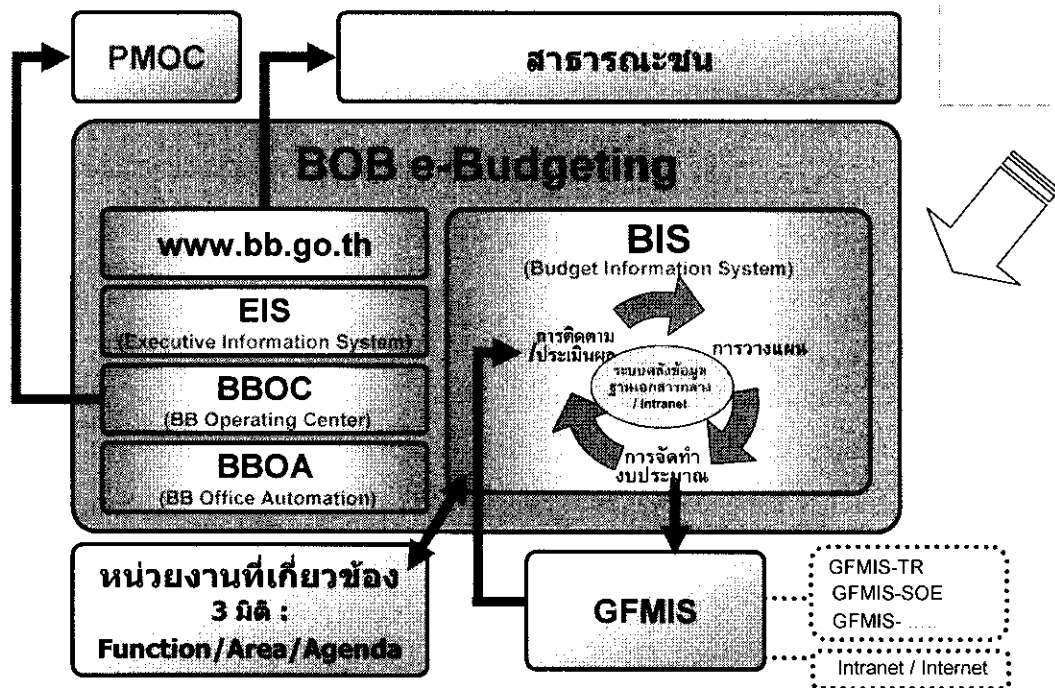


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การดำเนินงานเพื่อพัฒนา การบริหารจัดการรายจ่ายภาคสาธารณะ ของประเทศไทย : ปี 2007 (ต่อ)

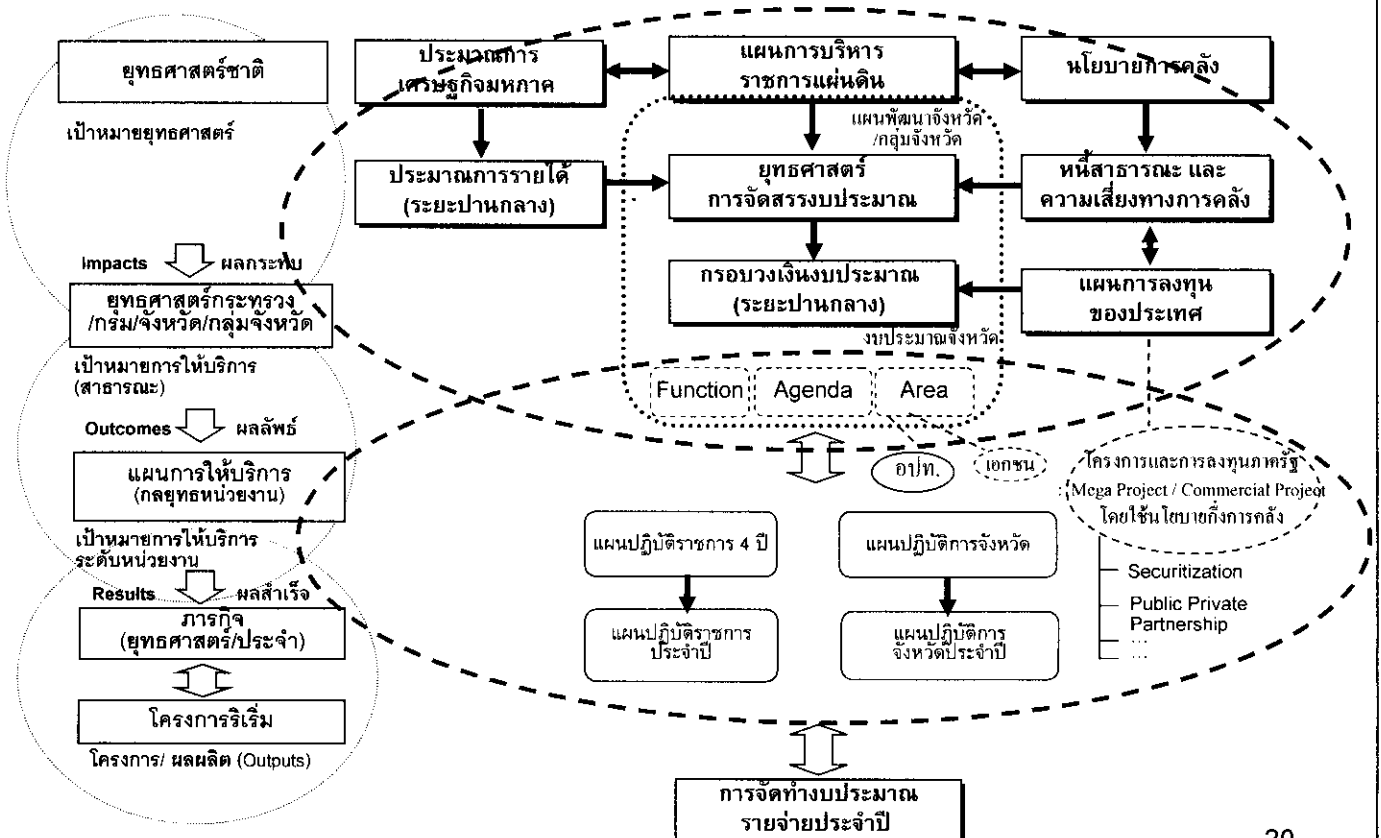
PEM/R Components	กิจกรรม*	ผู้รับผิดชอบ
E (IT Support)	1. พัฒนาระบบ Government Financial Management Information System : GFMS ให้เชื่อมโยงกับระบบงานต่างๆ ที่เกี่ยวข้อง เช่น - โครงการพัฒนาระบบบริหารหนี้สาธารณะ (GFMS-TR) - โครงการส่วนต่อขยายระบบงาน GFMS เพื่อรองรับข้อมูล รัฐวิสาหกิจ (GFMS-SOE)	กระทรวงการคลัง
	2. พัฒนาระบบ Government Financial Management Information System : GFMS ให้เชื่อมโยงกับระบบ Internet และ Intranet เพื่ออำนวยความสะดวกให้หน่วยเบิกจ่ายต่างๆ ทั่วประเทศ	กระทรวงการคลัง
	3. พัฒนาระบบฐานข้อมูลเอกสารกลางของระบบ e-Budgeting และเชื่อมต่อกับระบบ Intranet โดยพิจารณาครอบคลุมหน่วยงาน ที่เกี่ยวข้องทั้ง 3 มิติ : Function / Area / Agenda	สำนักงานงบประมาณ

PEM/R Component E: การประเมินระบบเทคโนโลยีสารสนเทศ ที่สนับสนุนการดำเนินงาน



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PEM/R Component A - B - C



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ความก้าวหน้าในการดำเนินงานตามหลักการบริหารจัดการ รายจ่ายภาคสาธารณะของไทย

หลักการบริหารจัดการ รายจ่ายภาคสาธารณะ	เครื่องมือที่ใช้	สถานะของเครื่องมือที่ใช้
1. ความยั่งยืนและวินัย ทางการคลัง	1.1 MTEF ระดับ Top Down และ Bottom Up	ใช้ในกระบวนการงบประมาณแล้ว และอยู่ในระหว่างการทบทวนให้ดีขึ้น
	1.2 Fiscal Rule	ใช้ในกระบวนการงบประมาณแล้ว และอยู่ในระหว่างการทบทวนให้ดีขึ้น
	1.3 Budget Ceiling	ใช้ในกระบวนการงบประมาณ
	1.4 อัตราส่วนงบประมาณและ งบลงทุน	ใช้ในกระบวนการงบประมาณ
	1.5 Mid- Term Review	อยู่ระหว่างการดำเนินโครงการนำร่อง (Pilot Testing)

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ความก้าวหน้าในการดำเนินงานตามหลักการบริหารจัดการ รายจ่ายภาคสาธารณะของไทย (ต่อ)

หลักการบริหารจัดการ รายจ่ายภาคสาธารณะ	เครื่องมือที่ใช้	สถานะของเครื่องมือที่ใช้
2. การจัดสรรทรัพยากรเชิง ยุทธศาสตร์ความยั่งยืน และวินัยทางการคลัง	2.1 ยุทธศาสตร์ระดับชาติ/ รัฐบาล	ใช้ในกระบวนการงบประมาณแล้ว และอยู่ในระหว่างการทบทวนให้ดีขึ้น
	2.2 แผนยุทธศาสตร์ระดับ กระทรวง/กรม	ใช้ในกระบวนการงบประมาณแล้ว และอยู่ในระหว่างการทบทวนให้ดีขึ้น
	2.3 การบูรณาการแผน งบประมาณในมิติพื้นที่	ใช้ในกระบวนการงบประมาณแล้ว และอยู่ในระหว่างการทบทวนให้ดีขึ้น

**ความก้าวหน้าในการดำเนินงานตามหลักการบริหารจัดการ
รายจ่ายภาคสาธารณะของไทย (ต่อ)**

หลักการบริหารจัดการ รายจ่ายภาคสาธารณะ	เครื่องมือที่ใช้	สถานะของเครื่องมือที่ใช้
3. การดำเนินงานที่มี ประสิทธิภาพ	3.1 เป้าหมายการให้บริการ และคำรับรองการปฏิบัติ ราชการ	ใช้ในกระบวนการงบประมาณแล้ว และอยู่ในระหว่างการทบทวนให้ดีขึ้น
	3.2 ฐานข้อมูลโครงสร้าง ผลผลิต	อยู่ระหว่างการทดสอบฐานข้อมูล
	3.3 ตัวชี้วัดความสำเร็จ	ใช้ในกระบวนการงบประมาณแล้ว และอยู่ในระหว่างการทบทวนให้ดีขึ้น

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**ความก้าวหน้าในการดำเนินงานตามหลักการบริหารจัดการ
รายจ่ายภาคสาธารณะของไทย (ต่อ)**

หลักการบริหารจัดการ รายจ่ายภาคสาธารณะ	เครื่องมือที่ใช้	สถานะของเครื่องมือที่ใช้
4. ความคล่องตัวและความ รับผิดชอบในการบริหาร จัดการ	4.1 การเพิ่มบทบาทให้กับ หัวหน้าส่วนราชการ	ใช้ในกระบวนการงบประมาณแล้ว และอยู่ในระหว่างการทบทวนให้ดีขึ้น
	4.2 PPP และนวัตกรรมทาง การเงิน	เริ่มใช้ในกระบวนการงบประมาณ
	4.3 เครื่องมือ PART	เริ่มใช้ในกระบวนการงบประมาณ
	4.4 ปรับโครงสร้างแผนงาน- กิจกรรม-ผลผลิต	ใช้ในกระบวนการงบประมาณแล้ว และอยู่ในระหว่างการทบทวนให้ดีขึ้น

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**ความก้าวหน้าในการดำเนินงานตามหลักการบริหารจัดการ
รายจ่ายภาคสาธารณะของไทย (ต่อ)**

หลักการบริหารจัดการ รายจ่ายภาคสาธารณะ	เครื่องมือที่ใช้	สถานะของเครื่องมือที่ใช้
5. ความโปร่งใสทางการคลัง	5.1 GFMIS	ใช้ในกระบวนการงบประมาณแล้ว
	5.2 พัฒนาระบบ BIS	ใช้ในกระบวนการงบประมาณแล้ว และอยู่ในระหว่างการทบทวนให้ดียิ่งขึ้น
	5.3 ปรับปรุงรูปแบบเอกสาร งบประมาณ	ใช้ในกระบวนการงบประมาณแล้ว
	5.4 ปรับปรุงรูปแบบรายงาน ผลการดำเนินงานและ รายงานผลทางการเงิน	ใช้ในกระบวนการงบประมาณแล้ว

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3. การดำเนินงานในระยะต่อไป

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3. การดำเนินงานในระยะต่อไป

1. ประสานความร่วมมืออย่างต่อเนื่องระหว่างหน่วยงานที่เกี่ยวข้องกับการพัฒนาการบริหารจัดการรายจ่ายภาคสาธารณะ เพื่อให้ประเทศไทยมีความเข้มแข็งด้านวินัยและความยั่งยืนทางการคลัง รวมทั้งเพิ่มความโปร่งใสและความเป็นธรรมในสังคม
2. ส่งเสริมความสัมพันธ์ทางการคลังระหว่างหน่วยงานภาครัฐ ทั้งส่วนกลาง ส่วนภูมิภาค ส่วนท้องถิ่น จังหวัด/ กลุ่มจังหวัด
3. เร่งรัดดำเนินการภารกิจสำคัญตามข้อกำหนดของกฎหมาย เช่น การจัดทำกฎหมายการเงินการคลังและอนุบัญญัติกฎหมายที่เกี่ยวข้อง การกำหนดเอกสารประกอบร่างพระราชบัญญัติงบประมาณรายจ่ายฯ
4. พัฒนาระบบและคู่มือ PART ให้สามารถนำไปใช้ได้จริงในทางปฏิบัติ พร้อมทั้งสนับสนุนให้หน่วยงานภาครัฐมีการวิเคราะห์ระดับความสำเร็จของการดำเนินงานจากการใช้จ่ายงบประมาณอย่างจริงจังเพื่อให้เกิดผลอย่างเป็นรูปธรรม
5. จัดทำศูนย์องค์ความรู้กลาง ด้านการบริหารจัดการรายจ่ายภาคสาธารณะ โดยเน้นการบูรณาการข้อมูลจากหน่วยงานที่เกี่ยวข้อง และพัฒนาส่งเสริมการเรียนรู้ผ่านระบบการเรียนรู้ทางอิเล็กทรอนิกส์ (e-Learning)
6. พัฒนาขีดความสามารถของบุคลากรในภาคการคลัง การงบประมาณอย่างเป็นระบบตามหลักวิชาการที่เป็นมาตรฐานสากล

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CHAPTER VIII Monetary, Finance and Budget

Section 167. In an introduction of the annual appropriations bill, the bill shall be annexed with documents stating estimated incomes, obscure objectives, activities, plans or projects of each item of expenditures including monetary and financial status of the country through the overview of economic condition arising from spending and gathering of incomes, benefits and deficiencies resulting from any specific tax exemption, justification for binding of over-year obligations, State debts and its incurring and financial status of State enterprises of that year and the previous year.

If any expenditure is unable to be directly allocated to a government agency, State enterprise or other State agencies, it shall be allocated to the item of reserved expenditure and, in such case, justification and necessary of such allocation shall also be stated.

There shall be a law on State monetary and finance laying down monetary and financial disciplines as well as the rules relating to a financial planning for medium term range, the gathering of incomes, a determination of guidelines for the making of expenditure estimates of State, the financial and properties management, an accounting, the public funds, an incurring of debts or any act resulting in the binding of properties of or the incurring of financial obligation of State, the rule for a determination of the amount of reserved money to be paid for emergency or necessity situation and other relevant acts which are the scope for the gathering of incomes and supervising of spending in accordance with the principles of balancing, economic sustainable development and social fairness.



สรุปลงสาระสำคัญด้านวิชาการ
2008 OECD Asian
Senior Budget Officials Meeting
กรุงเทพมหานคร

วันที่ 10 -11 มกราคม 2551

สำนักงานประมาณ

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บทสรุปผู้บริหาร

ตามที่นายกรัฐมนตรีได้อนุมัติให้สำนักงานงบประมาณเป็นเจ้าภาพร่วมกับองค์การเพื่อความร่วมมือทางเศรษฐกิจและการพัฒนา (Organization for Economic Co-operation and Development : OECD) จัดการประชุม OECD Asian Senior Budget Officials Meeting ครั้งที่ 4 ระหว่างวันที่ 10 - 11 มกราคม 2551 ณ ห้องดุสิตธานีฮอลล์ โรงแรมดุสิตธานี กรุงเทพมหานคร กรุงเทพมหานคร ซึ่งการประชุมครั้งนี้เป็นผลมาจากการที่รองนายกรัฐมนตรี (นายโฆสิต ปั้นเปี่ยมรัษฎ์) และนายวุฒิพันธุ์ วิชัยวัฒน์ ผู้อำนวยการสำนักงานงบประมาณ ได้เข้าเยี่ยมชมผู้บริหาร OECD ณ ประเทศฝรั่งเศส เมื่อเดือนตุลาคม 2550 ที่ผ่านมานั้น

การประชุมครั้งนี้ ประสบความสำเร็จอย่างยิ่ง บรรลุตามวัตถุประสงค์และเป้าหมายที่กำหนด โดยมีผู้บริหารระดับสูงด้านการงบประมาณของประเทศต่างๆ เข้าร่วมประชุม 18 ประเทศ อาทิ ออสเตรเลีย ตุรกี ญี่ปุ่น เกาหลีใต้ จีน อินเดีย และสิงคโปร์ รวมทั้งผู้เชี่ยวชาญด้านการงบประมาณ เช่น Prof. Allen Schick จาก University of Maryland, USA และ Prof. Paul Posner จาก George Mason University, USA โดยในการประชุมครั้งนี้ มีนายวุฒิพันธุ์ วิชัยรัตน์ ผู้อำนวยการสำนักงานงบประมาณ และ Mr. Ian Watt, Permanent Secretary, Department of Finance, Australia เป็นประธานร่วมในที่ประชุม สรุปประเด็นสำคัญในการประชุมได้ดังนี้

- **Recent Budgeting Developments in Asia** ผู้แทนแต่ละประเทศได้รายงานให้ที่ประชุมทราบระบบงบประมาณและแนวทางในการพัฒนาระบบงบประมาณไปสู่ระบบงบประมาณแบบมุ่งเน้นผลงาน (Performance-based Budgeting) การจัดทำประมาณการงบประมาณรายจ่ายระยะปานกลาง และกำหนดเป้าหมายทางการคลังอย่างเป็นรูปธรรม ในโอกาสนี้ สำนักงานงบประมาณได้นำเสนอความก้าวหน้าการดำเนินการ การบริหารจัดการรายจ่ายภาคสาธารณะ (Public Expenditure Management : PEM)
- **Developing Fiscal Space: Overcoming Rigidities in the Structure of Expenditures** Prof. Allen Schick, University of Maryland, USA ได้นำเสนอผลการศึกษเกี่ยวกับแนวทาง การนำ Fiscal Space หรือวงเงินงบประมาณรายจ่ายคงเหลือที่ภาครัฐมีในแต่ละปีที่สามารถนำมาดำเนินงาน/โครงการภายใต้นโยบายใหม่ หลังจากหักงบประมาณรายจ่ายตามภาระงบประมาณแล้ว และแนวทางการเพิ่ม Fiscal Space เช่น การให้เอกชนเข้าร่วมดำเนินงานกับรัฐ (Public Private Partnerships : PPP) การขายทรัพย์สินของรัฐ และการแปรรูปรัฐวิสาหกิจ เป็นต้น

- **PPP's and Outsourcing: Implications for Budgeting and Accountability** Prof. Paul Posner, George Mason University, USA ได้นำเสนอผลการศึกษาเกี่ยวกับการร่วมทุนระหว่างภาคเอกชนกับภาครัฐ (Public Private Partnerships : PPP) และการให้ภาคเอกชนเข้ามาดำเนินงานของภาครัฐ (Outsourcing) โดยมุ่งเน้นการลดภาระงบประมาณ และเพิ่มประสิทธิภาพในการดำเนินโครงการ ตลอดจนปัจจัยสำคัญที่จะนำไปสู่ความสำเร็จ ซึ่งครอบคลุมในเรื่อง ของกฎหมาย สัญญา การจัดซื้อ จัดจ้าง และการกระจายความเสี่ยง เป็นต้น
- **Integrating Tax Expenditures into the Budget Process** ทีมงานของ OECD ได้นำเสนอ รายงานการศึกษาผลกระทบที่เกิดจากการดำเนินนโยบายรายจ่ายภาษี (Tax Expenditure) ของภาครัฐ เช่น การลดหย่อนภาษี การยกเว้นภาษี และการคืนภาษี ที่มีต่อกระบวนการจัดทำงบประมาณ โดยเฉพาะการพิจารณาของฝ่ายนิติบัญญัติ เพื่อแสดงถึงความโปร่งใสทางการคลัง
- **Fiscal Relations with Lower Levels of Government** ทีมงานของ OECD ได้นำเสนอรายงาน การศึกษาเกี่ยวกับรูปแบบการจัดสรรเงินอุดหนุนและแนวทางปฏิบัติของส่วนภูมิภาคหรือท้องถิ่นใน รูปแบบต่างๆ

ข้อเสนอแนะ

1. ในการจัดทำงบประมาณรายจ่ายประจำปี สำนักงานงบประมาณได้เน้นการจัดลำดับความสำคัญของ แผนงบประมาณ งาน/โครงการ และดำเนินการทบทวน ปรับลดงบประมาณรายจ่ายตามกระบวนการ จัดทำงบประมาณแบบมุ่งเน้นผลงาน เพื่อให้มีวงเงินงบประมาณคงเหลือ (Fiscal Space) เพิ่มขึ้น มาโดยตลอด เพื่อการจัดสรรงบประมาณให้กับงาน/โครงการที่เป็นนโยบายเร่งด่วน ตลอดจนได้ จัดทำกรอบงบประมาณรายจ่ายงบประมาณระยะปานกลาง (MTEF) ทั้งจากระดับบนสู่ล่าง (Top-down) และจากระดับล่างสู่บน (Bottom up) เพื่อแสดงถึงการรักษาความยั่งยืนและวินัยทางด้านการงบประมาณและการคลัง
2. ในการดำเนินการรายจ่ายภาษี (Tax Expenditure) อาทิ การลดหย่อนภาษี การยกเว้นภาษี และการคืนภาษี ควรมีการศึกษาโดยละเอียดเกี่ยวกับ ความยุติธรรม ความโปร่งใส และผลกระทบจากการ ดำเนินการต่อผู้มีส่วนได้ส่วนเสีย (Stakeholders) ทั้งโดยตรงและโดยอ้อม มีการประเมินความคุ้มค่า จากการใช้จ่ายรายจ่ายภาษี อีกทั้ง ควรมีการพิจารณาและตรวจสอบจากฝ่ายนิติบัญญัติตาม กระบวนการงบประมาณรายจ่ายประจำปี

ประโยชน์ที่ประเทศไทยได้รับจากการจัดประชุมในครั้งนี้

1. มีการแลกเปลี่ยนองค์ความรู้ ประสบการณ์การทำงาน และนวัตกรรมใหม่ๆ ด้านการจัดการงบประมาณในระดับนานาชาติ เช่น Fiscal Space, Public Private Partnership (PPP), Tax Expenditure และการจัดสรรงบประมาณให้กับรัฐบาลท้องถิ่น
2. เป็นการส่งเสริมภาพลักษณ์และศักยภาพของประเทศไทยให้เป็นที่ประจักษ์และยอมรับในระดับนานาชาติ จากผลงานการจัดประชุม OECD Asian Senior Budget Officials Meeting จำนวน 4 ครั้งที่ผ่านมา ในปี พ.ศ. 2545 2548 2549 และ 2551
3. เป็นการเสริมสร้างความสัมพันธ์ระหว่างผู้บริหารสำนักงานงบประมาณในภูมิภาคเอเชีย และ OECD เพื่อให้เกิดความร่วมมือในการแลกเปลี่ยนองค์ความรู้ และทำงานร่วมกันในอนาคต
4. เป็นการพัฒนาศักยภาพบุคลากรของสำนักงานงบประมาณและหน่วยงานที่เกี่ยวข้องทางด้านการเงินและการคลังของประเทศไทย โดยบุคลากรได้มีโอกาสเพิ่มองค์ความรู้ นวัตกรรม ทางด้านการเงิน การคลัง และการงบประมาณ จากการเข้าร่วมการประชุม

บทที่ 1

Roundtable on Recent Budgeting Development in Asia

ผู้แทนแต่ละประเทศ ได้นำเสนอสาระสำคัญของการพัฒนาระบบงบประมาณ มีสาระสำคัญสรุปได้ดังนี้

1. ออสเตรเลีย

- ผลการเลือกตั้งนายกรัฐมนตรีเมื่อ พฤศจิกายน พ.ศ. 2550 ทำให้เกิดนโยบายการบริหารจัดการงบประมาณใหม่ รัฐบาลใหม่ให้ความสำคัญกับการทำการค้ากับประเทศจีน และมีการนำกลยุทธ์ด้านงบประมาณมาใช้ เพื่อให้มีวินัยทางการคลังมากขึ้น รวมทั้งมีการตั้งคณะกรรมการพิจารณาข้อเสนอของหน่วยงานต่างๆ จัดลำดับความสำคัญของโครงการต่างๆ ในการพัฒนาประเทศ โดยพิจารณาความเร่งด่วนของข้อเสนอหน่วยงานภาครัฐ จำกัดข้อเสนอใหม่ๆ ให้อยู่ในบริบทของงบประมาณที่เป็นไปได้
- รัฐบาลใหม่มุ่งเน้นการทบทวนงบประมาณ โดยเน้นผลกระทบระยะยาว มีมาตรการและกฎเกณฑ์ทางด้านงบประมาณเพื่อทบทวนโครงการต่างๆ นอกจากนี้ยังมีการปรับปรุงให้มีความโปร่งใสเชื่อถือได้ของงบประมาณ ซึ่งเรียกว่า ปฏิบัติการ Sunrise โดยระบุให้ผลลัพธ์และกรอบการดำเนินงานมีความกระชับและปรากฏในเอกสาร / รายงานด้านงบประมาณ ซึ่งจะทำให้การประมาณการด้านงบประมาณมีความชัดเจนยิ่งขึ้น
- รัฐบาลใหม่มีแนวคิดให้มีการรายงานเกี่ยวกับภาษีรายจ่าย (Tax Expenditure) ในระยะยาว โดยนำเสนอปีละหลายครั้ง โดยรัฐบาลใหม่มีความเห็นว่า จะต้องมีความพยายามกำจัดข้อจำกัดต่างๆ
- รัฐบาลใหม่มีนโยบายในการใช้จ่ายเพื่อปรับปรุงทักษะของผู้ปฏิบัติงาน

2. บรูไน

- มีการเปลี่ยนแปลงระบบการจัดทำงบประมาณ ให้การดำเนินการของฝ่ายนิติบัญญัติมีความโปร่งใสมากขึ้น โดยให้สื่อมวลชนเข้ามามีบทบาทในการนำเสนอต่อสาธารณชน
- ต้องการปฏิรูประบบงบประมาณให้เข้าไปสู่ระบบงบประมาณแบบ Block grant เพื่อให้เกิดความยืดหยุ่นมากยิ่งขึ้น ในปีต่อไป
- รัฐบาลมุ่งเน้นให้หน่วยงานภาครัฐที่เกี่ยวข้องรับผิดชอบในการจัดทำงบประมาณ มีการจัดทำรายงานทางการเงินของหน่วยงานของตน

3. กัมพูชา

- เนื่องจากเศรษฐกิจกับการเมืองมีการเกี่ยวพันกันอย่างแยกไม่ออก ดังนั้นการบริหารจัดการรายจ่ายภาครัฐจึงมีข้อจำกัดที่ฝ่ายการเมืองเข้ามาแทรกแซงนโยบายการบริหารรายจ่ายภาครัฐ

4. ติมอร์ตะวันออก

- ในเดือนพฤษภาคม ค.ศ. 2002 ติมอร์ตะวันออกได้รับเอกราช และจัดตั้งรัฐบาลเข้ามาบริหารประเทศ โดยประสบกับปัญหายุ่งยากมากมาย รัฐบาลที่มาจากการเลือกตั้งได้กำหนดจัดลำดับความสำคัญ ในระยะสั้น ระยะกลาง และระยะยาว โดยมุ่งเน้นการเจริญเติบโตทางเศรษฐกิจ การปฏิรูปด้านความมั่นคง การสนับสนุนการเดินทางกลับประเทศของผู้ลี้ภัยทางการเมือง การจ้างงานของคนหนุ่มสาว การฝึกอาชีพ การพัฒนาชุมชน การเกษตร โครงสร้างพื้นฐาน สาธารณสุข ความมั่นคงของกลุ่มต่างๆ
- มีการจัดทำแผนการพัฒนาประเทศ ซึ่งสอดคล้องกับเป้าหมายในการพัฒนาสหภาพภายในปี ค.ศ. 2008 จะมีการกำหนดแผนพัฒนาประเทศในปี ค.ศ. 2008 – 2013 ซึ่งจะมีการจัดลำดับความสำคัญในรายสาขา
- ในปี ค.ศ. 2006-2007 อัตราการเบิกจ่ายงบประมาณมีอัตราต่ำกว่าร้อยละ 60 อันเป็นผลมาจากข้อจำกัดในการบริหารจัดการการคลัง และการปฏิรูปการจัดซื้อจัดจ้าง
- รายได้หลักของประเทศส่วนใหญ่มาจากกองทุนน้ำมัน
- ขณะนี้ ประเทศติมอร์ตะวันออก อยู่ในช่วงการปรับปรุงระบบบัญชี ระบบการจัดซื้อจัดจ้าง การบริหารบัญชีเงินสดและการกระจายอำนาจ
- ความท้าทายในอนาคต คือภายในปี ค.ศ. 2009 รัฐบาลต้องการบริหารจัดการงบประมาณให้สอดคล้องกับมาตรฐานบัญชี การจัดลำดับความสำคัญของนโยบาย และสถิติต่างๆ ที่เกี่ยวข้อง

5. อินเดีย

- มีการจำแนกงบประมาณลงในระดับภูมิภาคและท้องถิ่น โดยมีกรรมการจากส่วนกลางพิจารณา
- มีการวางแผนงบประมาณล่วงหน้า 5 ปี
- ปี ค.ศ. 2008 – 2009 มีเป้าหมายการเพิ่ม GDP 9.5% เพื่อการขาดดุลงบประมาณ

- ใช้ระบบการบริหารจัดการบัญชีเงินสด โดยในช่วง 3 ปีที่ผ่านมา ประสบความสำเร็จในการบริหารจัดการเงินสด (Cash Management)
- มีการพัฒนากรอบความยั่งยืนทางการคลัง
- การบริหารจัดการงบประมาณที่มีความโปร่ง ผ่านการรายงานทางเอกสารงบประมาณจำนวน 14 ฉบับ โดยหน่วยงานต่างๆ ต้องทบทวนและนำเสนอรายละเอียดของงบประมาณเหลือจ่าย
- มีการบริหารจัดการรายจ่ายให้สอดคล้องกับการจัดเก็บรายได้

6. อินโดนีเซีย

- ตั้งเป้าหมายการขาดดุลงบประมาณให้น้อยกว่า 3% ของ GDP
- กำหนดนโยบายเพิ่มงบลงทุนให้มากขึ้น เพื่อลดความยากจน
- กำหนดนโยบายปรับปรุงการให้บริการสาธารณะ
- กำหนดนโยบายลดความเสี่ยงทางด้านสังคม
- มุ่งเน้นความโปร่งใส มีเสถียรภาพทางการคลังในระยะยาว

7. ฟิลิปปินส์

- ปี ค.ศ. 2008 มีการปฏิรูปกรอบงบประมาณรายจ่ายระยะปานกลาง (MTEF)
- ข้อจำกัดที่สำคัญในการพัฒนาระบบงบประมาณ คือ ขีดความสามารถของเจ้าหน้าที่ในการเสนอนโยบายที่ดีต่อรัฐบาล
- มีการจัดทำเอกสารงบประมาณ เพื่อนำเสนอผลงานของหน่วยงานต่างๆ ต่อรัฐสภา

8. เกาหลีใต้

- เศรษฐกิจเกาหลีในช่วงที่ผ่านมาขยายตัวในอัตราสูง
- มีการวางแผนการคลังระยะ 5 ปี เป็นการวางแผนแบบ TOP-DOWN
- การวางแผนทางด้านการคลัง โดยบูรณาการและเชื่อมโยงนโยบายระหว่างรัฐบาลกลางและรัฐบาลท้องถิ่น
- มีการริเริ่มการปฏิรูปด้านการคลังมากขึ้น
- ปัจจุบันมีการปฏิรูปการบริหารจัดการในเรื่องต่างๆ เพื่อให้มีข้อมูล Real time นำเสนอเพื่อการตัดสินใจในระดับนโยบายได้

9. ตุรกี

- มีการปฏิรูประบบงบประมาณอย่างต่อเนื่อง ตั้งแต่ปี ค.ศ. 1995 เพื่อแก้ปัญหาด้านการเงินสาธารณะ
- ปี ค.ศ. 2002 มีการออกกฎหมายใหม่ๆ เช่น กฎหมายบริหารจัดการหนี้สาธารณะ
- ปี ค.ศ. 2003 มีระบบงบประมาณ Electronic โดยให้หน่วยงานภาครัฐส่งข้อมูลผ่านระบบ Online
- ปี ค.ศ. 2004 มีการใช้มาตรฐานระบบบัญชีสากล
- งบประมาณของตุรกีมีสัดส่วน 16% ของ GDP
- ผลของการปฏิรูประบบงบประมาณทำให้เกิด
 - วินัยทางการคลัง
 - การจัดสรรงบประมาณได้อย่างเหมาะสม
 - ค่าใช้จ่ายมีค่าใกล้เคียงกับความเป็นจริง
- มีการจัดทำงบประมาณ 3 ปี
- มีการกระจายอำนาจ ซึ่งทำให้การทำงานของกระทรวงการคลังสอดคล้องกับการทำงานของหน่วยงานต่างๆ มากขึ้น
- อนาคตพยายามให้ระบบงบประมาณมีความเข้มแข็งมากขึ้น และพยายามจะปฏิรูปในเรื่องระบบบำเหน็จบำนาญ และยกระดับขีดความสามารถหน่วยงานด้านยุทธศาสตร์

10. ศรีลังกา

- มีการปฏิรูปด้านการบริหารการเงินการคลัง
- ปัญหาของประเทศ ได้แก่ ปัญหาเศรษฐกิจที่เกิดจากภัยสึนามิ และปัญหาด้านความมั่นคงภายในประเทศ ความต้องการลงทุนในโครงสร้างพื้นฐาน ปัญหานี้สินที่สูง
- มีแนวทางการปฏิรูปในเรื่อง การประเมินผล การเพิ่มประสิทธิภาพบุคลากร การจัดเก็บรายได้
- แนวทางการพัฒนา เน้นความรับผิดชอบด้านสังคม การพัฒนาสตรี การทำให้ระบบภาษีมีความง่ายสะดวกมากขึ้น ส่งเสริมความโปร่งใสภาครัฐ บรรเทาปัญหาความยากจน
- พยายามทำให้ระบบงบประมาณและภาษีมีความยืดหยุ่นมากขึ้น

- มีการประมาณการงบประมาณรายจ่ายล่วงหน้า ให้สอดคล้องกับความต้องการเพื่อให้เกิดประโยชน์สูงสุด

11. เวียดนาม

- เศรษฐกิจเวียดนาม มีการขยายตัวและมีเสถียรภาพ โดยในปี 2007 ขยายตัวมากกว่า 8%
- ปี 1997 มีกฎหมายงบประมาณฉบับแรก ซึ่งเป็นกฎหมายควบคุมเกี่ยวกับการใช้จ่ายอย่างเข้มงวดและมีการแบ่งสรรรายได้ระหว่างส่วนกลางและท้องถิ่น
- ปี 2004 มีการแก้ไขกฎหมายงบประมาณ เพื่อให้หน่วยงานมีอำนาจในการใช้จ่ายที่สอดคล้องกับความต้องการมากขึ้น
- มีการจัดทำกรอบงบประมาณรายจ่ายระยะปานกลาง (MTEF) จากล่างขึ้นบน
- แนวทางการปฏิรูปในอนาคต
 - ปรับปรุงกฎหมายงบประมาณ ในปี ค.ศ. 2009 เพื่อให้ทันสมัยในปี ค.ศ. 2011
 - แปรรูปรัฐวิสาหกิจ ให้เสร็จภายในปี ค.ศ. 2010
 - ปรับปรุงระบบสาธารณูปโภค

12. ไต้หวัน

- ระบบงบประมาณของประเทศไต้หวัน เป็นระบบที่บูรณาการระหว่างการมุ่งเน้นการจัดสรรงบประมาณที่มีอยู่อย่างจำกัด และการตรวจสอบแผนงานที่ไม่มีศักยภาพ ถ้าสมัย และหมดความจำเป็นลง เพื่อให้มั่นใจได้ว่าการจัดสรรงบประมาณรายจ่ายประจำปีเป็นการจัดสรรงบประมาณให้กับ แผนงานที่มีความจำเป็นอย่างแท้จริง
- ริเริ่มการจัดทำกรอบงบประมาณรายจ่ายระยะปานกลาง ในปี พ.ศ. 2545 และมีการการริเริ่มกลไกการทบทวนงบประมาณ ในปี พ.ศ. 2547 เพื่อให้มั่นใจได้ว่าการจัดสรรงบประมาณตอบสนองต่อความต้องการอย่างแท้จริง โดยการทบทวนงบประมาณ ได้ผลลัพธ์ในการปรับลดงบประมาณในโครงการที่มีความจำเป็นน้อย ไปใช้ในโครงการที่มีประโยชน์มากกว่า
- มีการกำหนดให้หน่วยงานรัฐ จัดทำ เป้าหมายการดำเนินงาน และตัวชี้วัดผลการดำเนินงาน ในแต่ละปี โดยผลการดำเนินงานในแต่ละปีนั้น จะถูกใช้ประกอบการจัดสรรงบประมาณในปีต่อไป

- เครื่องมือสำคัญประกอบการจัดทำงบประมาณคือ การประมาณการรายจ่ายล่วงหน้าระยะปานกลาง และวงเงินสำหรับการจัดสรรให้กับโครงการ/รายการใหม่ (Fiscal Space) ในปีต่อไป

13. ช่องก่ง

- สภาพแวดล้อมโดยทั่วไป
 - การเมือง : มีสถานะเป็นรัฐบาลท้องถิ่นของประเทศสาธารณรัฐประชาชนจีน
 - กฎหมาย : รัฐธรรมนูญกำหนดให้นโยบายงบประมาณเป็นงบประมาณสมดุล
 - เศรษฐกิจ : มีการปรับโครงสร้างทางเศรษฐกิจ ให้สอดคล้องกับภาวะเศรษฐกิจในปัจจุบัน
 - สังคม : สังคมผู้สูงวัย
- กำหนดนโยบายการบริหารจัดการภาครัฐ โดยมุ่งเน้นการพัฒนาศักยภาพในด้านต่างๆ ประกอบด้วย
 - ความโปร่งใส (Transparency)
 - ความรับผิดชอบ (Accountability)
 - ปรับปรุงความคล่องตัว (Improve Flexibility) อาทิ การบริหารจัดการทรัพยากรบุคคล
 - นวัตกรรม (Innovation) อาทิ PPP และ การปรับปรุงองค์กร
- ปัญหา/ข้อจำกัด ในกระบวนการงบประมาณ
 - ไม่ประสบความสำเร็จในการกำหนดเป้าหมาย
 - อุปสรรคในการวัดผลการดำเนินงาน
 - อุปสรรคในการรายงานผล
 - การตัดสินใจในระดับนโยบาย จากผลการดำเนินงาน

14. ญี่ปุ่น

- เศรษฐกิจญี่ปุ่นชะลอตัวลงตั้งแต่ปี ค.ศ. 2006 โดยนโยบายงบประมาณในปีงบประมาณต่อไปยังเป็นนโยบายขาดดุลงบประมาณ
- เป้าหมายนโยบายงบประมาณสมดุลภายในปี ค.ศ. 2011
- กำหนดนโยบายการปฏิรูปการบริหารจัดการภาครัฐในระดับหน่วยงานและระดับผู้ปฏิบัติ

- กำหนดนโยบายเศรษฐกิจที่มุ่งเน้นการรักษาเสถียรภาพทางการคลังระยะยาว และความโปร่งใสทางการคลัง
- ปลายเดือนมกราคม 2551 จะมีการปฏิรูประบบราชการ โดยมุ่งเน้นให้เกิดความน่าเชื่อถือสาธารณะ

15. ลาว

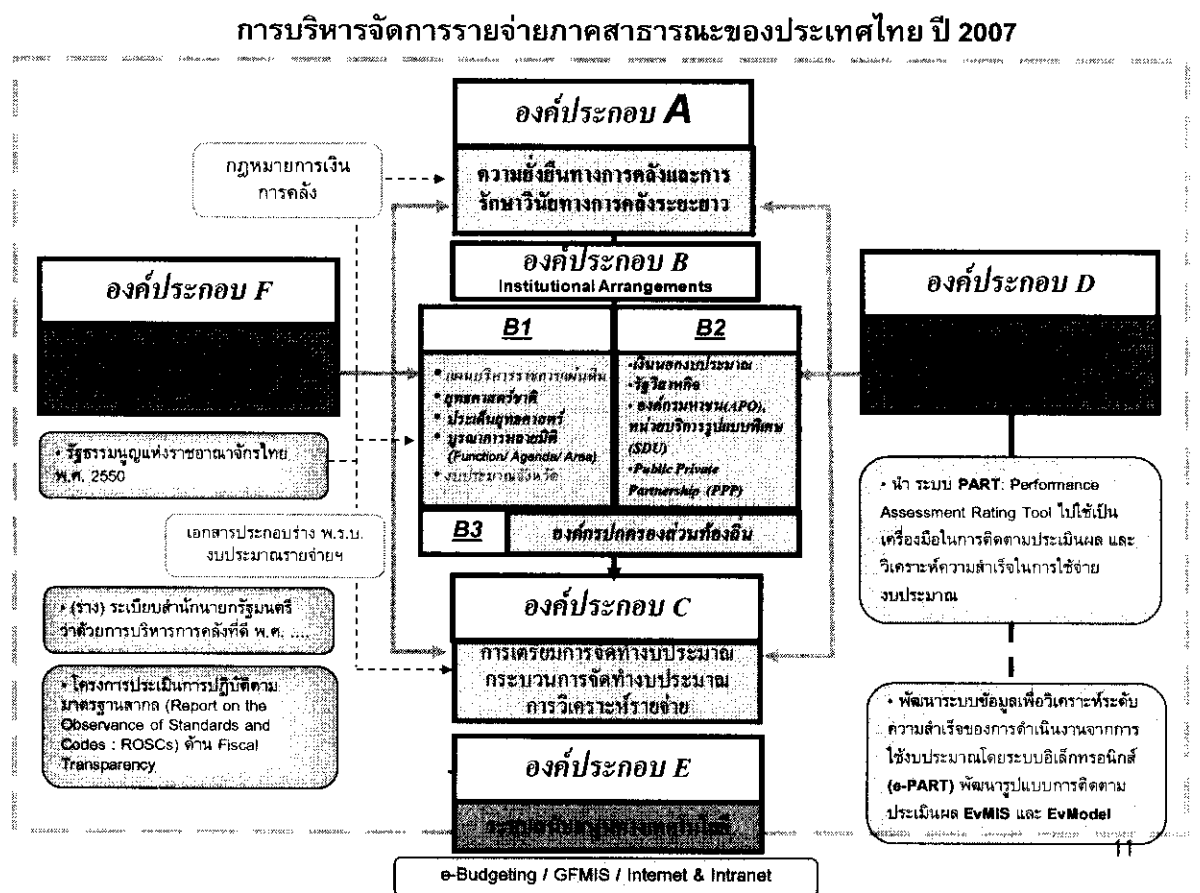
- มีข้อจำกัดคือความสัมพันธ์ระหว่างรัฐบาลกลางและรัฐบาลท้องถิ่นยังอ่อนแอ จึงทำให้การดำเนินงานของรัฐบาลท้องถิ่น เพื่อให้บรรลุเป้าหมายที่รัฐบาลกลางกำหนด เป็นไปอย่างยากลำบาก
- การจัดสรรงบประมาณให้รัฐบาลท้องถิ่นไม่สอดคล้องกับความต้องการของรัฐบาลท้องถิ่นอย่างแท้จริง
- นโยบายการบริหารจัดการของหน่วยงานระดับท้องถิ่นไม่ชัดเจน และมีข้อจำกัดในศักยภาพของข้าราชการ
- รัฐบาลกลางกำหนดนโยบายงบประมาณที่ลดการขาดดุลงบประมาณ
- รัฐบาลกลางอยู่ในระหว่างการกำหนดกลไกในการกระจายอำนาจในการบริหารจัดการให้กับรัฐบาลท้องถิ่นมากขึ้น

16. สิงคโปร์

- การจัดทำงบประมาณของประเทศสิงคโปร์ได้มุ่งเน้นทางด้านประสิทธิภาพ มีการพัฒนาตัวชี้วัดของผลสัมฤทธิ์ให้มีประสิทธิภาพมากยิ่งขึ้น และกำหนดนโยบายงบประมาณสมดุล
- บทบาทของกระทรวงการคลังคือการให้คำแนะนำในการจัดทำงบประมาณให้อย่างไรให้มีประสิทธิภาพ และควรใช้ตัวชี้วัดอย่างไรให้เหมาะสมกับการดำเนินงาน
- มุ่งเน้นการจัดสรรงบประมาณให้ตรงตามความต้องการของหน่วยงานอย่างแท้จริง
- กำหนดให้มีการรายงานตัวชี้วัดผลการดำเนินงาน รวมถึงสถานะของประเทศสิงคโปร์ในการจัดลำดับของการแข่งขันทางด้านเศรษฐกิจ และรองรับสังคมผู้สูงอายุ

17. ประเทศไทย

การประเมินผลรายจ่ายภาคสาธารณะของประเทศไทย มีองค์ประกอบ 6 ส่วน ซึ่งประเทศไทยได้เคยนำเสนอผลงานการวิเคราะห์และประเมินความสัมพันธ์ระหว่างองค์ประกอบทั้งหมดไปแล้ว ในคราวการประชุมเชิงปฏิบัติการทางวิชาการด้านการงบประมาณ Asian OECD Senior Budget Officials Meeting ปี พ.ศ. 2547 และ ปี พ.ศ. 2548 โดยการประชุมในครั้งนี้ ได้นำเสนอความก้าวหน้าในด้านรายจ่ายภาคสาธารณะของไทย มีสาระสำคัญตามแผนภาพด้านล่าง



ผลการดำเนินงานที่สำคัญ

1. กรอบกฎหมายและระเบียบ PER (ส่วนประกอบ F)
2. การติดตามและระบบการประเมินผลการดำเนินงาน (ส่วนประกอบ D)
3. การประเมินระบบเทคโนโลยีสารสนเทศที่สนับสนุนการดำเนินงาน (ส่วนประกอบ E)

การดำเนินงานในระยะต่อไป

1. ประสานความร่วมมืออย่างต่อเนื่องระหว่างหน่วยงานที่เกี่ยวข้องกับการพัฒนาการบริหารจัดการรายจ่ายภาคสาธารณะ เพื่อให้ประเทศไทยมีความเข้มแข็งด้านวินัยและความยั่งยืนทางการคลัง รวมทั้งเพิ่มความโปร่งใสและความเป็นธรรมในสังคม
2. ส่งเสริมความสัมพันธ์ทางการคลังระหว่างหน่วยงานภาครัฐ ทั้งส่วนกลาง ส่วนภูมิภาค ส่วนท้องถิ่น จังหวัด/ กลุ่มจังหวัด
3. เร่งรัดดำเนินการภารกิจสำคัญตามข้อกำหนดของกฎหมาย เช่น การจัดทำกฎหมายการเงินการคลังและอนุบัญญัติกฎหมายที่เกี่ยวข้อง การกำหนดเอกสารประกอบร่างพระราชบัญญัติงบประมาณรายจ่ายฯ
4. พัฒนาระบบและคู่มือ PART ให้สามารถนำไปใช้ได้จริงในทางปฏิบัติ พร้อมทั้งสนับสนุนให้หน่วยงานภาครัฐมีการวิเคราะห์ระดับความสำเร็จของการดำเนินงานจากการใช้จ่ายงบประมาณอย่างจริงจังเพื่อให้เกิดผลอย่างเป็นรูปธรรม
5. จัดทำศูนย์องค์ความรู้กลาง ด้านการบริหารจัดการรายจ่ายภาคสาธารณะ โดยเน้นการบูรณาการข้อมูลจากหน่วยงานที่เกี่ยวข้อง และพัฒนาส่งเสริมการเรียนรู้ผ่านระบบการเรียนรู้ทางอิเล็กทรอนิกส์ (e-Learning)
6. พัฒนาขีดความสามารถของบุคลากรในภาคการคลัง การงบประมาณอย่างเป็นระบบตามหลักวิชาการที่เป็นมาตรฐานสากล

บทที่ 2

Budgeting for Fiscal Space

1. แนวคิดของการมี Fiscal space

ทำให้ทราบจำนวนเงินงบประมาณคงเหลือเพื่อนำไปจัดสรรตามนโยบายใหม่ ให้สอดคล้องกับความยั่งยืนทางการคลังในระยะปานกลางและระยะยาว

2. การใช้ Fiscal space ในแต่ละประเทศ

กลุ่มประเทศที่มีรายได้ต่ำ

- จะทำอะไรที่จะให้มี Fiscal space คงเหลือ ในขณะที่ประเทศนั้นไม่สามารถเพิ่มรายได้จากระบบภาษี หรือกำลังประสบกับปัญหาทางการคลังอยู่
- นโยบายการกำหนดให้มี Fiscal space จะส่งผลต่อความเจริญเติบโตทางเศรษฐกิจ ถึงแม้ว่าอาจจะส่งผลต่อความสมดุลทางการคลังในระยะสั้น และทำให้ต้องกำหนดวงเงินงบประมาณเป็นจำนวนที่สูงขึ้นเรื่อยๆในอนาคต

กลุ่มประเทศที่พัฒนาแล้ว

- จะจัดสรรวงเงินที่เหลืออยู่อย่างไร ภายใต้ความเจริญเติบโตทางเศรษฐกิจ นโยบายรายได้ และการออมในปัจจุบัน

กลุ่มประเทศที่มีรายได้ปานกลาง

- โอกาสในการสร้าง Fiscal space ขึ้นอยู่กับปัจจัยต่างๆ ได้แก่ อัตราส่วนรายได้จากภาษีต่อ GDP รายจ่ายด้านโครงสร้างพื้นฐานและลงทุนต่างๆ และวงเงินงบประมาณที่มีอยู่อย่างจำกัด

3. Fiscal space กับ ความยั่งยืนทางการคลัง

- รัฐบาลควรพิจารณาผลกระทบของการจัดสรรวงเงินคงเหลือในการดำเนินนโยบายใหม่ ในระยะยาว นอกเหนือจากการพิจารณาเฉพาะวงเงินคงเหลือในแต่ละปีเพียงอย่างเดียว

4. ปัจจัยที่ทำให้ Fiscal space มีจำนวนจำกัด

- การกำหนดวงเงินงบประมาณที่อาจถูกจำกัดโดยกฎเกณฑ์ทางการคลัง (Fiscal Rules) ของประเทศนั้นๆ
- นโยบายทางการเงินที่จะไม่เพิ่มภาษี

- การจัดทำประมาณการรายจ่ายขั้นต่ำ (Baseline Projection) โดยจัดสรรงบประมาณให้กับแผนงาน/โครงการต่อเนื่อง (ทำให้โอกาสที่จะถูกปรับลดหรือตัดงบประมาณสำหรับแผนงาน/โครงการดังกล่าว เป็นไปได้ยาก)
- กฎหมายหรือกฎข้อบังคับต่างๆ ที่กำหนดให้มีการจัดสรรงบประมาณในเรื่องต่างๆ เป็นการเฉพาะ
- โครงสร้างประชากรมีการเปลี่ยนแปลง ทำให้รัฐบาลต้องจัดสรรงบประมาณในด้านสวัสดิการสังคมและสาธารณสุขเป็นจำนวนมากขึ้นเรื่อยๆ
- นโยบายการกระจายอำนาจทางการคลัง ทำให้งบประมาณส่วนหนึ่งต้องถูกจัดสรรให้องค์กรปกครองส่วนท้องถิ่น

5. แนวทางการเพิ่ม Fiscal space

- เพิ่มวงเงินงบประมาณ
- เพิ่มรายรับผ่านรายได้จากภาษี
- จัดลำดับความสำคัญของแผนงาน/โครงการใหม่
- ขายทรัพย์สินของรัฐ หรือ การแปรรูป
- การให้เอกชนเข้าร่วมดำเนินงานกับรัฐ (Public Private Partnership)

Third Party Governance : Transformations in Public Management

สรุปสาระสำคัญ

1. การบริหารจัดการภาครัฐสมัยใหม่

- การร่วมมือของภาคเอกชน
- กำหนดเป้าหมายการดำเนินงาน
- การปรับเปลี่ยนจากหน่วยงานราชการเป็นองค์กรอิสระ
- ปรับเปลี่ยนความรับผิดชอบจากปัจจัยนำเข้า (Input) เป็นผลลัพธ์ (Results)
- เปลี่ยนจากการผูกขาด (Monopolies) เป็น การแข่งขันอย่างเสรี
- เน้นแนวคิดทางการตลาดมากขึ้น

2. กลยุทธ์ของหน่วยงานภาครัฐ

- เน้นการให้แรงจูงใจมากกว่าการใช้การบังคับบัญชาตามสายงาน
- เน้นการแข่งขันมากขึ้น
- ปรับเปลี่ยนความรับผิดชอบจากปัจจัยนำเข้า (Input) เป็นผลลัพธ์ (Results)
- สนับสนุนการบริหารจัดการที่คล่องตัว
- เครื่องมือที่ใช้ ประกอบด้วยอาทิ ข้อตกลง/สัญญาระหว่างผู้บริหารหน่วยงานกับรัฐมนตรี
เงินทุนหมุนเวียน บริษัทในกำกับของรัฐบาล และหน่วยงานอิสระ

3. เครื่องมือของภาครัฐ ประกอบด้วย Direct Government เงินอุดหนุน เงินกู้ Tax Expenditure Privatization และมาตรการต่างๆ

4. การปรับเปลี่ยน(การยกระดับ) ของการบริหารจัดการภาครัฐ

- เปลี่ยนจากแผนงาน/หน่วยงาน (Program/Agency) เป็นเครื่องมือและผู้แสดง (Tools and Actor)
- เปลี่ยนจากสายงานบังคับบัญชาเป็นโครงข่ายการบังคับบัญชา (Networks)
- เปลี่ยนจาก ภาครัฐและภาคเอกชน เป็น ความร่วมมือระหว่างภาครัฐและภาคเอกชน
- เปลี่ยนจาก คำสั่ง การควบคุม เป็น การเจรจาต่อรอง
- เปลี่ยนจากทักษะการบริหารจัดการ เป็น ความสามารถในการดำเนินการให้บรรลุผลสำเร็จ
- เปลี่ยนจากการควบคุมภายในเป็น การออกแบบ (Design)

5. การแปรรูปหน่วยงานภาครัฐ

- ปรับเปลี่ยนการผูกขาดเป็นการแข่งขันอย่างเสรี
- เน้นนวัตกรรมในการหารายได้
- ปรับปรุงศักยภาพทางเทคนิค
- สนับสนุนการบริหารจัดการที่มีความยืดหยุ่นและคล่องตัว

6. บทบาทของภาครัฐและเอกชน และเครื่องมือที่ใช้

Public-Private Roles and Tools		
Finance Delivery	Public Finance	Private Finance
Public Delivery	Direct Government	User Fees
Private Delivery	Contract	Vouchers PPP's

7. Public Private Partnership (PPP)

- รูปแบบที่ใช้โดยทั่วไป คือ Design Build Finance Maintain และ Operate
- PPP มีความแตกต่างจาก Outsourcing คือ
 - เอกชนเป็นผู้จัดหาเงินลงทุน (Capital Cost)
 - เอกชนรับผิดชอบโครงการในหลายระยะ
 - รูปแบบสัญญาจะเป็นสัญญาในระยะยาว
 - ความสัมพันธ์ระหว่างภาครัฐ และเอกชน เป็นในรูปแบบความร่วมมือระหว่างกัน
 - การแข่งขันไม่สูงมาก เนื่องจากเป็นโครงการที่ลงทุนสูงและเป็นข้อผูกมัดในระยะยาว
 - การจัดสรรเงินทุนหรืองบประมาณ เป็นรายปี ไม่ใช่เป็นแบบต้นทุนที่ปรากฏจริง

8. การประเมินต้นทุนและประโยชน์ของ PPP

- ประเมินต้นทุนจากการเปรียบเทียบ Long Term Net Present Value กับ การประเมินโครงการ
- ผลกระทบจากข้อจำกัดของงบประมาณและการจัดลำดับความสำคัญ

9. ปัจจัยสำเร็จของ PPP

- การสนับสนุนจากฝ่ายการเมือง
 - กฎหมายที่เกี่ยวข้องในการจัดทำ PPP
 - การวิเคราะห์ ประเมินผล จากภาครัฐที่มีประสิทธิภาพ
 - กระบวนการจัดซื้อจัดจ้าง
 - สัญญาที่เน้นผลการดำเนินงาน
 - การกระจายความเสี่ยงในด้านต่างๆ
 - การรับประกันรายได้
 - การสนับสนุนจากผู้ที่เกี่ยวข้อง
-

บทที่ 5

Tax Expenditures in OECD Countries

สรุปสาระสำคัญโดยสังเขป

รายจ่ายภาษี หรือ Tax Expenditure เป็นข้อกำหนดหรือบทบัญญัติ ของกฎหมายหรือระเบียบ ในการลดรายได้จากการจัดเก็บภาษีของรัฐบาล หรือการเลื่อนเวลาการจัดเก็บภาษี ให้กับกลุ่มผู้เสียภาษี บางประเภท

รูปแบบของ Tax Expenditure ประกอบด้วย

- การลดหย่อนภาษี (Allowances)
- การยกเว้นภาษี (Exemptions)
- การลดอัตราภาษี (Rate Relief)
- การเลื่อนการจัดเก็บภาษี (Tax Referral)
- การคืนภาษี (Credits)

จากการวิเคราะห์ในเบื้องต้น Tax Expenditure เป็นนโยบายงบประมาณที่มีข้อบกพร่องใน ด้านความยุติธรรม (Fairness) ความมีประสิทธิภาพ (Efficiency) ประสิทธิภาพ (Effectiveness) ความง่าย (Simplicity) และความรับผิดชอบทางด้านการคลัง (Fiscal Responsibility) อย่างไรก็ตาม Tax Expenditure กลับมีแนวโน้มการนำไปใช้เพิ่มขึ้นอย่างกว้างขวาง เนื่องจากในบางครั้งการดำเนินนโยบายผ่าน การใช้เงินงบประมาณเพื่อให้บรรลุวัตถุประสงค์บางประการของภาครัฐ อาจก่อให้เกิดต้นทุนการบริหาร ที่สูงกว่า ดังนั้น การปล่อยให้เอกชนดำเนินการโดยใช้ระบบภาษีเป็นแรงจูงใจอาจทำให้มีประสิทธิภาพ มากกว่า ตัวอย่างเช่น การออมเงินเพื่อวัยเกษียณ (Retirement saving) และการประกันสุขภาพ (Health Insurance) เป็นต้น

เมื่อเปรียบเทียบ Tax Expenditure กับการดำเนินนโยบายรายจ่ายผ่านระบบงบประมาณซึ่ง ต้องผ่านความเห็นชอบของรัฐสภาที่เป็นตัวแทนของประชาชนทั้งประเทศ Tax Expenditure เป็นมาตรการ ที่มีความโปร่งใสน้อยกว่า ผู้กำหนดนโยบายและประชาชนสามารถประเมินผลมาตรการที่ซ่อนอยู่ใน กฎหมายภาษีเหล่านี้ได้น้อยหรือยากกว่าการใช้จ่ายเงินของรัฐบาลผ่านระบบงบประมาณ นอกจากนี้ การ จัดทำโครงการต่างๆ โดยใช้เงินที่ได้รับการจัดสรรผ่านระบบงบประมาณมักมีการประเมินความคุ้มค่าของ

โครงการก่อนและต้องมีหน่วยงานที่บริหารจัดการเพื่อให้การดำเนินโครงการนั้นมีประสิทธิภาพสูงสุด แต่มาตรการ Tax Expenditure หน่วยงานจัดเก็บภาษีมักไม่มีการประเมินความคุ้มค่าหรือผลของมาตรการว่าหลังจากการดำเนินมาตรการแล้วประโยชน์ของมาตรการเป็นไปตามที่ต้องการไว้หรือไม่ หรืออาจถูกเบี่ยงเบนวัตถุประสงค์และก่อให้เกิดผลเสียคือ เกิดช่องทางหลบเลี่ยงภาษีได้มากขึ้น หรือทำให้เกิดการเบี่ยงเบนพฤติกรรมของผู้เสียภาษีที่ไม่ใช่กลุ่มเป้าหมายของมาตรการ แต่ต้องการได้รับประโยชน์จากมาตรการ นอกจากนี้ ผู้ได้รับประโยชน์หรือได้รับการอุดหนุน (Subsidy) ก็ไม่ต้องผ่านการพิจารณาที่ยุ้งยาก

ผลกระทบที่เกิดจาก Tax Expenditure

- **Fairness** : Tax Expenditure อาจก่อให้เกิดความไม่ยุติธรรมกับผู้เสียภาษี โดยในระบบภาษีแบบก้าวหน้า ผู้เสียภาษีที่มีรายได้สูงหรือผู้เสียภาษีในอัตราภาษีสูง มักจะได้ประโยชน์จาก Tax Expenditure มากกว่าผู้เสียภาษีที่มีรายได้ต่ำกว่าหรือผู้เสียภาษีในอัตราที่ต่ำกว่า และผู้ที่ไม่ต้องเสียภาษีก็จะไม่ได้รับประโยชน์จากมาตรการ Tax Expenditure ดังนั้น Tax Expenditure จึงถูกมองว่าเป็นมาตรการในการสนับสนุนคนรวย และเป็นข้อเสียในการที่จะเป็นเครื่องมือด้านนโยบาย
- **Efficiency & Effectiveness** : การประเมินความคุ้มค่าจากการใช้ Tax Expenditure ทำได้ยาก จึงอาจทำให้เกิดช่องทางการหลีกเลี่ยงภาษี และในกระบวนการนำเสนองบประมาณจะไม่มีการเปรียบเทียบ TE กับงบประมาณรายจ่ายประจำปี
- **Complexity** : ทำให้กฎหมายภาษีมีความซับซ้อนมากขึ้น ซึ่งอาจจะเป็นการเอื้อประโยชน์เฉพาะผู้เสียภาษีบางกลุ่ม หรืออาจจะทำให้เกิดผลลัพธ์ที่ไม่ตรงตามวัตถุประสงค์ที่กำหนด
- **Revenue Sufficiency** : ทำให้เกิดความยากลำบากในการประมาณการรายได้ โดยจะส่งผลกระทบต่อความรับผิดชอบด้านการคลัง (Fiscal Responsibility)

บทที่ 6

Intergovernmental Transfers and Decentralised Public Spending

การจัดสรรเงินอุดหนุนและการกระจายอำนาจการใช้จ่ายงบประมาณให้แก่รัฐบาลท้องถิ่น

1. ข้อมูลพื้นฐาน

ในหลายประเทศรัฐบาลกลางได้จัดสรรเงินอุดหนุนให้แก่รัฐบาลท้องถิ่น เพื่อให้รัฐบาลท้องถิ่นสามารถปฏิบัติงานให้เป็นไปตามนโยบายที่รัฐบาลกลางกำหนด อย่างไรก็ตาม การจัดสรรเงินอุดหนุนดังกล่าว มีวิธีการดำเนินการที่แตกต่างกันไปในแต่ละประเทศของกลุ่มประเทศ OECD บทความนี้ จึงมีวัตถุประสงค์เพื่อศึกษาวิจัยและประมวลความรู้ การจัดสรรเงินอุดหนุนแก่รัฐบาลท้องถิ่นที่มีวิธีการที่แตกต่างกันดังกล่าว และยังสามารถนำเสนอสาระสำคัญ และระบบการจัดสรรเงินอุดหนุนที่มีประสิทธิภาพ

2. รูปแบบของเงินอุดหนุนและวิธีการใช้จ่าย การกระจายอำนาจและการให้อิสระทางการคลัง

1. เงินอุดหนุนจากรัฐบาลกลางเป็นแหล่งรายได้ที่สำคัญสำหรับรัฐบาลท้องถิ่น นอกเหนือจากรายได้จากภาษีในท้องถิ่นที่รัฐบาลท้องถิ่นเรียกเก็บเอง รัฐบาลท้องถิ่นมีภาระหน้าที่ต้องปฏิบัติเพิ่มมากขึ้น ทำให้มีรายจ่ายเพิ่มขึ้น แต่การจัดเก็บรายได้ในท้องถิ่นไม่เพียงพอ เนื่องจากรัฐบาลท้องถิ่นไม่มีอำนาจและอิสระทางการคลังที่จะดำเนินการดังกล่าว อิสระทางการคลังในที่นี้หมายถึง สัดส่วนของรายได้ที่จัดเก็บได้เองเปรียบเทียบกับรายได้ทั้งหมดในท้องถิ่นนั้น

2. เงินอุดหนุนจะมี 2 รูปแบบ คือ เงินอุดหนุนแบบมีเงื่อนไข หมายถึง เงินอุดหนุนที่มีการระบุจุดประสงค์ของการใช้จ่ายอย่างชัดเจน และเงินอุดหนุนแบบไม่มีเงื่อนไขซึ่งหมายถึง เงินที่ไม่ได้ระบุวัตถุประสงค์ไว้ รัฐบาลท้องถิ่นสามารถนำไปใช้จ่ายได้ตามที่เห็นเหมาะสม

3. เงินอุดหนุนที่จัดสรรให้ตามกฎหมายและเงินอุดหนุนที่จัดสรรให้ตามดุลพินิจ เงินอุดหนุนทั้งแบบมีเงื่อนไขและไม่มีเงื่อนไขถูกจัดสรรได้ 2 วิธี คือ วิธีที่หนึ่ง รัฐบาลกลางต้องจัดสรรให้รัฐบาลท้องถิ่นตามข้อผูกพันทางกฎหมายหรือตามกฎหมายระเบียบที่ได้กำหนดขึ้น อีกวิธีหนึ่ง คือ รัฐบาลกลางพิจารณาจัดสรรให้เป็นคราวๆ ไป ตามความจำเป็นและเหมาะสม เช่น เงินช่วยเหลือกรณีเกิดภัยพิบัติ เป็นต้น

4. เงินอุดหนุนแบบมีเงื่อนไขที่จัดสรรให้ตามกฎหมายยังสามารถแยกได้เป็น 2 ประเภท คือ อุดหนุนแบบสมทบจ่ายหรืออุดหนุนทั้งก้อนโดยไม่สมทบ ซึ่งขึ้นกับเงื่อนไขตามที่กฎหมายหรือระเบียบกำหนดไว้

5. เงินอุดหนุนประเภททั่วไปและเงินอุดหนุนเป็นก้อน (general purpose and block grants) เงินอุดหนุนทั้ง 2 ประเภทนี้จะมีลักษณะคล้ายกัน คือ เป็นเงินอุดหนุนที่รัฐบาลกลางจัดสรรเพื่อเพิ่ม

รายได้ให้รัฐบาลท้องถิ่น เงินช่วยเหลือประเภทนี้ไม่ได้กำหนดเงื่อนไข จึงไม่มีการควบคุมการใช้จ่ายเงิน แต่อาจต้องกำกับดูแลในเรื่องผลผลิต

6. เงินอุดหนุนเพื่อเป็นรายจ่ายลงทุนและรายจ่ายประจำ เงินอุดหนุนเพื่อช่วยเหลือรัฐบาลท้องถิ่นจะจำแนกเป็นงบลงทุนและรายจ่ายประจำ การจำแนกดังกล่าวเพื่อเป็นไปตามหลักการจำแนกเพื่อจัดทำบัญชีประชาชาติ

3. การเลือกจ่ายเงินอุดหนุนประเภทต่างๆ

แหล่งรายได้หลักของรัฐบาลท้องถิ่น คือ รายได้จากภาษีและเงินอุดหนุน สำหรับจำนวนเงินช่วยเหลือจะแตกต่างกันในแต่ละประเทศ เช่น รัฐบาลระดับมลรัฐได้รับเงินอุดหนุนช่วยเหลือโดยเฉลี่ยร้อยละ 4.3 ของ GDP น้อยที่สุดคือร้อยละ 1.8 ในเบลเยียม และสูงสุกร้อยละ 8.3 ในประเทศเม็กซิโก

สำหรับรัฐบาลท้องถิ่นมีความแตกต่างกันยิ่งขึ้น เช่น รัฐบาลท้องถิ่นในประเทศออสเตรเลียได้รับเงินช่วยเหลือร้อยละ 0.3 ของ GDP ในขณะที่โปแลนด์เป็นร้อยละ 13 และเดนมาร์กร้อยละ 12 ตามลำดับ

ในประเทศที่มีรัฐบาลระดับมลรัฐ มลรัฐจะเป็นผู้ให้เงินอุดหนุนที่สำคัญแก่รัฐบาลท้องถิ่น บางประเทศมีการให้เงินอุดหนุนระหว่างท้องถิ่นด้วยกันในแนวนอนด้วย เช่น ประเทศออสเตรเลีย เบลเยียม และสวิสเซอร์แลนด์

นอกจากนี้ แต่ละประเทศมีการอุดหนุนแตกต่างกัน โดยเฉลี่ยแล้วทั้งรัฐบาลมลรัฐและรัฐบาลท้องถิ่นจะได้รับเงินช่วยเหลือแบบมีเงื่อนไขถึงร้อยละ 55 และมักเป็นเงินช่วยเหลือแบบ มีเงื่อนไข และเป็นเงินสมทบ การใช้เงินช่วยเหลือแบบมีเงื่อนไขในแต่ละลักษณะงานมีความแตกต่างกันเกือบร้อยละ 25 ถูกนำไปใช้ในเรื่องการให้บริการสาธารณะทั่วไป รองลงมา คือ ด้านการศึกษา เศรษฐกิจ ตามลำดับ

4. รูปแบบเงินอุดหนุนและการนำไปปฏิบัติ

รัฐบาลกลางมีวัตถุประสงค์ในการให้เงินอุดหนุนรัฐบาลท้องถิ่น ดังนี้

1. สนับสนุนการให้บริการสาธารณะและการลงทุน สร้างความเสมอภาค รัฐบาลกลางจัดสรรเงินอุดหนุนเพื่อให้รัฐบาลท้องถิ่นมีความสามารถในการให้บริการสาธารณะแก่ชุมชน เป็นการอุดหนุนให้รัฐบาลท้องถิ่นสามารถดำเนินการเพิ่มเติมจากส่วนที่ต้องรับผิดชอบ ซึ่งหากรัฐบาลกลางดำเนินการเองอาจจะไม่คุ้มค่า

2. การสนับสนุนทางการเงิน มีจุดมุ่งหมายประการแรกคือ ต้องการสนับสนุนรัฐบาลท้องถิ่นให้สามารถจัดบริการสาธารณะในพื้นที่ของตนได้ เงินอุดหนุนไม่ควรจัดสรรให้นำไปใช้ในเรื่องของสวัสดิการหรือค่าตอบแทน จุดมุ่งหมายประการที่สองคือ รัฐบาลกลางอุดหนุนทรัพยากรที่จำเป็นในการที่รัฐบาลท้องถิ่นต้องดำเนินงานตามแผนงานใหม่หรือเพิ่มประสิทธิภาพในการทำงาน

3. การจัดสรรเงินอุดหนุนอาจจะใช้วิธีการคำนวณโดยสูตรหรืออาจพิจารณาเป็นคราวๆ ไป ระบบการคำนวณควมมีเหตุผล แต่ในระยะยาวอาจสร้างความไม่แน่นอนได้เช่นเดียวกัน ตัวอย่างเช่น สูตรคำนวณอาจคิดตามร้อยละของภาษีมูลค่าเพิ่มที่รัฐบาลจัดเก็บได้ เมื่อมีการเชื่อมโยงเช่นนี้ รัฐบาลกลาง จึงมักจะขยายฐานภาษีอื่นๆ เพื่อหารายได้เก็บไว้ที่ส่วนกลางมากขึ้น นอกจากนี้ อาจมีการตีความที่แตกต่างกันระหว่างรัฐบาลกลางและรัฐบาลท้องถิ่น ในการให้คำนิยามรายได้ทั้งหมดหรืองบประมาณรายจ่าย ทั้งหมดเหล่านี้ เป็นต้น

Public Budgeting in Hong Kong, China

1

Hong Kong's context

- Political
 - HK's status as a local government of PRC
 - Budgetary autonomy
- Legal
 - Constitutional requirement for a balanced budget
- Economic
 - Restructuring
 - Economic decline
- Social
 - More engaged civil society
 - Aging population

2

Budget formulation

- Key players
- Process
 - *May* – call for estimates
 - *June-Sept* – resource allocation exercise
 - *October* – Policy address
 - *Oct-Dec* – Public consultation
 - *Feb-April* – Appropriations Bill & Estimates presented to Legislative Council

3

Public consultation

- http://www.isd.gov.hk/eng/tvapi/07_ms167.html
- 2008-09 Budget consultation
- Engineer: Logistics and infrastructure are cornerstones of economic development. Elderly man: Health care and welfare deserve more attention. Student: Education and training are major issues. Expatriate man: Environmental protection and conservation are important. Businessman: We must maintain a level playing field for business. Retired person: We love arts and culture. All: We have the right to express our views! Financial Secretary, Mr John Tsang: I am preparing the 2008-09 Budget. We value your opinion. So please make use of this website and let us have your views. Super: www.budget.gov.hk

4

Legislative Council's role

- Composition
- Key player
 - Finance Committee
 - Establishment Subcommittee
 - Public Works Subcommittee
- Weaknesses

5

Structure of public sector

- Core government
 - 12 policy bureaus and 61 departments
- Hybrids
 - Publicly funded
 - Mixed-funded
- SOEs
- Private sector public service providers

6



- Core government (civil service system plus non-civil service contract staff)

- 8

Civil service reform

- Entry/exit
- Compensation
- Conduct and discipline
- Performance management and training

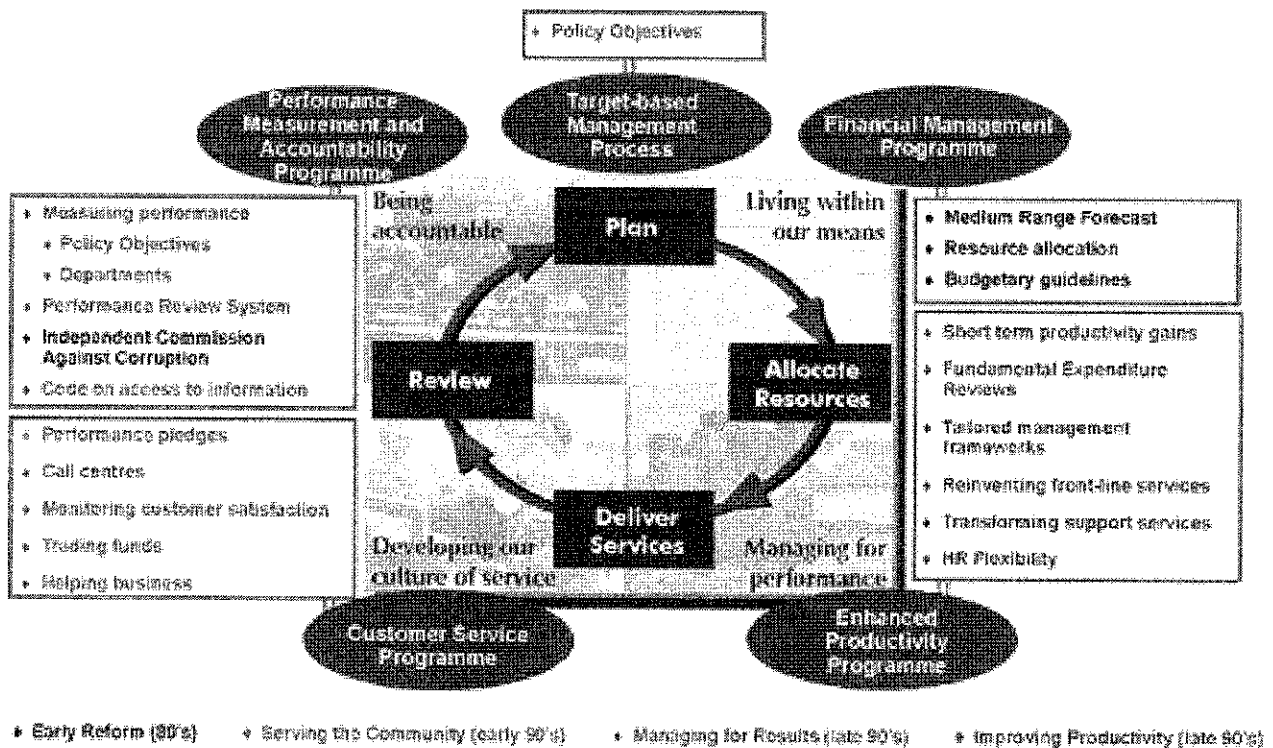
9

Performance and results initiatives

- Official policy
 - Policy objectives
 - Key results areas
 - Policy initiatives
 - Identifying responsibilities
 - Controlling Officers and their reports

10

Public Sector Reform Processes in HK, 1980s and 1990s



Source: Efficiency Unit, HKSARG

11

Problems

- Failure to set targets
- Problems with measures chosen
- Reporting problems
- Decisions based on performance

12

Managerial capacity, flexibility and innovation

- Adaptability
- Transparency
- Accountability
- Improved flexibility (e.g., hrm)
- Innovation?
 - Public private partnerships
 - Organizational re-engineering



2008 OECD Asian
Senior Budget Officials Meeting
Bangkok, Thailand

January 10 -11, 2008

Content

1. Agenda of 2008 OECD Asian Senior Budget Officials Meeting
2. The Development of the Performance Budgeting System in Chinese Taipei
3. (Power Point) Budgeting for Fiscal Space by Prof. Allen Schick
4. (Power Point) Third Party Governance : Transformations in Public Management by Prof. Paul Posner
5. Tax Expenditures in OECD Countries Draft by Joseph Minarik
6. (Power Point) Tax Expenditures in OECD Countries by Barry Anderson
7. (Power Point) Tax Expenditures in Korea by John Kim
8. Intergovernmental Transfers and Decentralised Public Spending by Claire Charbit
9. (Power Point) Intergovernmental Transfers and Decentralised Public Spending by Claire Charbit
10. Provisional List of Participants

1

ANNOTATED AGENDA
5th ANNUAL MEETING OF OECD-ASIA SENIOR BUDGET OFFICIALS

Bangkok, 10-11 January 2008

This meeting is hosted by the Thai Bureau of Budget. The Australian and Korean governments are gratefully acknowledged for their financial assistance.

For further information, please contact Mr. Jón R. BLÖNDAL:
Jon.blondal@oecd.org; Tel: +33-1-45 24 76 59; Fax: +33-1 44 30 63 34

MEETING OF OECD-ASIAN SENIOR BUDGET OFFICIALS
Bangkok, 10-11 January 2008

Thursday, 10 January

- 9:00- 9:30 Keynote Address by the Minister Attached to the Prime Minister's Office**
- **Mr.Thirapat SERIRANGSAN**
- 9:30-9:45 *Group Photo***
- 10:00-10:30 Opening Ceremony**
- **Mr. Vudhibhandhu VICHAIRATANA**, Director-General, Bureau of the Budget, Office of the Prime Minister, Thailand
 - **Mr. Ian WATT**, Permanent Secretary, Department of Finance, Australia
- 10:30-11:00 *Coffee Break***
- 11:00-13:00 Roundtable on Recent Budgeting Developments in Asia**
- This session is designed for participants to make informal presentations on recent budgeting and public expenditure developments in their countries. This allows participants to exchange information on the changes in budgetary systems and the financial management reforms which are taking place in many of the countries in the region and provides a useful opportunity for participants to keep up to date with developments in the region in an informal setting.
- Participants at this year's meeting are accordingly invited to speak briefly on recent developments which may be of interest to others. Given constraints on time within this round table discussion, participants may wish to provide short, written statements to supplement their presentations.
- 13:00-14:00 *Luncheon***

14:00-15:30 Developing Fiscal Space: Overcoming Rigidities in the Structure of Expenditures

Fiscal space is defined as room in a government's budget that allows it to provide resources for a desired purpose without jeopardizing the sustainability of its financial position or the stability of the economy. Fiscal space must exist or be created if extra resources are to be made available for worthwhile government spending.

This session will discuss the specific pressures that limit fiscal space at present, including rigidities in government expenditure programs due to standing (entitlement) legislation and demographic changes. It will also outline the various approaches to reprioritizing expenditure by curbing unproductive spending and at the same time protecting - and reinforcing - productive spending.

The session will be led by **Mr. Allen SCHICK** of the Brookings Institution, Washington, D.C.

15:30-15:45 *Coffee Break*

15:45-17:15 PPP's and Outsourcing: Implications for Budgeting and Accountability

There is a growing trend in many countries for partnering with private and not-for-profit providers for the provision of public services. This includes PPP's (public-private partnerships) and outsourcing (contracting out).

This session will move beyond a discussion of the specific instruments themselves to focus on the implications of their use for budgeting and accountability. For example, how can the budget process best be organized so that potential PPP projects are scrutinised in the same rigorous manner as general expenditures. What arrangements can be made to ensure that accountability by private and not-for-profit providers is not diminished in the provision of outsourced public services?

The session will be led by **Mr. Paul POSNER** of the George Mason University, Washington, D.C.

18:00 *Meeting at Hotel's Lobby & Depart from the Hotel to River City Port*

19:00-21:00 *Gala Dinner Cruise*

Thailand invites participants to a Gala Dinner Cruise on the Chao Phraya River.

Friday, 11 January

9:00-10:30 Integrating Tax Expenditures into the Budget Process

Tax expenditures are losses to the budget from granting certain deductions, exemptions, or credits to specific categories of taxpayers. Tax expenditures are an alternative to direct government spending on policy programs.

Tax expenditures are an important form of government expenditure and is growing in importance in many countries. Furthermore, more and more countries have moved or are considering moving towards fiscal rules that make use of expenditure ceilings. Tax expenditures pose a particular problem in this environment.

This session is design to discuss tax expenditure classification and reporting and how the review and control of tax expenditures can best be integrated into the (expenditure) budget process.

The session will be led by the **OECD Secretariat**.

10:30-11:00 *Coffee Break*

11:00-12:30 Fiscal Relations with Lower Levels of Government

Lower levels of government – both the regional and local levels – are increasingly assuming a greater fiscal role. By definition, they are in a better position to know the specific needs of their respective areas and therefore should be able to deliver government services in a more effective and efficient manner.

The fiscal resources of lower levels of government are often provided in the form of general and/or specific-purpose grants from the national government.

This session will focus on the various forms of fiscal grants and discuss the advantages and disadvantages of each. It will also discuss the necessary preconditions in terms of capacity of lower levels of government in assuming a greater fiscal role

The session will be led by the **OECD Secretariat**.

12:30-14:00 *Luncheon*

14:00-15:00 Report by the OECD

This session is designed to update participants on current and future projects by the OECD in the field of budgeting and public expenditures. It is also an opportunity for participants to identify emerging priority areas for future work, the nature of their interest in the subject and their willingness to participate in particular studies.

15:00 Closing

GENERAL INFORMATION

DISCUSSION FORMAT

Each substantive session will open with a brief overview of the topic by the OECD Secretariat or resource person. The floor will then be opened to all participants for general discussion.

CONFERENCE LOCATION & HOTEL ACCOMMODATIONS

The meeting will take place at the Dusit Thani Hotel, which is located at 946 Rama IV Road in central Bangkok [<http://bangkok.dusit.com>].

Special room rates have been negotiated for conference participants at the Dusit Thani Hotel. Please make reservations directly with the hotel, noting the “OECD-Asia Senior Budget Officials Meeting,” in order to qualify for the special room rates.

REGISTRATION

All participants are requested to complete the attached registration form and return it to the Secretariat ahead of the meeting.

The meeting will commence promptly at 9:30 a.m. Participants are kindly asked to arrive 15-30 minutes in advance in order to complete registration formalities.

DOCUMENTATION

Background documents and/or Powerpoint presentations will be available for each of the five main substantive sessions. The documents will be distributed electronically to all registered participants prior to the meeting.

LANGUAGE

The meeting will be conducted in English.

2



PUBLIC GOVERNANCE AND TERRITORIAL DEVELOPMENT
PUBLIC MANAGEMENT COMMITTEE

OECD-ASIA SENIOR BUDGET OFFICIALS NETWORK

HAND OUT

The Development of the Performance Budgeting System in Chinese Taipei

BANGKOK, THAILAND
10-11 JANUARY 2008

5th Annual OECD-Asian Senior Budget Officials Meeting

The Development of the Performance Budgeting System in Chinese Taipei

Directorate General of Budget, Accounting and Statistics

January 2008

1. Background

It is the responsibility of the public sector to properly allocate limited resources to achieve the program performance, which are also demanded by the people. Therefore we have been dedicated to a review of program management and of the budgeting system in recent years. The mechanism for the conduct of the review of the general program budget under the mid-term program budgeting framework is to make sure that the allocation of the budget to various programs meets respective needs at the budget compilation stage, that there is a link between the program budget review mechanism and the with program execution assessment process, and that the revision of the execution of the program will gradually achieve the ultimate and expected object of the program.

2. The system and practice

(1) Introduction of the mid-term program budgeting system in 2002

The mid-term program budgeting system decides the estimated mid-term quota for the four-year statutory government period with which agencies could control and manage their mid-term programs so as integrate with annual programs and operate in coordination with the appropriate program review agencies to start the primary stage program review to avoid unlimited expansion of demand and to boost the effectiveness in the utilization of resources. After applying the mid-term program budgeting system, the annual expenditure scale has been well controlled so that expenditure over GDP in the year of 2008 is 12.9%, which marks a significant decrease from 16.6% in the year of 2001.

(2) Introduction of a general program budget review mechanism in 2004 to make sure that all agencies compile budgets based on actual need and within quota

The general program budget review meetings or panel discussions are convened for the respective programs during the fiscal year. The main function of this mechanism is to set up a budget review communications platform for the various agencies. Programs subject to the review system are listed as following:

- (a) Programs with common characteristics and for which it is especially worthy of conducting an analysis.
- (b) Programs may overlap with the functions of which the functions of other programs which are being dissolved and for which there may be a need for some integration.

- (c) Programs with a poor performance but still with resource inputs.
 - (d) Programs with a poor execution leading to an out unexpected budget surplus or surplus carrying over to the next fiscal year.
 - (e) Programs meeting supply more than demand.
 - (f) Programs with common expenditures which require an examination of where they can be integrated.
 - (g) Programs with different costing standard which need to be clarified.
- (3) The budget review program has brought about specific results due to the effort of budgeting department and all the related agencies. Here are some examples :
- (a) For the year 2007 budget, the expenditure cut from programs with a lower economic effectiveness and poor performance in execution amounted to NT\$10.2 billion (US\$3.1 billion).
 - (b) In the year 2005, there was a review of the labor housing mortgage loan subsidy program and program expenditure was reduced by NT\$2.5 billion (US\$0.8 billion) after negotiation of the interest rate with the relevant banks.

The preceding expenditure cut which resulted from the use of the general review mechanism could provide finance for more important programs such those for economic development and the strengthening of public security.

- (4) In order to manage every program effectively and to strengthen the performance of the agencies in the assessment process, each agency is requested to set performance objectives and measurement indicators for annual programs so that the results of the annual performance can be examined and reported in accordance with the evaluation guidelines of the program. The results of evaluation may provide a benefit in improving shortcomings in the execution of the program and serve as a reference in future reviews of the budget.

3. Conclusion

The system has not only focused on the allocation of resources, but also on the examination of those programs which are less economic, out-of-date, or unnecessary on the allocation of resources based on the perspective of integration where possible, and on the allocation of budgets resources to the programs which most need it. According to the present mid-term fiscal estimates, the fiscal space will be limited in the next few years. We are dedicated to continuing the reform of the mid-term program budgeting system and to the use of the program review mechanism under the aims of allowing for the proper allocation of resources and the simplification of budgeting system.

3

BUDGETING FOR FISCAL SPACE

Allen Schick

Asian OECD Senior Budget Officials
Meeting

Bangkok, Thailand

January 2008

Alternative Concepts of Fiscal Space

Sustainability

The availability of budgetary room that allows a government to provide resources for a desired purpose without any prejudice to the sustainability of a government's financial position.

Peter Heller, IMF 2005

Development

The financing that is available to government as a result of concrete policy actions for enhancing resource mobilization, and the reforms necessary to secure the enabling governance, institutional, and economic environment for these policy actions to be effective for a specific set of development objectives.

Rathin Roy and others, UNDP 2007

Budgeting

The money available for policy initiatives within an annual or medium term budget framework.

How the Fiscal Space Concept is Applied

All Countries

To measure the money available for policy innovation consistent with medium to long term fiscal sustainability

Low Income Countries

To assess the opportunity for additional spending to promote development, thereby stimulating future economic growth and increases in government revenue

Middle Income/Developmental Countries

To promote rapid development without undue risk to the government's future fiscal position

Highly Developed Countries

To assess the resources available for allocation through annual or medium-term budget decisions

3

Fiscal Space has Different Meanings to Countries at Different Stages of Development

Low Income Countries

- The key question is how to create fiscal space for countries that have inadequate tax bases, chronic financial imbalances, and compelling need to invest in human and physical resources
- The concept of fiscal space was devised in response to discredited policies of international organizations that required poor countries to adopt austerity programs when they faced economic stress
- Fiscal space justifies policies that may worsen current financial imbalances but would promote growth and thereby enlarge the future scope of public expenditure

Developed Countries

- The key question is how to rationally allocate the space that is available through economic growth, revenue policy and savings
- The opportunity to enlarge future space through growth-stimulating budget policies is limited

Middle-Income Countries

- The opportunity to create fiscal space depends on variables such as the tax revenue/GDP ratio, spending on infrastructure and other investment, and budget rigidity
- These variables differ greatly among middle-income countries, and so too does their capacity to create space

4

Fiscal Policy for Growth

- Growth promoting fiscal policy in developed countries generally is counter cyclical, and focused on remedying short term economic weakness
 - In poor countries, economic weakness may generate a procyclical response under pressure from international organizations (stabilization) or capital markets (lack of funds)
- Many developed countries recognize that investment in human and physical capital and increased savings can raise the long term potential of the economy
 - Many poor countries under spend on investment and have inadequate savings, leading to deterioration of long-term growth potential
- Recent work by the World Bank and IMF have suggested that some poor countries would benefit from fiscal policy that emphasizes both stabilization and growth
 - But case studies of various countries suggest that inadequate investment/savings is not a hindrance to growth in all countries
- Fiscal policy for growth must be country specific and take account of existing impediments to growth
 - It must also take account of whether there would be payback from additional expenditure

5

Budgeting is the Process of Allocating Fiscal Space

- The fiscal space concept is based on what budget makers actually do when they allocate money.
 - It makes few changes in the practice of budgeting.
- It recognizes that budgeting is inherently incremental, allocating resources that are available for policy initiatives.
 - Although the budget covers all expenditures, decisions are made at the margin.
- If there were no fiscal space, there would be no need for budgeting.
 - Government could continue what it did the previous year without all the stresses of budgeting.
- The fiscal space concept adds a medium or longer term dimension to budgeting.
 - It requires consideration of how future space would be impacted by current decisions.

6

Incremental Budgeting and Fiscal Space

- Major reforms during the past half century attempted to uproot budgetary incrementalism
 - The fundamental aim was that existing and proposed programs should compete on an equal footing for limited resources
- Zero based budgeting was the most far reaching effort to uproot incrementalism
 - As applied, ZBB was more a form of marginal analysis
- Incrementalism has triumphed in every country
 - Incrementalism has survived because it reduces conflict and eases the task of compiling the budget
- Incremental budgeting focuses on allocating additional resources and marginal reallocations in ongoing programs
 - Over time, incremental budgeting does accumulate to major changes in government policy
- MTEF has the potential to institutionalize incremental budgeting
 - This explains why MTEF, in contrast to previous reforms, has been successful
- The starting point for budget decisions in the MTEF is the baseline (or estimates)
 - The baseline projects future budgets assuming no change in current policy

7

Fiscal Space is Measured in Terms of Fiscal Sustainability

- In assessing “room” for policy initiatives, it is necessary to consider the long-term impact of additional expenditure, not only whether space is available in the annual budget
- In the absence of a medium-to-long-term horizon, politicians may take actions that deprive future governments of fiscal space
- The critical question is whether creating space (low-income countries) or spending space (high-income countries) will impair the long term sustainability of public finance
- Governments can measure space and sustainability by projecting future conditions or by estimating the present value of future conditions
- Baseline projections can be extended to the long-term, using methods similar to those applied in MTEF
- Discounting entails measuring the current fiscal balance by estimating the present value of future revenues and expenditures
- Measuring sustainability is especially important when low-income countries debt finance spending increases in the expectation that doing so will create future fiscal space

8

The Shrinkage of Fiscal Space in Developed Countries

- Fiscal rules that constrain budget aggregates
 - The potency of fiscal rules depends on how they are enforced
- Political resistance to tax increases
 - The recent trend in most developed countries has been to reduce taxes
- Baseline projections protect existing programs and built-in increases
 - This tendency is strongest when the baseline is adjusted for projected price changes
- Growth of entitlements and other mandatory spending
 - In many countries, expenditures are more rigid than in the past
- Demographic trends compel government to spend more on pensions and health care
 - The problem is greatest in countries that do not prefund future obligations
- The spread of fiscal decentralization
 - This trend requires central governments to transfer a large portion of revenue to subnational governments
- Ad hoc budget decisions
 - Political pressures and other factors now impel governments to allocate money yearround, not only during budget season

9

Enlarging Fiscal Space

- Many tactics for creating space are perennial features of budgeting
 - Enlargement is likely to be marginal in high-income countries, potentially very significant in low-income countries
- Generating additional revenue through changes in tax policy
 - The lower revenue is a proportion of GDP, the greater the prospect for boosting revenue
- Reallocation from lower to higher priorities.
 - This is difficult in all governments, including those that invest in program evaluation, but spending units often adjust expenditures without vetting the changes through the budget process
- Asset sales and privatization
 - When these transactions are booked as current revenue, government may actually shrink future space
- Public Private Partnerships
 - These transactions can enlarge space for investment provided they are well structured, risks are assessed and limited in advance, and there are genuine efficiencies in relying on private providers

10

4

THIRD PARTY GOVERNANCE: Transformations in Public Management

Paul L. Posner
George Mason University
January 10, 2008

Study of Selected OECD Nations

- ▣ Third Party Governance and Transformations in Public Management
- ▣ Internal Reforms to Promote Efficiency
- ▣ Growing Use of Indirect Governance Tools to Engage Other Sectors
- ▣ Impetus and Rationale
- ▣ Implications for Performance and Accountability
- ▣ Implications for Budgeting

Metaphors

- ▣ Hollow state
- ▣ Disarticulated state
- ▣ Third Way
- ▣ Third party governance
- ▣ Privatization
- ▣ Hiving off, boarding out, outsourcing
- ▣ Devolution
- ▣ Governance, not government
- ▣ Network management
- ▣ Not your father's public administration

Impetus for Third Party Governance

- ▣ Fiscal constraints
- ▣ Rising public expectations for performance
- ▣ Global economies and pressures
- ▣ Rise of “wicked problems” on the agenda for public action
- ▣ Political vulnerabilities of leaders in a 24-7 media era
- ▣ Increase in private market interest in public services

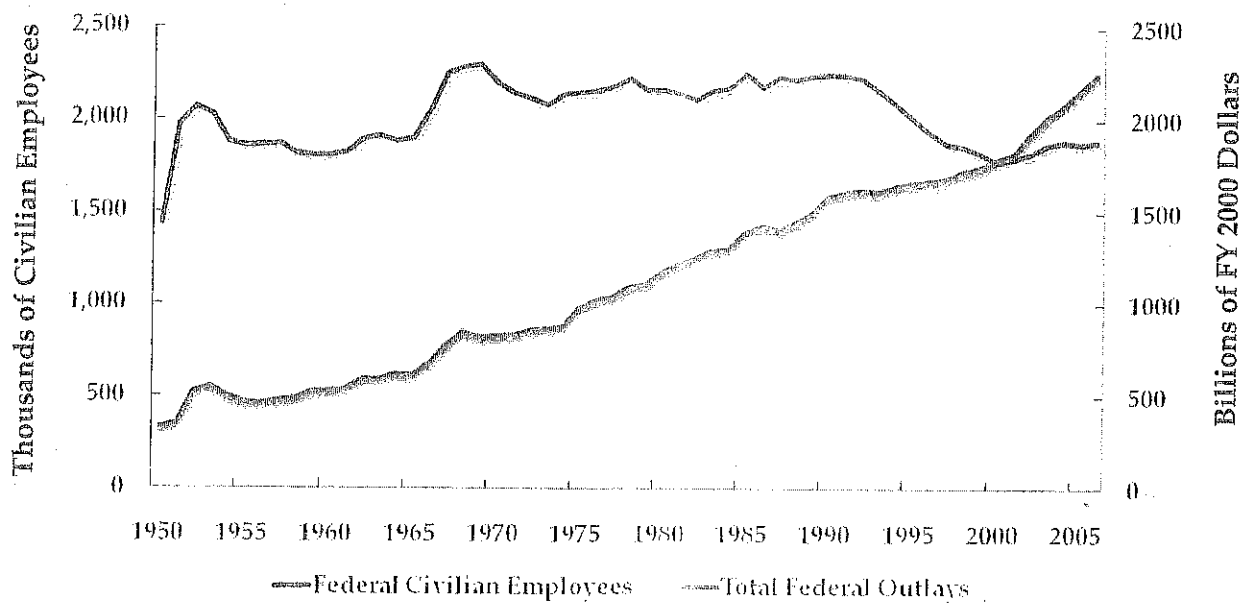
External Governmental Strategies

- ▣ Business oriented approach to government
- ▣ Performance goals and contracting
- ▣ Shift from traditional bureaucracies to quasi-autonomous units
- ▣ Shifting accountability from inputs to results
- ▣ Replacing monopolies with competitive suppliers
- ▣ Greater reliance on market institutions

Internal Governmental Strategies

- ▣ Focus on replacing hierarchical controls with incentives
- ▣ Separating Financing From Provision
- ▣ Instilling greater competition
- ▣ Shifting accountability from inputs to results
- ▣ Promoting greater managerial flexibility
- ▣ Internal Tools
 - Contracts with ministries
 - Government franchise and revolving funds
 - Government corporations
 - Quango's and other nondepartmental public bodies

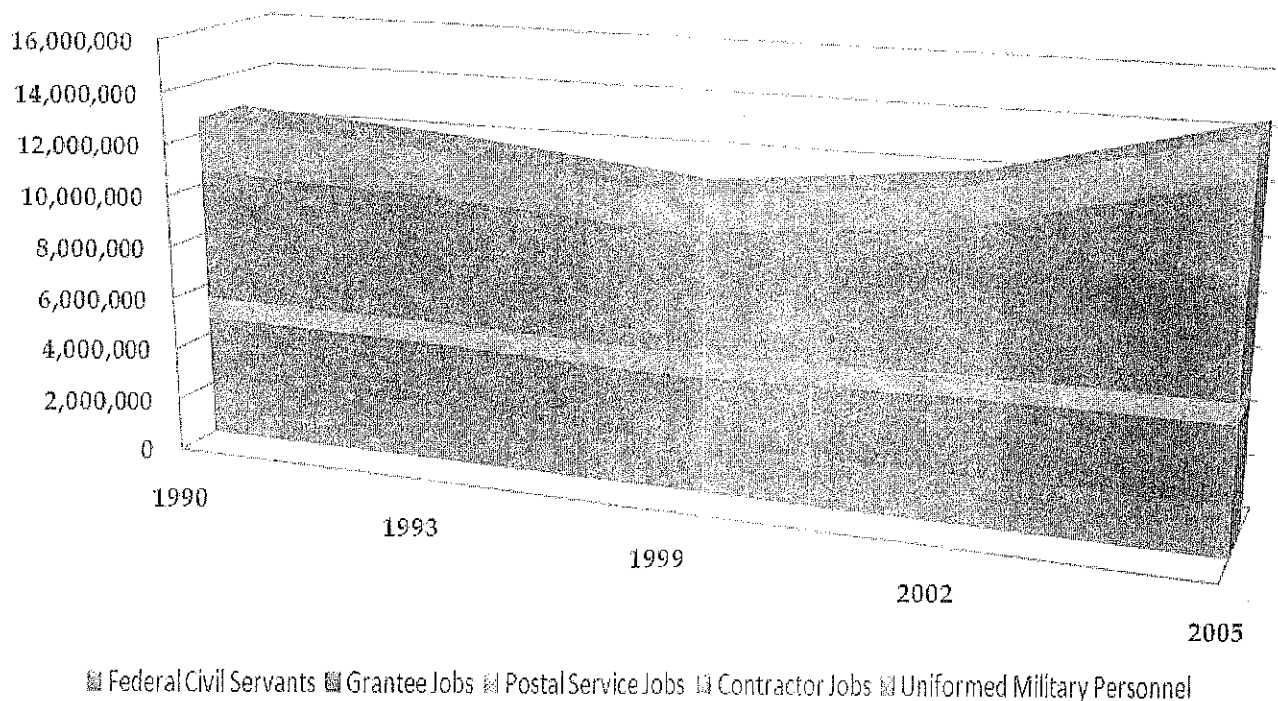
Federal Civilian Employment and Outlays (Fiscal Years 1950 – 2006)



Note: Executive branch civilian employees excluding postal service.

Source: Office of Management and Budget.

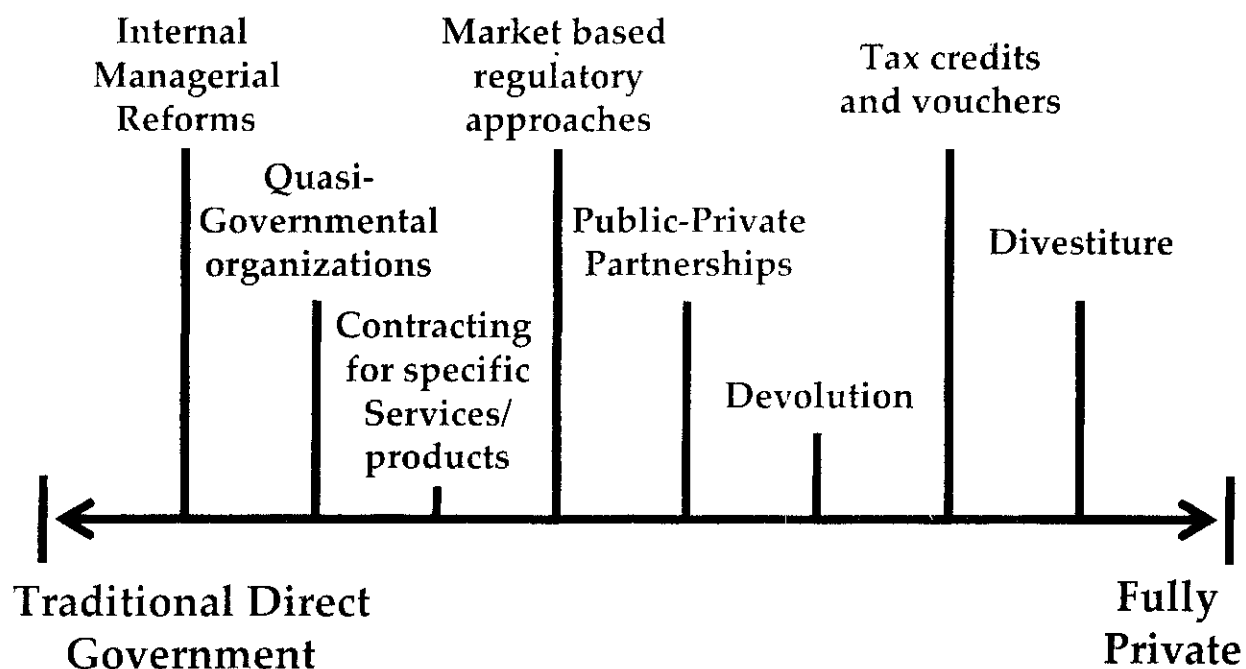
The True Size of Government (Fiscal Years 1990 – 2005)



Tools of Government

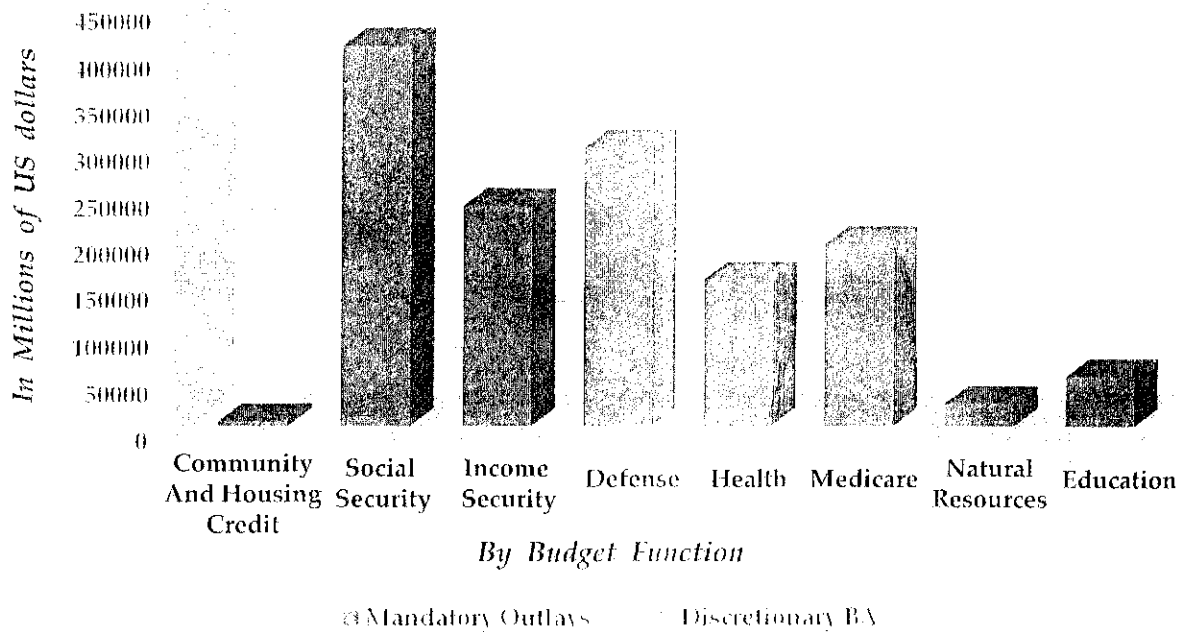
- ▣ DIRECT GOVERNMENT
- ▣ GRANTS
- ▣ LOANS/GUARANTEES
- ▣ TAX EXPENDITURES
- ▣ INSURANCE
- ▣ PRIVATIZATIONS
- ▣ REGULATION

Continuum of Indirect Governance Tools



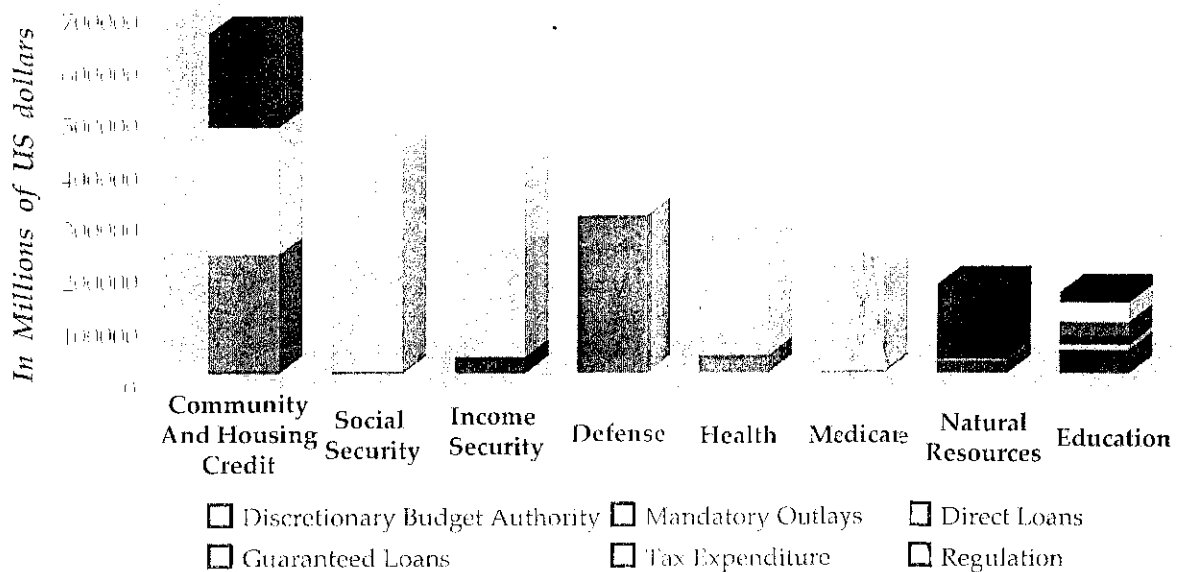
Total Federal Effort in FY 2000

(by Budget Function and in millions of dollars)



Total Federal Effort in FY 2000

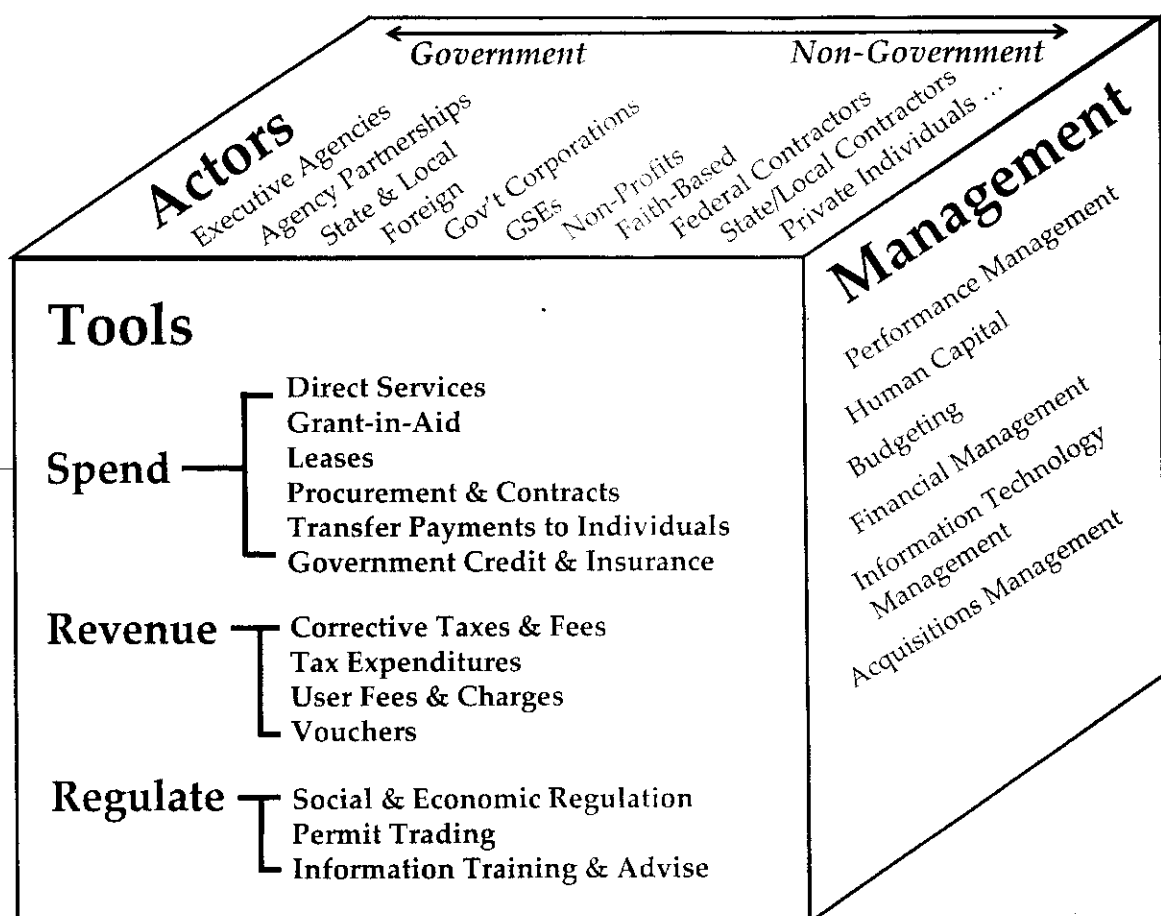
(by Budget Function for Selected Budget Functions)



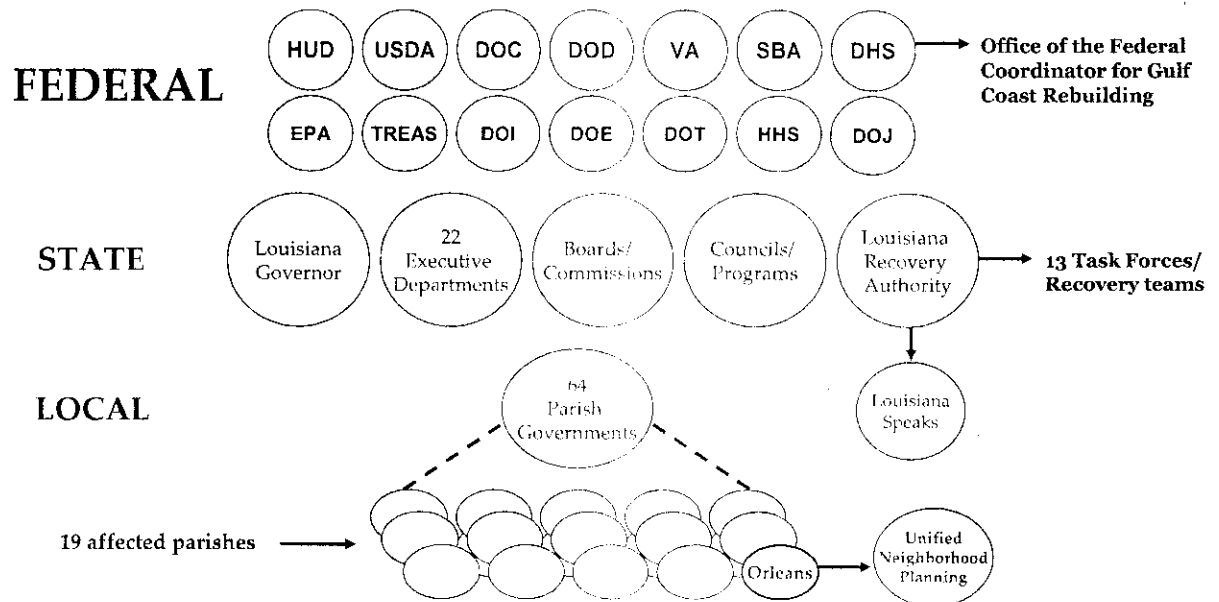
* Regulatory Costs are the mid-point of a range estimate for annualized costs. Direct Loans are measured by loan disbursements, and guaranteed loans are the face value of the loan guarantee.

Shift in Public Management

- ▣ From program/agency to tools and actors
- ▣ From hierarchies to networks
- ▣ From public vs. private to partnerships
- ▣ From command/control to negotiation
- ▣ From management skills to “enablement”
- ▣ From internal controls to design



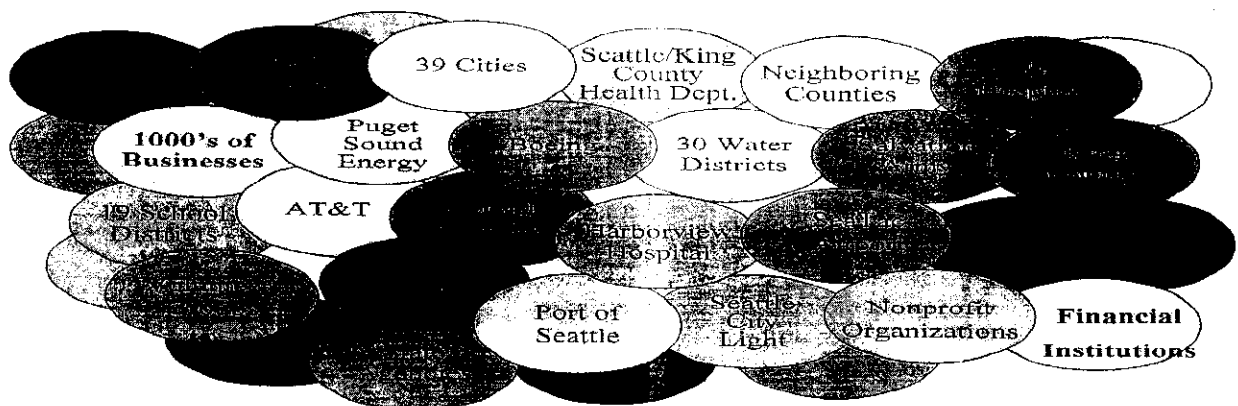
Rebuilding Involves Networking Among Sectors: Government Stakeholders in Louisiana



State and Local Fragmentation

Current Disaster Planning Efforts:

39 cities, 30 fire districts, 19 school districts, 16 sewer districts, 32 water districts, 19 hospitals, Port of Seattle, American Red Cross, Freight Mobility Roundtable, utility providers, private sector, etc.



Advantages of Indirect Government

- ▣ Expands reach of government
- ▣ Access skills and technology
- ▣ Leverage additional financing
- ▣ Promote efficiency
- ▣ Access to clients
- ▣ Reflect diverse local values and interests
- ▣ Gain legitimacy

Public Managers and Budgeters Need Help

- ▣ More demanding context for policy design and oversight
- ▣ Little knowledge of networks
- ▣ Poor understanding of tools
- ▣ Ambiguity in defining and measuring governmental budgetary implications

Unique Accountability Challenges

- ▣ Accountability to multiple constituencies
 - Multiple actors empowered to bargain
- ▣ Third parties enjoy leverage
 - Political resources
 - Voluntary participation
 - Monopolies over beneficiaries
 - Information asymmetries
- ▣ Complex implementation chains

Unique Performance Problems

- ▣ Goal diversion
- ▣ Fiscal windfalls
- ▣ Rent seeking
- ▣ Moral hazards
- ▣ Adverse selection
- ▣ Incentives for inefficiency
- ▣ Opportunistic partners
- ▣ Less public transparency – “too many hands”

New Dimensions for Performance and Accountability

- ▣ **Tool selection** – are tools selected to reinforce each other or do they work at cross purposes?
 - Determination of public vs. private should be based on full cost-benefit analysis
 - Permit public and private to compete
- ▣ **Tool design** – are incentives built in to encourage ownership and accountability by third parties?
 - Fixed price contracts
 - Capitation and closed ended grants
- ▣ **Third party networks** – are the incentives and interests aligned?
 - Selection of “principled agents
- ▣ **Oversight** – does government have the capacity and authority to effectively oversee the variety of third parties?
 - Performance based contracts
 - Too big to fail?
- ▣ **Public Transparency** – Are roles and responsibility clearly delineated?

Privatization: A Multi-Faceted Concept

Privatization Pressures

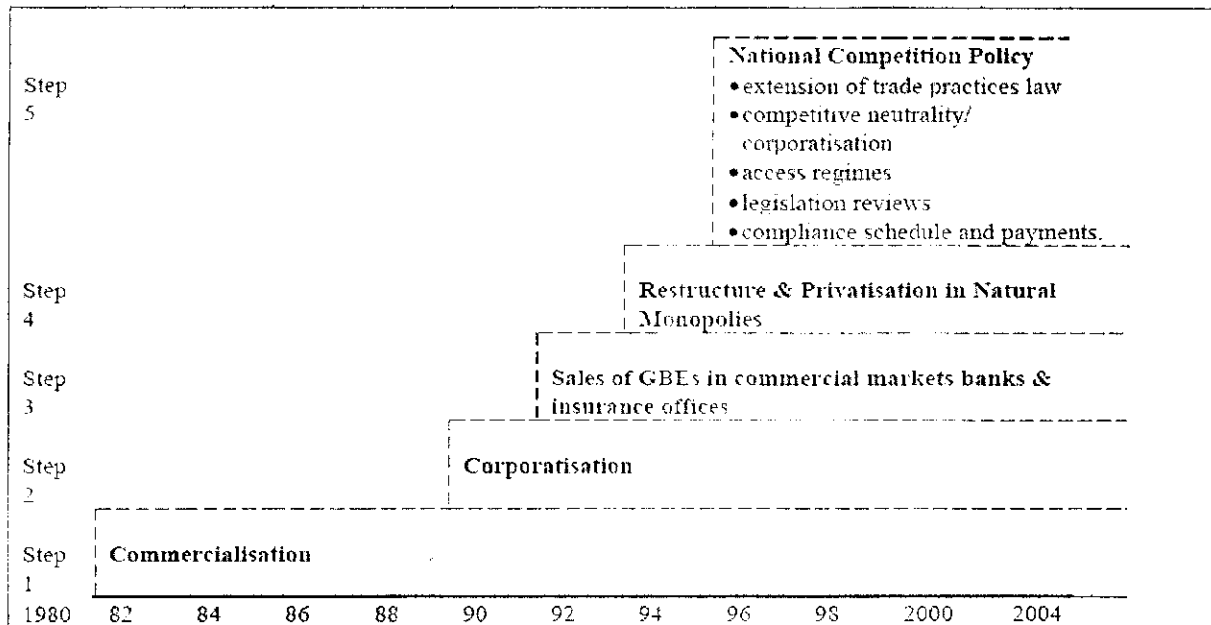
- ▣ Supplant monopolies with competition
- ▣ Increase financing for public initiatives
- ▣ Improve technical capacity
- ▣ Promote greater flexibility

Public-Private Roles and Tools

Finance Delivery	Public Finance	Private Finance
Public Delivery	Direct Government	User Fees
Private Delivery	Contract	Vouchers PPP's

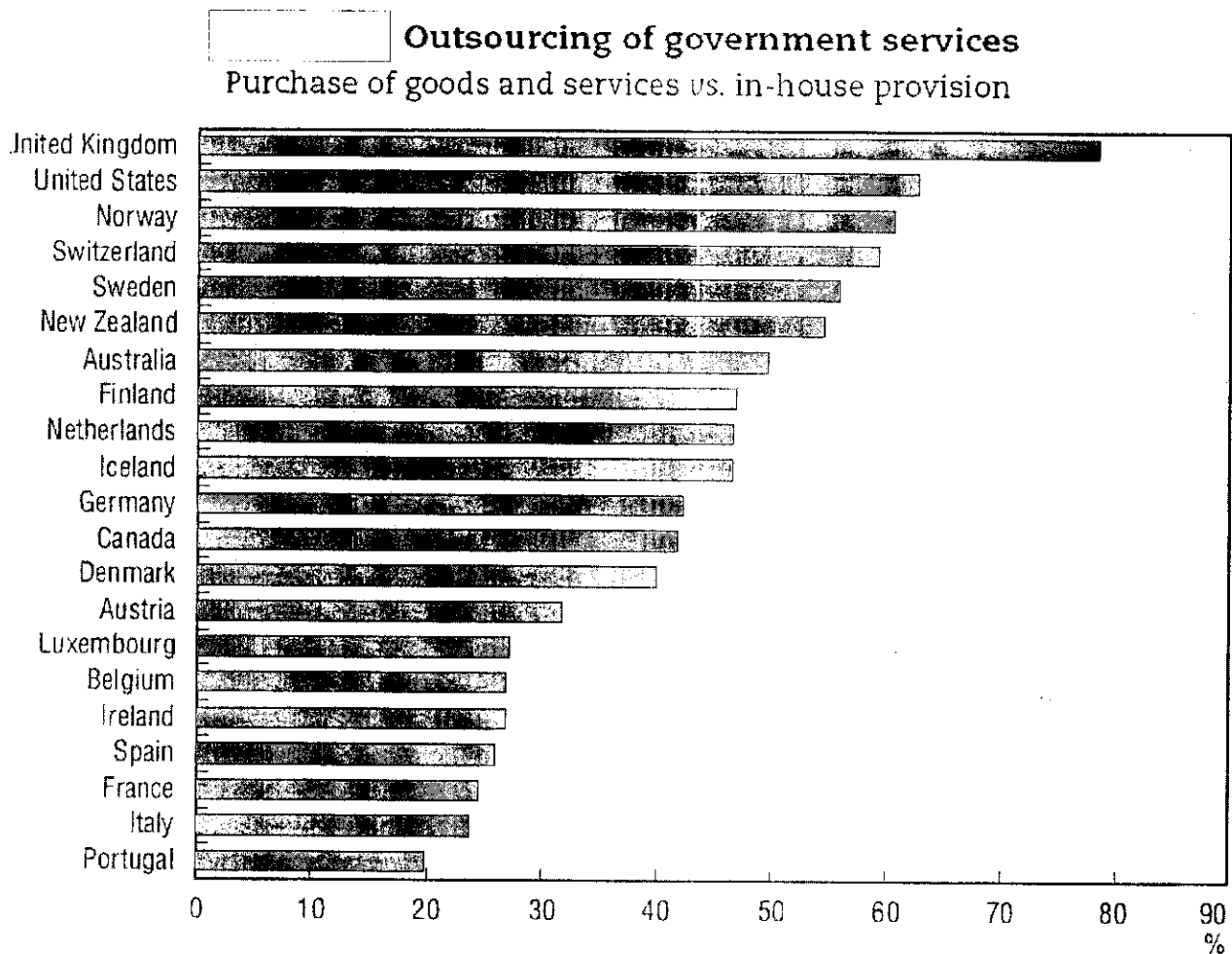
Case Study: Australia

Figure 1.6. GBE Reform Strategies and Timing : Australia



Types of services outsourced

- ❑ Support services – non critical to mission and easily measured. Examples including building cleaning, guard services
- ❑ Information technology and other back-office functions – economies of scale,
- ❑ Traditional core government activities – prisons, food inspection, audit office, welfare administration, education, health care.
- ❑ Infrastructure assets – public private partnerships



Benefits gained from private provision

- ▣ Savings considerable. 33 percent savings in U.S. federal government from 2000 outsourcing initiatives.
- ▣ UK – 20 percent savings, 15 percent in Australia
- ▣ US - \$6 billion savings achieved over four years
- ▣ Economies of scale through shared services
- ▣ Enhanced capacity and access to technology
- ▣ Improved public sector productivity when they compete with private firms

General Privatization Concerns

(1/2)

- ▣ Lack of competition reduces rationale for private over public
 - Exclusivity at outset- sole source
 - Overdependence over time - indispensable
 - From competition to monopoly - entropy
- ▣ Accountability and principal agent issues
 - Difficulty in specifying outputs
 - Competition not always available
 - Low balling and overpromising
 - Risk shifting to government through cost plus contracts
- ▣ Capacity of government to oversee contracts
 - Exodus of government employees to contractors

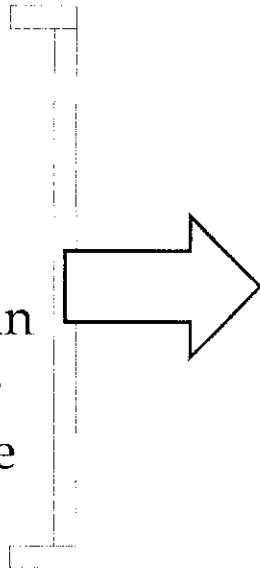
General Privatization Concerns

(2/2)

- ▣ Cost shifting and cherry picking
- ▣ Inherently governmental functions
 - Public ensures we get right things done
 - Private ensures we do them right
- ▣ Transparency - assigning credit and blame
 - Private contractors' information not publicly accessible
 - Laws on public accountability and redress may not apply

Public Private Partnerships For Assets

- ▣ B = Build
- ▣ D = Design
- ▣ F = Finance
- ▣ L = Lease
- ▣ M = Maintain
- ▣ O = Operate
- ▣ P = Purchase
- ▣ T = Transfer



- ▣ DB – contracts with public for design and construction
- ▣ FDBOM – private role in all phases
- ▣ BOT – private transfer to public
- ▣ PMO – sale from public to private
- ▣ LDO – private lease of public facilities
- ▣ LO/LPO – public lease/public lease purchase

Public Private Partnerships

- ▣ Classic PPP – Design, build, finance, maintain and operate over many years
- ▣ Different from traditional outsourcing
 - Private financing of up front capital costs
 - Private responsibility for multiple phases of project
 - Long term nature of contract
 - Relationship between public and private collaborative rather than arms length
 - Competition limited due to high capital financing and long term nature of commitment
 - Budgetary treatment tends to annualize costs, rather than recognize up front

Public Private Partnerships: Rewards

- ▣ Private Sector Brings Capabilities
 - Financing
 - Capitalize underutilized assets
 - Technical expertise
 - Market efficiencies
 - Integrated management across all phases of projects including maintenance
- ▣ Benefits include greater efficiency and savings
 - UK – 90% on-time completion, compared with 30% for public projects
 - UK – 75 percent of projects meet or exceed performance expectations

Public Private Partnerships: Concerns

- ▣ Risks from Private Participation
 - Public values and support – concern over fees and control
 - Budgetary control
 - Contingent Liabilities – how much risk is government responsible for?
 - Oversight and Accountability
 - Truncated Competition

Public Private Partnerships: Budgetary Issues

- ▣ Budgetary control can be eluded
 - Replacement of up front funding with annualized funding stream may undermine discipline
 - Creation of long term mandatory payment commitments
 - Potential loss of revenue stream for public projects
 - Emergence of contingent liabilities
 - ▣ Explicit liabilities such as guarantees
 - ▣ Implicit liabilities for services with inelastic social demands
 - Eurostat 2004 decision results in classification of PPP's as private reflecting private risk for construction/availability

Assessing Costs and Benefits of PPP's

- ▣ Cost assessment involves comparing long term net present value tradeoffs for projects with traditional approaches
 - + Potential efficiency of private financing and provision
 - - Lower cost of capital of public sector
- ▣ Consequences for overall budget constraint and spending priorities
 - Potential lowering of near term price of capital
 - ▣ Can promote a larger number of effective projects
 - ▣ Can promote lower value projects
 - Increased importance of budgetary capacity to
 - ▣ Institutionalize long term perspective
 - ▣ Assess prospective costs and benefits over time
 - ▣ Assess potential affordability of changes in allocations for capital against near and long term budget constraint
 - ▣ Measure and budget for future commitments and contingencies
 - ▣ Assess potential social affordability of capital user charges for beneficiaries

PPP Success Factors

- ▣ Political leadership support
- ▣ Legal frameworks to ensure enforcement of contracts
- ▣ Effective governmental analysis and monitoring
- ▣ Competitive procurement
- ▣ Performance based contracts
- ▣ Explicit risk allocations
- ▣ Guaranteed revenue stream
- ▣ Support from stakeholders including unions, public clients, other interests

The Role of the Budget Process

Does the budget process encourage reliance on indirect tools of governance?

- Shared costs with other sectors lower budgetary costs
- Transparency is often less pronounced for indirect tools
- Budgetary treatment often fails to capture full costs and risks up front
 - ▣ Public private partnerships
 - ▣ Government corporations
 - ▣ Tax expenditures
 - ▣ Loan guarantees
 - ▣ Insurance
- Role of limits on full time employees

Concerns in the Budget Process

Tool	Transparency	On Budget	Up Front	Ex Post
Direct	X	X	X	X
Contract	X	X	X	?
Grant	X	X	X	?
PPP	?	X	?	?
Loan	?	X	Credit Reform	X
Guarantees	?	X	Credit Reform	X
Tax Expenditure	X	X	?	?
Government Corporation	?	?	?	?

Concluding Quotes

- ▣ “Public and private sectors are alike in all unimportant respects”
- ▣ “We don’t want workout coaches to take over from surgeons just because their clients are healthier”
- ▣ Isadora Duncan to George Bernard Shaw
 - “If we had a child together, it would combine my beauty and your brains.”
 - Shaw declined, horrified at the prospect that their union might produce the opposite- a child with her intellect and his looks.

5



PUBLIC GOVERNANCE AND TERRITORIAL DEVELOPMENT
PUBLIC MANAGEMENT COMMITTEE

OECD-ASIA SENIOR BUDGET OFFICIALS NETWORK

TAX EXPENDITURES IN OECD COUNTRIES
DRAFT (2) - 17-Dec-2007

Joseph J. Minarik
Committee for Economic Development
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BANGKOK, THAILAND
10-11 JANUARY 2008

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TAX EXPENDITURES IN OECD COUNTRIES

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INTRODUCTION

Tax expenditures – broadly defined as provisions of tax law, regulation or practice that reduce or postpone revenue for a comparatively narrow population of taxpayers – have been a serious concern of budget and tax analysts for almost half a century.¹ The concern is that tax expenditures have ill effects on both budget and tax policy, and that both political and policymaking considerations make tax expenditures easier to enact, and less likely to undergo rigorous review and repeal, than equivalent but more straightforward spending programs.

Though the concept of tax expenditures was first identified and analyzed in the United States, the concern about the issue now extends across nations. Accounting in many countries suggests that the use of tax expenditures is pervasive and growing.² At any time, the possibility that a back channel for resource allocation could lead to inefficient government “spending” would be troubling. When government budgets are too commonly in excessive deficit, the concern is only greater.

Accordingly, the Organization for Economic Cooperation and Development (OECD) has decided to devote its attention to this issue, along with associated and similar budgetary questions. The Senior Budget Officials group put a paper on *Off-budget and Tax Expenditures* on the agenda of its 2004 meeting in Madrid,³ following previous work on tax expenditures by the OECD Centre for Tax Policy and Administration.⁴ The World Bank has evidenced similar concern in its report, *Tax Expenditures – Shedding Light on Government Spending through the Tax System*.⁵ Such concern and attention has contributed to some improved and extended procedures of tax expenditure reporting, review and control by the OECD countries.⁶ Still, there is considerable room for improvement. There is a perceived need for greater understanding of the issue, of the trend in tax expenditures, and in best practice with respect to their enactment, budgetary reporting, and review.

An important and timely associated issue is that some OECD countries have enacted or are considering fiscal rules that make use of expenditure ceilings. The handling of tax expenditures

¹ Surrey, Stanley S., *Pathways to Tax Reform: The Concept of Tax Expenditures*, Cambridge: Harvard University Press, 1973, based on work done by the author in government service in the late 1960s, may have been the earliest full explication of this concept.

² Polockova Bixi, Valenduc, Swift (2004).

³ Kraan (2004).

⁴ OECD (1984), OECD (1996), OECD (2003).

⁵ Polockova Bixi, Valenduc, Swift (2004).

⁶ Koiwa (2006).

under such a rule is critical, because a systematically lesser degree of budgetary control on tax expenditures, as opposed to spending narrowly defined, could direct increasing flows of what would – and often should – be “spending” through the tax systems of all of the affected nations.

All of these considerations suggest that continued and even greater attention to the use of tax expenditures would be timely and worthwhile. This paper will address the issue from several directions. A key part will be a survey of the level, and change, of the number and revenue effect of tax expenditures across the largest OECD countries. An analysis of these data will suggest the underlying forces that have led to the prevalence of tax expenditures, and the tax, efficiency, and fiscal implications of these trends.

Further discussion will identify best practices regarding the reporting of tax expenditures. Questions regarding the review (such as it is) of tax expenditures in the policy process will be explored, including some ideas that have been proposed but not implemented. Finally, additional analysis will put these best practices into the particular context of budget rules, especially spending-based rules. In combination, these discussions should address a broad range of issues of government finance, from policymaking to tax and budget efficiency, and on to fiscal responsibility and rulemaking.

POLICY BACKGROUND

From the very earliest analyses, there was a strong sense that tax expenditures were an inferior form of budget policy. Tax expenditures were believed to be unfair, distortionary and costly, but also to be prone to rapid growth in both number and size, and resistant to eradication – in effect, to be a non-native plant in the garden of government-program alternatives. Logically and for purposes of discussion, it is worth separating the ill effects of tax expenditures that we might or do have from the tendency of tax expenditures to multiply and grow regardless of those flaws and failings.

Theoretical Allegations: Why Are Tax Expenditures Bad?

Tax expenditures are enacted because there are, at least in some quarters and in some instances, perceived legitimate reasons for their use. The pursuit of some public objectives might be administratively costly through conventional government spending programs, and the employment of private effort using incentives in the tax system, directed through perhaps differing private preferences, might be thought to be more efficient. Instances of perceived underconsumption of private goods resulting in adverse externalities, such as retirement saving or health insurance, are prominent examples. In such instances, it might be thought that close government supervision is not necessary, and use of a tax expenditure might gracefully relieve the bureaucracy of unneeded obligations.

Despite this rationale, and admittedly not in every case, there is concern that tax expenditures too often have proved to be less than optimal tools for their designated objectives. Perhaps the simplest framework to categorize the long-alleged flaws of tax expenditures is the equally long-lived taxonomy of the objectives of tax policy: fairness, efficiency and effectiveness, simplicity, and fiscal responsibility.

Fairness. Tax expenditures are alleged to be unfair both in the likelihood of undeserving groups of taxpayers to obtain them and their benefits, and in their operation once they have been enacted.

It is argued that the least needy in society are probably the most capable of influencing the legislative process to obtain the benefit of tax expenditures. Though it is hard to judge whether this bias would be more likely to affect the enactment of tax provisions than spending programs, it does have the ring of truth.

Selective and lucrative tax expenditures are most usually those that provide advantages for income from capital,⁷ or for self-employment, rather than labor. Those who own wealth, including businesses, tend to be those with higher incomes.

There is the at least superficially reasonable argument that the well-to-do are the most capable of influencing the legislative process. Reinforcing this point, there is the recognition that, at least in the United States, tax expenditures can be established by practice or in regulation, as well as by law. It would not be surprising if those most equipped to look beyond the relatively (though usually not absolutely) straightforward tax instructions into the minutiae of regulations and practice would be those with the most resources.

Once tax expenditures are in place, they are likely to benefit well-off taxpayers more than the rank and file. In progressive tax systems, the well-to-do simply have more tax liability in the first instance, and so have more to gain from tax expenditures. To the extent that tax expenditures are complex, and confront those who wish to claim the tax benefits with complex tasks, the most well-to-do are most likely to have the financial and technical knowledge to take advantage of those opportunities.

There is also a particular aspect of the tax law that makes tax expenditures most likely to benefit upper-income taxpayers. Under a progressive system, any tax expenditure that reduces taxable income, or that postpones the recognition of taxable income, will benefit most those taxpayers who are in the highest tax-rate brackets. Those who are not taxable do not benefit at all from tax expenditures structured in that way. This effect has been labeled an "upside-down subsidy," and has been considered a disadvantage of tax expenditures as a policy tool.⁸ This upside-down effect can be defeated by using non-wastable tax credits – that is, tax credits that are payable in full to taxpayers even if the credits exceed the amount of tax liability – at the cost of additional

⁷ This point, of course, abstracts from the argument by some that the appropriate individual tax system, and therefore the appropriate reference tax system, is a consumption tax that would not tax income from capital at all.

⁸ Surrey, Stanley S., and Paul R. McDaniel. "The Tax Expenditure Concept and the Legislative Process," in *The Economics of Taxation*, edited by Henry J. Aaron and Michael J. Boskin (121-44), Washington, DC: Brookings Institution Press, 1980; Jane G. Gravelle, "Tax Expenditures," in *NTA Encyclopedia of Taxation and Tax Policy*, Second Edition, edited by Joseph J. Cordes, Robert D. Ebel, and Jane G. Gravelle, Urban Institute Press.

complexity. For some purposes, this issue can be extremely important, and it will be close to the heart of later discussions of tax expenditures designed to “make work pay.”

Efficiency and Effectiveness. Existing tax expenditures are difficult to evaluate and trade off with existing spending programs that might pursue similar objectives. This is in part because of the customary division of labor in legislative bodies, where tax policies and spending programs are often considered by different committees. It is also true because of the nature of tax expenditures, with benefits flowing to individuals and corporations through reduced tax liabilities. The effects of tax expenditures in terms of induced individual and business behavior can be difficult to measure, and difficult to compare with the outputs of government spending programs.

Similarly, the core competencies of revenue authorities generally do not include program management, as opposed to straightforward revenue collection. There are sometimes alleged administrative efficiencies or economies of scale and scope in the use of tax expenditures, on the ground that relevant data already are collected on tax forms, and that the existing tax-filing process can therefore fulfill an additional function. However, these alleged efficiencies can at bottom be merely the absence of truly necessary program administration. Tax authorities may lack the programmatic expertise necessary to determine eligibility, and the premium on quick processing of tax returns may conflict with sufficient oversight. The need for additional data to judge eligibility can conflict with the value of limiting the number of tax forms and the amount of information on them. Beyond outright undetected fraud, this can mean that the objectives of tax expenditure programs are not truly met, or are met at higher net cost than would be the case under spending program administration.

Both the efficiency of the achievement of the objectives of tax expenditures, and the ease of evaluation of their relative success, are reduced by the upside-down subsidy effect. Perhaps the simplest way to implement a tax expenditure may be to exclude or deduct from income an item of income or expenditure. In some instances, it might be judged appropriate that an item of income simply not be reported. However, under a progressive income tax with some unconditional amount of tax relief, the behavioral incentive of such an exclusion or deduction to earn such specified income or undertake such expenditure would be greater for higher-income persons, less for moderate-income persons, and perhaps nil for those with the lowest incomes. In instances such as a policy inducement to save for retirement or to purchase medical insurance, this incentive pattern might easily be judged as absolutely perverse – and yet it is the common practice in at least some countries.

Though evaluation of tax expenditures may be difficult, a more serious problem may be the failure to try. Tax expenditures typically are written into permanent law, in contrast with annual appropriated spending, and even mandatory or entitlement programs that sometimes are required to be reauthorized every few years. Thus, there is a perceived opportunity on the part of potential beneficiaries who approach the political and policymaking process to achieve a long-term, or even a perpetual, benefit by achieving enactment of a tax expenditure rather than a spending program.

There are also weaknesses in tax expenditure reporting in the budget. Tax expenditures are seldom presented together with equivalent spending programs, so that cost amounts can be weighed and tradeoffs considered. Especially when combined with the legislative stovepipe

structure of responsibility between outlay and tax policy, an out-of-sight, out-of-mind pattern can arise and continue to insulate inefficiencies from scrutiny for periods of years.

Complexity. Tax expenditures, like tax systems themselves, can be complex. Still, aspects of tax expenditures can cause the whole of the resulting complexity to exceed the sum of the complexity of the parts. Public perceptions probably add to this unfortunate phenomenon. As legal provisions, regulations, instructions and forms are piled upon one another, the body of tax wisdom needed to navigate the system can grow beyond the capacity of many non-experts. The additional provisions, even if they do not apply to a particular taxpayer, obscure that taxpayer's field of vision of what he or she needs to know. From a simple systems perspective, the potential interactions among additional tax expenditures could grow geometrically as they are added. At least in the United States, some of the greatest perceived abuses of so-called "loopholes" in the tax system have arisen not from individual provisions, but from the opportunistic use of combinations of provisions whose interactions were never intended or even considered.⁹

To the typical taxpayer, as the mass of the tax system's processes becomes increasingly forbidding, the perception of unfairness and of being left out from unknown but assumed benefits for others could be demoralizing. Likewise, the manipulation of unintended interactions among tax expenditures could reduce the efficiency of the allocation of resources, and reduce revenue relative to what was intended or needed, as well as reducing real and perceived fairness. Thus, the lack of transparency of tax expenditures can have a real cost in the effectiveness of government.

Revenue Sufficiency. Though tax expenditures may be judged in some instances to be optimal uses of public resources, they always reduce revenue,¹⁰ and thus always present a tradeoff with general rate reduction. To the extent that tax expenditures or interactions among them are used opportunistically, or that the revenue costs of tax expenditures are simply underestimated at their creation, revenues will fall short of what was intended or needed.

The revenue cost of tax expenditures can be more difficult to estimate than the cost of government spending programs. To be sure, the cost of even annually appropriated spending programs can be unpredictable; for a conspicuous example, large-scale, long-term construction programs can experience cost overruns, or delays that add costs due to cumulative general inflation. However, tax expenditures can confront unanticipated levels of taxpayer take-up. Mis-estimations of revenue cost can lead to unanticipated fiscal deficits.

Tax expenditures can also confront cost uncertainties simply because of changes in utilization across the progressive marginal tax rate schedule. Measurement difficulties are increased because of the progressive rate schedules typical of individual income taxes. A tax expenditure delivered through a deduction or exclusion, and even some tax credits that are phased out as income

⁹ Examples include real estate tax shelters, which combined accelerated depreciation and the capital gains exclusion, among other tax expenditures (along with the deductibility of interest, which in the US system is not considered a tax expenditure); and the tax-motivated sale and leaseback of non-profit and foreign property for the purpose of claiming deductions for depreciation that otherwise would have accrued outside of the tax system.

¹⁰ Ignoring the highly unlikely eventuality that a tax expenditure would have such beneficial effect that it would increase GDP sufficiently to replace its own direct revenue loss. In some instances, as well, negative tax expenditures have been measured for, for example, tax depreciation slower than the amount necessary to compensate for true depreciation or for the effect of inflation.

increases, can fluctuate in cost as taxpayers move between tax rate brackets. This phenomenon can be driven by unexpected changes in inflation as well as real economic growth, because adjustments in tax parameters for inflation typically are made only with a lag. Such measurement unpredictability renders the measured “cost” of a tax expenditure or tax expenditures much less useful as a budgetary target.

By this same token, however, the case against tax expenditures on fiscal grounds must be fair. The cost of existing unchanged tax expenditures can increase because of real economic growth or inflation, in fashions that might arouse undue concern. For example, accelerated real economic growth could push taxpayers into higher progressive tax rate brackets, even if those tax brackets are indexed, thereby increasing the measured cost of tax expenditures that operate by deduction or exclusion from income – while increasing net revenues and decreasing fiscal deficits at the same time. And given the typical nature of tax expenditure cost estimates, which are undertaken for each tax expenditure separately, income growth pushing a taxpayer into a higher marginal rate bracket can increase the measured cost of multiple tax expenditures that operate through exclusion or deduction. Slower real economic growth might have a disproportionate slowing effect on tax expenditure growth, as this same mechanism operates in reverse. Or slower growth might make more taxpayers eligible for wage-supplement tax expenditures, thereby increasing the measured cost. In the United States, in addition, even the number of tax expenditures, as well as their estimated cost, can “float” from year to year without legislative action. Some tax expenditures are not specifically created in law, but rather arise over time through practice as justified by interpretations of regulations. Thus, there have been occasions in which tax expenditures have been “discovered” by the analysts who prepare the lists, and so the numbers of tax expenditures have changed without legislative action. For these reasons, the measured revenue cost of tax expenditures should not be used without deeper analysis that documents a deterioration of tax expenditure policy.

Practical Allegations: Why Do Tax Expenditures Multiply and Grow?

The Number of Tax Expenditures. Tax expenditures arguably can be less difficult than spending programs to shepherd into law. This could be true for several reasons. As noted earlier, tax laws follow their own stovepipe through the legislative process, using committees with tax rather than substantive-program expertise. Thus, merit relative to alternative spending programs to pursue the same objective might not be well evaluated. It may be easier to add generally unrelated provisions to a tax bill than to a spending bill that could be focused on a single program or objective, allowing the number of tax expenditures included in a single tax bill to grow.

There may be opportunities to create marginally justifiable tax expenditures where no such opportunities would exist on the spending side of the budget. There is probably a lower perceptual hurdle to surmount to justify reducing the taxes of someone who engages in a particular meritorious behavior, relative to printing a physical government check to the same individual. Thus, tax expenditures may sometimes be the only option available to private interests who seek government support for their chosen activities. Perception of such a double standard could contribute to a popular sense of unfairness and reduced taxpayer morale. Specific industry subsidies might be taken to be particularly subject to this criticism. At the same time, counter-arguments to repeal of such targeted tax expenditures would be raised on the ground that the value of the subsidies had been capitalized into the market prices of the assets, and that recent

purchasers would in effect lose part of their investments should the tax benefits be eliminated. (The same arguments could be made with respect to industry subsidies in the spending budget, of course.)

Every new tax bill is a potential vehicle for new tax expenditures. In some countries, tax revenues might be perceived to run at some customary level, in terms of the share of the GDP. For example, in the United States, federal revenues have averaged slightly more than 18 percent of GDP for many years, and deviations in either direction have been short lived. In good times, when receipts rise, there can easily become a perception that it is time for a tax cut. At such times, the enactment of a tax bill is more likely, and given this underlying motivation to cut taxes, the opportunity to enact additional tax expenditures could be great. For example, in 2001, with recent revenues at record highs, there arose considerable momentum for a tax cut, and the legislation that year included perhaps three net new tax expenditures (while increasing the revenue cost of several others).¹¹

Both the complexity and the perceived unfairness of the tax code could be driven as much by the number of tax expenditures as by the size of their revenue loss. The volume of paperwork in law, regulations, instructions and forms is not necessarily proportional to the revenue cost of a tax expenditure. Thus, in some dimensions, the harm due to several small tax expenditures could be greater than that from one much larger provision.

The Growth of Tax Expenditures. Tax expenditures tend to evade systematic and critical review. As a result, they can grow over time, and avoid reform, reduction or repeal.

Common practice is that the tax law is permanent, and not subject to regular legislative reauthorization or review. In contrast with appropriated spending, which must be reenacted annually, or even those entitlement programs that are subject to periodic reauthorization, this puts tax expenditures in a much less vulnerable position.

Similarly, tax expenditures tend to be less visible than spending programs. Tax expenditures are displayed side-by-side with spending programs with similar objectives in only a few countries' budgets. This weakness of presentation fails to call attention to the inevitable tradeoffs between similar tax and expenditure programs, leaving dormant the possibility that tax expenditures might be reformed, trimmed back or eliminated to pursue the same objectives in alternative ways. In fact, in many countries, it has required considerable effort to ensure that tax expenditures are reported at all, or are reported in the governments' budget documents.

The nature of tax expenditures is also different in important respects than that of spending programs. A US policymaker once described the difference by making reference to the vernacular reference to budget analysts as "bean counters," counting the "beans" that are spent under outlay programs. He then drew a contrast between the spending "beans" and the "might-have-beans" that are not collected by the revenue system because of tax expenditures. This different nature has made analysis more difficult, thereby inhibiting comparative analysis of tax

¹¹ The increase in the number of tax expenditures reported in the federal budget documents for fiscal year 2003 over that in fiscal year 2002.

expenditures and outlay programs, and making reductions or eliminations of tax expenditures harder to justify.

To the extent that tax expenditures evade review, they contribute to longer-term budgetary problems – just as would any spending programs that were similarly neglected. Any changes in circumstances over time would render those tax expenditures less efficient and effective, thereby with progressively lesser returns for the continuing (perhaps even increasing) reduction of government revenue. Tax rates would have to be higher, or government deficits and debt would be greater, and other more-important priorities would be neglected.

Furthermore, even in the instance of a strong efficiency, effectiveness, or equity case against a tax expenditure, repeal or reform of that provision might need to surmount an additional hurdle, in that it would be a tax increase – an option that is anathema in many political quarters. There has of late been the unfortunate phenomenon in the United States of temporary tax reductions being enacted in a time of fiscal surplus, with the justification that they could be allowed to expire if deficits were to reappear, and then with renewal of those tax reductions justified on the ground that no tax increase could ever be tolerated. Similar political gymnastics are surely within recent experience elsewhere around the world.

Are “Make Work Pay” Tax Expenditures an Important Special Case?

To summarize the arguments to this point: Tax expenditures are often inferior policy instruments, degrading the efficiency and effectiveness, fairness, and simplicity of the tax system and of government operations generally, and threatening fiscal sufficiency as well. Tax expenditures may under important circumstances be easier to enact than spending programs – and not always for reasons that relate to underlying policy merit. Tax expenditures also generally are less subject to review and remedial action in instances of policy deficiency. Recent anecdotal evidence, to be examined in greater depth later in this paper, suggests that in keeping with this analysis, the incidence and magnitude of tax expenditures has been growing. All of this justifies significant attention to tax expenditures, including analysis of best practices on reporting and review.

With that said and acknowledged, the so-called “make-work-pay” tax incentives, which are designed to increase the attractiveness of participation in the labor force for those who have comparatively low potential wages, might require a separate and somewhat different evaluation. This fairly narrow class of tax expenditures anecdotally represents a significant share of growth over the last 20 years. If that anecdotal account should prove accurate, it could alter the sense of the growth of the number and revenue cost of tax expenditures as a problem – depending upon the assessment of the merit of the non-wastable make-work-pay tax credit model. It would not likely, however, reduce the importance of best-practice management of all tax expenditures, including the make-work-pay provisions.

The goal of making work pay has been widely accepted. Concerns that benefits for non-working adults have deterred labor-market effort have been widespread. Given an arguable conviction that cutting such benefits would be inhumane, the only remaining options would be for public policy to increase the reward for work.

The menu of non-governmental initiatives is very short and unsatisfying. Increasing statutory minimum wages increases business costs, and so is at best a policy tool of limited power, and at

worst unacceptable. At the lowest wage levels, where income tax liabilities are at or near zero in any event, that leaves some form of publicly financed cash wage supplement – hence the interest in the kind of “make work pay” policies that we have seen in recent years. Arguably, the question in most countries is not whether there should be a cash-transfer policy to make work pay, but rather what form that policy should take.

Although the “make work pay” class of tax expenditures might well be defined to include provisions that relieve working parents of some of the costs of care of pre-school aged children, and of schoolchildren before and after school hours, those provisions might be argued by some to provide merely a more accurate measurement of the cost of earning wage income. More prominent among this class of tax expenditures are wage supplements, generally delivered as a percentage of wage income phased down once earnings pass a particular amount.

Origin. The pioneer among tax-expenditure policies of this type was the earned income tax credit (EITC) in the United States. That provision was enacted in 1974, and has been increased in stages ever since. It is controversial on both policy and administrative grounds, but appears secure within the US system. Its initial history might shed some useful light on the broader issue of the role of tax expenditures in today’s tax systems, and the potential best practices for managing those provisions.

In 1974, the United States was in recession, in no small part owing to the disruption of the world petroleum market at the time. The US income tax was not yet indexed for inflation, and despite the weakness of the economy, receipts were rising as a percentage of the GDP. There was a broad consensus that the economy needed a tax cut for macroeconomic stimulus, the inflation notwithstanding, and the taxpayers demanded relief from the effect of oil prices and rising taxes on living standards. At the same time, the same hardships on low-wage workers created some pressure to increase the federal statutory minimum wage. There was interest in a policy to “make work pay,” although that phrase had not yet attained the identity that it has today.

A spending program to the same effect as the EITC would not have addressed the particular policy needs of the time, which imposed constraints upon the choice of a tool to pursue the overall objective. Existing cash transfer programs, notably the Aid to Families with Dependent Children (AFDC) program, were partly federally funded but were managed by the states. Those state programs generally did not cover working people (for the most part, or at least apart from extremely low wages), and a federal government mandate to expand existing programs or create a new program, at least to this degree and with this cost, would have been perceived as overbearing. The alternative, to create a new federal spending program and the proportionate bureaucracy, would also have been thought excessive. In the case of the United States, the additional administrative burden on either a new federal or an expanded state program would have been massive. As of 2004, more than 22 million tax returns claimed the EITC.¹² The current number of families benefiting from the successor to the AFDC program, called Temporary Assistance to Needy Families (TANF), is less than two million.¹³ Even allowing for the decline in the transfer

¹² Internal Revenue Service, “Returns With Earned Income Credit, By Size of Adjusted Gross Income, Tax Year 2004,” <http://www.irs.gov/pub/irs-soi/04in04ic.xls>, accessed November 2, 2007.

¹³ Gregory Acs and Pamela Loprest, “TANF Caseload Composition and Leavers Synthesis Report,” March 28, 2007.

program caseload and the increased generosity of the EITC since the 1970s, and for duplication of participation between the two programs, it is clear that implementation of the EITC as an outlay program would have increased the administrative workload of the existing transfer programs by orders of magnitude.

One advantage of the tax expenditure alternative was that it would enlist the existing tax administrative apparatus, including the reporting obligations of employers, possibly making efficient double use of those resources rather than in effect duplicating that effort. The availability of tax data might assist in compliance monitoring and enforcement. Furthermore, existing federal programs, which subsidized purchases of food (Food Stamps) and housing (public housing and rent subsidies), could not logically be expanded to the extent desired. Because these programs were already intended to provide adequate access to the “necessities of life,” it might not be deemed appropriate to provide additional allocations of those goods and services as a reward for work, and in the latter instance might merely bid up the price of a relatively fixed supply of housing.

The desire to “make work pay” could not have been fulfilled by an increase in the minimum wage. Given that inflation already was accelerating, there was no justification for adding to employer costs. Also, the minimum wage benefited not only adult workers, but also teenagers with part-time jobs. There was strong sentiment for targeting the relief more narrowly, even so far as to restrict it to families with children.

Although anti-tax ideology was not as well developed at that time as it became less than a decade later, there was a political preference for delivering relief in the form of a tax cut. And there were preferences for a total tax cut package that could be demonstrated to give a “fair share” to low-income taxpayers – even though many low-income families paid no income taxes, given relatively significant low-income relief provisions already in the tax structure.

The sum of this combination of circumstances leaned heavily in the direction of a non-wastable income tax credit based on wage income. This combination of circumstances, though obviously different in the particulars, has persisted in the following years and apparently has been duplicated in other countries. It appears that these policy imperatives have made the “make-work-pay” non-wastable tax credit a standard and enduring item in the policy arsenals of the major OECD countries. Analysis of tax expenditure policy arguably should take account of this imperative. Perhaps the analysis might begin not with the question, “Why a tax expenditure?”, but rather, “What is the alternative?”

Advantages Relative to Mandatory Spending Programs. Given the need for any wage supplement for low-income families to be a reliable source of income, a spending program to fulfill the “make work pay” function likely would be a mandatory or entitlement program, rather than an annually appropriated problem. There has been some US interest in in effect converting entitlement programs into discretionary programs, on the ground that they would then demand more attention and oversight.¹⁴ That notion has not carried the day thus far, probably in part

http://www.acf.hhs.gov/programs/oprc/welfare_employ/tanf_caseload/reports/tanf_caseload_comp/tanf_caseload_final.pdf, accessed November 2, 2007.

¹⁴ Stuart M. Butler, “Solutions to Our Long-Term Fiscal Challenges,” testimony before the Committee on the Budget, United States Senate, January 31, 2007, <http://www.heritage.org/Research/Budget/tst013107a.cfm>.

because it would at least in form put at risk what are considered essential supports to needy persons.

Given that tendency to provide such benefits through mandatory spending, any operational distinctions relative to a tax expenditure program would be differences of degree rather than of kind. So, for example, a mandatory spending program might or might not be subject to greater periodic legislative review and oversight than a tax expenditure. At least in the United States, there is at least as much criticism of the lack of review, oversight, and legislative action on costly entitlement programs as there is with respect to tax expenditures. How a non-wastable tax credit is counted in the budget – as a spending program, a tax reduction, or a combination of the two – might have some impact on the degree of oversight.

Another concern about tax expenditures is that they can grow excessively, and are not cut back in times of fiscal stress. On the first count, it is not clear that a make-work-pay tax expenditure would grow any more than an equivalent make-work-pay entitlement. If the tax expenditure were to grow more rapidly because it was more effective in reaching eligible beneficiaries, that would most likely be considered an advantage, both for helping deserving families, and for increasing the likelihood of the success of the program in encouraging work. On the second point, reducing a low-income support program in hard times would likely be both inhumane and counterproductive from a macroeconomic standpoint, and so that concern would seem no better placed in the context of make-work-pay tax expenditures than with respect to the alternative of mandatory spending programs.

Because make-work-pay provisions are linked to labor income, and labor income is reported to tax authorities as a matter of course, choosing a tax expenditure vehicle might cut out an additional round of processing wage and employment records by government outlay offices, at least in some instances. Tax authorities, after the initial investment is made, can compute the amount of the benefit and the phaseout of that benefit, if applicable, from employer information that they have already. Pulling low-wage workers into the tax system to obtain a benefit might be thought to increase the probability of later tax compliance if and when their wage incomes increase.

A potential argument for a make-work-pay tax expenditure, and against a mandatory spending program, would be on the ground of inclusion. A humane government that wanted to deliver wage supplements to low-wage workers might believe that those workers might be more willing to accept what was couched as a tax refund than what might be perceived as a welfare payment. On the same ground, that government might believe that it would be more likely to find workers who were unaware of their deserved benefit through the administration of a tax program than through an outlay program. A taxpayer who files a return to claim a refund of wage withholding, and who is apparently eligible for but does not claim the non-wastable make-work-pay tax credit, can be pursued by the tax authorities to verify his or her eligibility. It's not clear that there would be such an opportunity for spending-program administrators to pursue a low-wage worker who simply does not come forward to claim an outlay wage supplement.

Potential Disadvantages; the Growth of Make-Work-Pay Non-Wastable Tax Credits. There has been substantial growth in the cost of make-work-pay tax expenditures across countries in recent

years. Some consideration yields at least ten possible reasons why the cost of these make-work-pay provisions might have increased in absolute terms, or relative to projections of future costs:

1. Existing spending programs might have been converted to new make-work-pay tax expenditures.
2. New additive make-work-pay tax expenditures might have been created.
3. Existing tax expenditures might have been made more generous.
4. Population growth (including immigration) might have increased the population eligible for the tax expenditures.
5. Recession might have pushed workers' incomes down and made them eligible for the tax expenditures.
6. Secular economic decline might have had the same effect.
7. Manipulation and/or fraud might increase costs.
8. Estimation and projection error might have made the estimates of future costs too low.
9. Improved administration and outreach might find more eligible people and encourage them to apply.
10. The tax expenditures might work: Because they make work pay, more people may be working more.

Of all of these reasons for growth in revenue forgone, or in non-wastable refund outlays, only (7) and (8) present unqualified causes for concern. Obviously, fraud must be combated, certainly involving more intensive oversight, and estimating errors should be resolved. However, the other potential causes are more benign – certainly including program success, through either greater labor force participation or more successful outreach to beneficiaries.

Other potential sources of growth are at least somewhat ambiguous. If these tax expenditures replaced similar mandatory outlay programs, then policy observers would want to be sure that these decisions were not made to evade necessary oversight. However, absent such manipulation, policy analysts need a straightforward evaluation of the merits of mandatory spending programs versus tax expenditures for this particular purpose. The creation of such tax expenditures, or increases in their generosity, could be simple efforts to make work pay, which would be commendable. Unexpected population growth, or changes in macroeconomic conditions, either cyclical or secular, should be factored into program plans, but would not necessarily indicate a need to change the tax expenditures.

Non-wastable tax credits as wage supplements are undeniably complex. In the United States, the earned income tax credit is thought to be one of the most complex provisions of the tax system. Because the most generous US credit is restricted to workers with children, there are complex requirements to define families, and to ensure that only one of two separated parents claims the credit. There are provisions to offset income from capital against income from labor, so that wealthy persons with temporary property-income losses and incidental amounts of labor income do not benefit from the credit. Other countries surely have encountered similar complications. To some extent, the involvement of both the tax authorities and employers lifts some of the compliance burden of such non-wastable tax credits from the individual taxpayers and from spending-program administrators, relative to what would be the case if those programs were created as spending programs rather than tax expenditures.

Make-work-pay tax expenditures do raise some new and unique issues. Tax authorities normally collect money, not give it away. Their usual task is to ensure that individuals report incomes that might otherwise be concealed. The revenue agencies may be less well equipped to deal with people who come forward claiming that they made more income, not less. This leaves open the prospect of a new kind of abuse. (In the United States, there was metaphorical concern about people claiming labor income from taking in each other's laundry to become eligible for larger EITCs. And there were actual cases of fraud, using forged employer earnings reports to claim the EITC.) Presumably, countries with non-wastable make-work-pay tax expenditures have by now adapted to this new challenge, but with government resources always scarce, it remains a concern.

In broader administrative terms, non-wastable tax credits add a new dimension to the workload of tax agencies, in terms of both the interaction with taxpayers and data demands. Closer working relationships with outlay agencies may be helpful, but given that an important rationale of non-wastable credits is that their administration can double-up on normal tax processes, the potential role of outlay administrators is to some degree contrary to the rationale of the tax expenditure in the first place.

Non-wastable make-work-pay tax expenditures raise a second unique issue. Almost by definition, most of the beneficiaries of such tax credits live on tight budgets, and need the additional cash from the credits day to day. The United States has never been successful at delivering cash from the EITC to its beneficiaries in real time, largely because of the annual-accounting basis for the income tax. Instead, the credit is delivered as a lump-sum payment after tax returns are settled in the early months of the following year. A mechanism has been created by which firms could give the cash to their workers in effect as negative tax withholding, but it is rarely used. Firms find it administratively burdensome. Some formulations of a real-time benefit might leave the employer at financial risk if an employee claim is found to be unjustified. A related complication is that the actual EITC amount is determined on annual tax returns, but providing the benefits to individuals in real time would require a weekly or monthly estimate starting at the beginning of a year. US tax authorities are always reluctant to pass out tax benefits in advance, for fear that a subsequent change in circumstances could increase the taxpayer's legal liability, and that the excessive tax benefits already distributed could never be recovered, or could be recovered only with significant taxpayer hardship.

Other countries have apparently had more success at addressing this issue. Germany provides the option of taxpayers receiving their credits on a periodic basis throughout the year from government benefits offices. This, of course, raises the question of why the provision is construed as a tax expenditure program in the first place. The potential advantages of the tax expenditure tool cited above are likely candidates. Further research is underway. The German model also raises the question of whether, to those who are skeptical of tax expenditures, a tax expenditure some of whose benefit is delivered via outlay-program administrators is any more desirable, or whether program oversight or management would be any better for that reason.

Finally, non-wastable credits do confuse measurement of the size of government. If, arguably, there is no substantive difference between a non-wastable tax credit and a mandatory transfer payment that delivers the same benefit, then budget analysts must be concerned that in the former case the government has lower measured outlays and lower measured revenues. With respect to intergovernmental comparisons, the importance of this issue is reduced to the extent that many

developed economies use the same non-wastable tax credit policy tool; the differences among countries are thus restricted to whether the distributed monies are accounted for as outlays or negative tax revenues, and to the relative generousities of their tax expenditures. However, in focusing on any one country, and in looking at the size of government over time, there might be concern that make-work-pay non-wastable tax credits distort the picture.

With respect to both intergovernmental comparisons and analyses of individual governments, accounting conventions for non-wastable tax credits are important. The total budgetary cost of non-wastable credits might be counted a reduction of revenues, or as an outlay. Alternatively, the cost might be divided, with the cash refund portion counted as an outlay, and the reduction of tax liability counted in that fashion. Different criteria might favor different choices of accounting treatment. Some have argued for full outlay accounting, on the grounds that this most accurately reflects the substantive intent of the program, and most directly encourages analysis of the tradeoffs with similar outlay programs.¹⁵ Others believe that dividing the cost between tax reduction and outlay cash refunds most accurately measures the impact on the size of government. The division of the cost can be uncertain, however, because for various reasons, including taxpayer morale, cash payments can be deemed as refunds of payroll taxes or other non-income taxes. Identification of the provision as a tax program might argue for full tax treatment; those who for political reasons would wish to portray the program as a tax reduction, or who would wish to minimize the measured size of government, would choose full tax treatment. Arguably, a non-wastable tax credit recorded solely as a reduction in tax liabilities would be less transparent and less visible in the budget process, and therefore less open to review and oversight.

To summarize, non-wastable “make-work-pay” tax credits have arguably become a justifiable fixture of developed-economy tax systems. Where there is a significant degree of inequality of wage incomes, with potentially limited incentives for work on the part of less-skilled individuals, a wage supplement through the tax system can reward effort without adding to employer costs. The administrative apparatus of the tax system arguably can be used to manage the program at lesser incremental cost than would running it as a spending program. Although there are undeniable complications to tax systems as a result, it is not clear that those are significantly greater than would be running the programs through spending agencies. The growing number of such tax expenditures is testimony to the conclusion of many countries that this vehicle is the policy instrument of choice for making work pay.

The anecdotal growth in the number and size of tax expenditures in recent years is troubling, and justifies investigation of the implications of this growth for the efficiency and effectiveness of government, and for fiscal sufficiency. To the extent that tax expenditure growth has arisen from efforts to make work pay, it might be somewhat less troubling, and it would be less an indication of a new and more perilous situation broadly. Still, the need to maximize the efficiency and effectiveness of the allocation of scarce public resources, and to limit higher-than-desirable fiscal deficits, remains, and best-practice management of all tax expenditures, including make-work-pay initiatives, must be an important part of that effort. Furthermore, the need to document and disseminate best practices for nations newly adopting make-work-pay tax expenditures, much less other tax expenditures, also remains.

¹⁵ Koiwa, op.cit.

POLICYMAKING BEST PRACTICES

In theory, it is government's job to look at everything, all the time. There is nothing physically to stop a policymaking and political process from considering all alternative policy tools to achieve each objective, and choosing the tools that work the best, even without rules and guidelines. There are numerous instances in recent history when problems were solved with political will but without a formalized process. There are few instances when problems have been solved with a formalized process but without political will. Although this statement might seem a truism, it is worth remembering that the absence of rules should not inhibit analysis, and even the strongest rules require analysis to make them work.

This reality is as true of tax expenditures as it is of other policy issues. Policy analysts should not allow policymakers the excuse that they could not take action because there was no robust process; nor should policy analysts take a holiday from documenting the flaws in current institutions because an existing process should solve the problems.

Still, in the real world, at the margin, process can help. Sound process and rules can help to fend off an out-of-sight, out-of-mind mentality that can keep important issues from ever coming to debate. However, once the debate begins, it is up to political will and compelling analysis to lead to action.

One thing that rules can do is put known important issues on the agenda, at least nominally. Rules can also force policymakers at least to take explicit action that acknowledges through their votes and statements that they are violating widely accepted best practice. Rules and processes can also force advocates of one perspective or another at least to articulate the unstated premises of their arguments. In these important respects, process can help.

To be sure, agendas determined by rules have been given short shrift, and best practice has been violated. It is always within the power of those who write the law to change carefully considered existing law. But policy analysts should not ignore process, because it is sometimes the best tool available to put the facts on the table. Perhaps the ultimate testimony to process and rules will occur when advocates of some particular narrow-interest policy seek to avoid having it classified as a tax expenditure.

This section will divide best practice into three categories: reporting; review and oversight; and the legislative process. The following section will consider the major issue of the role of tax expenditures in the budget process.

So what are the best practices for reporting and dealing with tax expenditures, to maximize fiscal responsibility, oversight, transparency, and administrative efficiency?

Reporting. Again, in theory and in an ideal world, policymakers can add and subtract, and can compare any data regarding tax expenditures from any source with the corresponding data on outlays in the budget. They also can compare data on tax expenditures with other data on receipts to determine the impact of tax expenditures on the tax base.

However, in that ideal world, policymakers also can compare data on outlays from whatever source with one another, and can schedule oversight and review of outlay programs at their discretion. Yet, it is considered basic good practice to create processes that prompt regular oversight of outlay programs (though whether that basic good practice is fully observed is another question). There is no reason why tax expenditures, which just as surely allocate scarce national resources, should receive any less intense and frequent review than outlay programs.

One basic standard of tax expenditure reporting is that data be included in the budget. For purposes of comparison, that is merely a convenience. More important beneath the surface is that the tax expenditure data have the same standing and be of the same level of quality as spending data in the budget.

There has been discussion over which agency – the revenue agency, or the programmatic agency – should prepare the data. Some might have a preference for data coming from the programmatic agency. Thinking strictly of the source of the tax expenditure estimates, such a preference might not be well founded. There are considerable economies of scale in the estimation of the revenues forgone from multiple tax expenditures. There are also benefits of consistency of methodology. If different programmatic agencies created their own estimates of different tax expenditures, say under the individual income tax, there likely would be added costs of creation and maintenance of the various models, and there would be inconsistencies of concept and quality among the different estimates. It might make sense that all of the estimates be made by the revenue authorities. A separate and different point, however, is that the revenue authorities certainly should cooperate with the programmatic agencies on obtaining and controlling the quality of any estimating input data that do not come directly from tax returns or other tax documents. Cooperation at that level would entail no additional cost, and should increase quality.

A second standard is that tax expenditures should be reported in the budget in proximity to the outlay programs that have similar objectives. Such reporting might reasonably be in addition to, rather than instead of, reporting in a separate tax expenditure section of the budget. The objective is to invite and prompt comparison of tax expenditure programs with outlay programs, so that choices and tradeoffs are confronted. Again, however, looking at tax expenditures next to outlays is not quite an apples-and-apples comparison; it is, rather, as was suggested earlier, a comparison of “beans” with “might-have-beans.” Although it might be realistic to consider the elimination of one outlay program to finance the creation (or the expansion) of another, it might not be equally politically feasible to eliminate a large tax expenditure and expect to retain the additional revenues to increase outlays, even for programs with the same ostensible objective, simply because there are perceived limits to the level of taxes and the size of government. However, if there were duplications of objectives, and tax expenditures were found to be less effective than outlay programs, it might be highly realistic to discuss the elimination of one tax expenditure to finance another, or to finance tax rate reduction. Thus, comparisons of tax expenditures with outlay programs might not be undertaken in quite the same fashion as evaluations of outlay programs, but nonetheless should be highly desirable.

Comparisons of outlay programs with checks cut for the refundable portions of non-wastable credits might be a more natural use of tax expenditure data juxtaposed with outlays in the budget. Policymakers need to consider whether changing public preferences and technologies might

change the balance of merit between non-wastable credits and outlay programs, and a shift from one to the other would be less likely to raise widespread concern over the level of the tax burden.

The somewhat different context of non-wastable tax credits raises the question of what should be the best reporting practice – whether the entire amount of the credit should be reported as outlays, or revenues, or divided between the non-wastable portion as an outlay and the portion offsetting other tax liability as forgone revenue. Koiwa argues that reporting as spending as opposed to divided between spending and outlays highlights the tradeoff between the tax expenditure and outlay programs, and therefore yields better budgetary and fiscal control. That may be true. However, if both portions of the tax expenditure are presented in the budget along with outlays, the difference in oversight may be minimal; and counting even the portion of the credit that reduces other tax liability as an outlay arguably overstates the size of government.¹⁶ This choice seems arguable either way.

Review and Oversight

Beyond having tax expenditures reported in the budget, in close proximity to the related outlay data, an even higher objective of process might be to obtain regular formal evaluation of tax expenditures in the budget documents, or elsewhere. After all, the point of any presentation of tax expenditures is to weigh their efficiency and effectiveness against alternative spending programs or, for that matter, general tax rate reduction. Such evaluation could contribute to changes in policy that would yield more efficient allocations of public resources.

However, obtaining such analyses, and maintaining such a level of commitment over time, would not be easy. An elected government with different priorities would not want to distract attention from its agenda priorities toward problems elsewhere, including in tax expenditures. Even more so, a government would not want to antagonize its potential supporters on its priority issues by raising problems with tax expenditures that might be politically unassailable in any event. Government analysts would not want to anger their political superiors by picking such fights, or to exert considerable effort in analyses that they might believe to be quixotic wastes of time.

Elected governments have formidable tools at their disposal to discredit and weaken the analysis of tax expenditures. Analyses in the budget can be altered fundamentally by changes in the reference tax system, in particular from an income tax to a consumption tax, which would define away tax expenditures that reduce the tax burden on income from capital. Tax expenditures can even show negative revenue forgone if they do not eliminate entirely the tax on capital income. Merely changing the reference tax system at frequent intervals, in whatever way, can render the underlying analysis less useful.

Also disruptive to serious analysis of tax expenditures is a conviction that tax expenditures reflect an underlying premise that all income belongs to the government, and that therefore any tax expenditure, however distortionary and ineffective, is preferable to its repeal.¹⁷ As an example of

¹⁶ Admittedly, in the United States, the refundable portion of the credit is far larger than the amount that offsets other taxes; and much of the latter part is construed to offset the payroll tax, rather than the income tax.

¹⁷ “The tax expenditure concept relies heavily on a normative notion that shielding certain taxpayer income from taxation deprives government of its rightful revenues. This view is inconsistent with the proposition that income belongs to the taxpayers and that tax liability is determined through the democratic process, not through arbitrary,

a dispute over this point, the non-partisan auditing and analysis arm of the US Congress concluded a recommendation for greater attention to tax expenditures with the following:

As we move forward in shaping government for this century, the federal government cannot accept all of its existing programs, policies, functions, and activities as “givens.” Outmoded commitments and operations constitute an encumbrance on the future that can erode the capacity of the nation to better align its government with the needs and demands of a changing world and society. Reexamining the base of all major existing federal spending and tax programs, policies, functions, and activities by reviewing their results and testing their continued relevance and relative priority for our changing society is an important step in recapturing our fiscal flexibility and bringing the panoply of federal activities into line with 21st century trends and challenges.¹⁸

The Administration submitted the following response, which by custom was printed in the very same report:

The GAO analysis in this report is deeply flawed and it would be unwise for the Administration to follow its recommendations. GAO believes that the Administration should pay more attention to tax expenditures as it formulates the budget, because of “the severity of the nation’s long-term fiscal imbalance.” The Administration rejects any attempt to address the long-term fiscal imbalance with tax increases.¹⁹

An elected government with such principles would of course seem unlikely to pursue an aggressive analysis of the merits of particular tax expenditures. And in the United States, that reasoning would appear to hold, with two clear manifestations. First, spending programs in the US budget are subject to a methodology called the Program Assessment Rating Tool, or PART. According to the Budget, “These reviews have helped ensure that all programs have clear, specific definitions of success; performance measures to track that success; and concrete improvement plans.”²⁰ Tax expenditures are not subject to PART review. And second, the report of the Senate Governmental Affairs Committee on the Government Performance and Results Act (GPRA) of 1993 calls on the executive branch of the government to undertake a series of analyses to assess the effect of specific tax expenditures on the achievement of agencies’ performance objectives.²¹ The latest Budget, produced 14 years later, provides only two pages of general comments on measurement issues, including a statement that current data are inadequate for systematic evaluation of tax expenditures.

To be fair to the current US administration, the prior elected government of the other major political party made little progress on this front either. There are many institutional reasons

bureaucratic assumptions.” US Joint Economic Committee, “Tax Expenditures: A Review and Analysis,” August 1999, <http://www.house.gov/jec/fiscal/tax/expend.pdf>, accessed November 5, 2007.

¹⁸ US Government Accountability Office, “Government Performance and Accountability: Tax Expenditures Represent a Substantial Federal Commitment and Need to Be Reexamined,” GAO-05-690, September 2005, p. 72.

¹⁹ “Comments from the Office of Management and Budget,” *ibid.*, p. 82.

²⁰ Budget of the United States Government, Fiscal Year 2008, p. 25.

²¹ Committee on Government Affairs, United States Senate, Government Performance and Results Act of 1993 (Report 103-58, 1993).

why.²² Every tax expenditure has a political constituency behind it, else it would not exist. The institutions that protect tax expenditures, including the customary status in continuing law and the lack of regular mandated review, mean that any discussion of a tax expenditure is easily construed as an attack. A government that has different priorities will not want to distract attention and to generate ill will for its own proposals by calling attention to the failings of other politically unassailable programs. The government's policy analysts will not want to alienate their political superiors by providing rigorous critical analyses of those unassailable programs under the same circumstances.

There may be ways to ensure that there is rigorous analysis of tax expenditures, even though it may fall short of political ownership by the elected government. In the United States, the non-partisan Congressional Research Service, a part of the Library of Congress, has approximately every two years produced a compendium of analyses of every tax expenditure.²³ The compendium includes an estimate of each tax expenditure's revenue cost, its legal authorization, a description of the tax provision and its impact, the rationale at the time of adoption, an assessment which reports the arguments for and against the provision, a distributional analysis where available and relevant, and bibliographic references. In this way, the compendium makes the latest scholarship on each tax expenditure available without the interference of political ownership – but by the same token, without the impetus for reform provided by political ownership, either.

In a somewhat more selective vein, the nonpartisan Congressional Budget Office has every other year produced a volume now entitled *Budget Options*, which includes over 100 potential policy changes, generally to provide fiscal savings, including both spending and tax options.²⁴ Not surprisingly, many (but not all) of the revenue options involve reduction, repeal or reform of tax expenditures. Not all tax expenditures are addressed, and the presentations do not include the same comprehensive analysis of those tax expenditures that are considered as does the Congressional Research Service volume. However, this CBO document does hold selected tax expenditures up to scrutiny they would not otherwise receive.

The US experience reinforces the controversy that surrounds the tax expenditure concept. Some in the political and policymaking realm reject policy analysts' criticism of the inherent weaknesses of the tax expenditure vehicle; others merely reject any criticism of the particular tax expenditures that they support. Given this controversy, the ideal of regular, rigorous analysis of all tax expenditures by governments, feeding back into their policy decisions and proposals, can be difficult to achieve. It is still the goal. However, for those nations that have sufficient resources to have quasi-independent and non-partisan governmental research organizations, a second-best and more attainable and reliable approach might be to commit those institutions to the task of providing ongoing evaluation and review, or at least cataloging the review undertaken by academics and others outside of government.

²² Burman, Leonard E. "Is the Tax Expenditure Concept Still Relevant?" *National Tax Journal* 56, no. 3 (September 2003): 613-28.

²³ United States Senate, Committee on the Budget, *Tax Expenditures: Compendium of Background Material on Individual Provisions*, Senate Print 108-54, December 2004, prepared by the Congressional Research Service, is the latest volume.

²⁴ Congress of the United States, Congressional Budget Office, *Budget Options*, February 2007, is the most recent edition.

A remaining question that is much more relevant in presidential (as opposed to parliamentary) systems is whether the locus of review and oversight should be in the executive or the legislative branch of government. Usually, executive review would be more likely to yield proposals for reform. Precisely for that reason, institutionalized review in the executive would be highly sensitive. The US example suggests that a second-best approach of institutionalized non-partisan legislative review might be a preferable alternative to blissful ignorance. Especially in the context of process rules that force consideration of alternatives for budget savings, legislative review might prove productive; this context is discussed later in this paper.

Legislative Process and Enactment

Some nations have formal budget processes that involve quantitative disciplinary rules. Many nations do not. This section presents some thoughts regarding possible best legislative practices *apart from* a budget process – for those nations without formal processes, or for nations with budget processes to consider *in addition to* those budget rules. Discussion of tax expenditures and the budget process rules themselves will come in the following section.

Apart from the fiscal deficit dimension, tax expenditures arguably can increase tax system complexity and distort the allocation of resources. Some techniques have been used in other contexts to try to address such problems arising from other forms of government action.

So for example, the United States requires regulatory consideration of the paperwork impacts of changes in tax law, and in other regulatory decisions.²⁵ Regulation impact statements have been used in New York State,²⁶ Australia,²⁷ and have been proposed for broader use in the field of taxation.²⁸ A required assessment of the impact of any proposed tax expenditure might force policymakers to face up to any additional administrative or compliance burden.

The dimension of economic distortion might be measured, imperfectly to be sure, by the revenue cost of a proposed tax expenditure. One way to focus attention on the distortionary cost of tax expenditures would be to require reporting of the amount of tax rate reduction that could be financed with the revenue loss.

In the United States, some entitlement programs (although not the largest and most important ones) are legally authorized for only limited periods of time (typically five years), and so require periodic authorization. Doing the same for tax expenditures might improve oversight, by requiring additional examination in the course of consideration of the reauthorization legislation. However, the benefits of such requirements should not be oversold. As was discussed above, the passage of large temporary tax cuts earlier in this decade, on the presumption that they would be reconsidered upon their expiration in light of any further developments on the fiscal deficit, has proven to many to be at best ineffective, and at worst highly disruptive and divisive.

²⁵ <http://www.whitehouse.gov/omb/legislative/testimony/graham050103.html> .

²⁶ <http://www.tax.state.ny.us/pdf/rulemaking/oct307/part90/sapa/ris.pdf>

²⁷ <http://www.aph.gov.au/library/pubs/bd/1998-99/99bd087.htm>

²⁸ <http://www.austlii.edu.au/au/journals/SydJLRev/1999/20.html>

BUDGET PROCESS

One reason why tax expenditures have attracted more attention of late, beyond their apparent recent growth in number and size, is that fiscal deficits have drifted upward. Growing deficits are particularly troublesome now because in the coming decades many developed economies face either accelerating or strongly continuing population aging, which will tend to make fiscal deficits even worse.

Another result of looming fiscal deficits is growing interest in budget process and disciplines. Experience suggests that budget rules based on the size of the fiscal deficit are painful to enforce in bad economic times, when spending reduction or revenue increases would be pro-cyclical, and unattractive politically in good economic times, when apparently healthier budgets suggest more spending and new tax cuts. Accordingly, some budget analysts have proposed rules that are based not on the size of the fiscal deficit, but rather on the level of spending.

However, the term “spending rule” can, and probably should, be recognized as a misnomer for such budget disciplines. As the most fundamental analysis of tax expenditures has explained from the very beginning, preferential exceptions to broad-based, neutral tax systems are the equivalent of spending. A budget process that limited the amount of spending but not the expansion of tax expenditures could be expected to steer plans for the use of public resources over the path of least resistance to the revenue side of the budget, in the form of tax expenditures.

Disciplining tax expenditures is not easy or simple. There are several discontinuities between the measure of tax expenditures and the reality of budget outcomes. For one example, the most straightforward and widely used method of measurement of tax expenditures, the revenue forgone method, does not account for taxpayer behavior. For that reason, amounts of tax expenditures explicitly do not equal the revenues to be gained by terminating them. The most likely outcome after the repeal of a tax expenditure is that taxpayers would attempt to minimize the impact on their spendable incomes, and so would attempt to minimize the increase in their tax liabilities. Some tax expenditures likely could be eliminated only with “grandfathering” of existing investments and transactions. Thus, on this one count, the increase in tax revenue from the repeal of a tax expenditure is likely to be less than the measured amount of the tax expenditure. A typical treatment of retirement-saving tax expenditures, the deferral of tax on investment income and sometimes on contributions, means that the amount of revenue forgone in any one year is the net of the loss of tax on deferrals of current saving and investment income, and tax collections on distributions. Repeal or reduction of the tax subsidy likely would affect the first component, but not the second.

Other data regularities make the picture murkier. Tax expenditures interact with each other in varying ways. Eliminating multiple tax expenditures might push taxpayers into higher progressive tax rate brackets, and so raise more additional revenue than the sum of the individual estimates. Under other circumstances, multiple repeals could raise less than the sum of the individual items.²⁹ For this reason, revenue agencies routinely warn analysts against summing the

²⁹ In a US example, repealing one itemized deduction might leave a taxpayer claiming the fixed standard deduction, such that additional repeals would have no revenue effect from that taxpayer.

estimates of individual tax expenditures to arrive at a total. It would seem rather curious, then, if such an inexact total were canonized as a target of budget policy. In general, it is difficult to predict the revenue effects of changes in tax expenditure policies from the published estimates, especially under the revenue forgone method. Of course, estimating the effects of policy changes for mandatory or entitlement spending programs is also difficult.

There are more potential peculiarities. Faster income growth could push taxpayers into higher tax rate brackets, increasing measured tax expenditures even if the underlying law does not change.³⁰ Tax expenditures can evolve through changes in taxpayer practice or tax regulations, even without legal action, such that their revenue costs could increase or decrease relative to prior estimates.

Yet another question is the tenor of public attitudes toward the level of taxation, however replete with tax expenditures the tax system may (or may not) be. In the United States, for example, over a half century, receipts have averaged between 18 and 19 percent of GDP, with relatively small variation in either direction. When revenues have grown much above that level, there has generally been a strong public sentiment pushing toward a tax cut. If such an implicit limit on tax revenues should be binding, it is unlikely that tax expenditures could be repealed, thus increasing receipts, without compensating reductions in tax rates or similar changes in other structural tax features that would reduce the level of revenue back down toward the historical range. Of course, this argument could be broadened to hold that taxes are not likely to be an acceptable tool to narrow the budget gap under any circumstances. That broader argument may be politically realistic, but it would be most discouraging from the point of view of fiscal responsibility. A broader view may suggest that major government spending programs are just as politically entrenched as are tax expenditures, meaning that any deficit reduction is an uphill climb, and no option should be discarded.

There is another side to the budget control process, which is preventing the enactment of policies that worsen the outlook. Here, vigilance against the expansion of existing tax expenditures or the enactment of new ones would seem to be of considerable importance. Furthermore, because tax expenditures are typically enacted into permanent law with little or no regular subsequent review and oversight, allowing the enactment of new tax expenditures without careful consideration would make subsequent budget control much harder.

In sum and as a broad conclusion, *measured* tax expenditures are an imperfect target, at best, for a budget control strategy. On the other hand, individual tax expenditure *policies* as a matter of principle should be as likely candidates for action to reduce a fiscal deficit as any other government policies, including spending programs and structural tax features. Thus, tax expenditure evaluation should be a part of efforts for fiscal consolidation, which might or might not occur under the influence of a fiscal rule or a budget process. A key following question is how budget control processes can be designed to put tax expenditures on an equal footing with spending decisions.

³⁰ This would certainly apply to faster real economic growth. It could apply to faster inflationary economic growth if the tax law is not perfectly indexed, or if tax rate brackets and allowances are indexed with a lag (as they almost certainly would be).

To reprise some of the earlier discussion, tax expenditures can be the budgetary path of least resistance, offering multiple political benefits and advantages. Tax expenditures have the appeal of reducing taxes, for however narrow a beneficiary population. Relative to a spending program to the same effect, tax expenditures result in a smaller measured size of government, which may be politically attractive. Tax law can be complex, meaning that benefits for targeted populations can be less obtrusive, and might be politically acceptable as tax reductions when they would be unthinkable as spending programs. Because they are typically written as permanent law, tax expenditures can be a more secure source of benefit for favored populations than spending programs that require annual appropriation, or at least periodic reauthorization. Indeed, tax expenditures may have advantages in the policymaking process over general, structural tax cuts. For the revenue cost of a general tax cut so small as to be quite unattractive, a substantial benefit can be directed to a small group of favored taxpayers.

The political attraction of tax expenditures can affect even the mix of receipts by type of tax. If the policymaking system can give favors to selected constituencies most easily through tax expenditures in the income tax, there may be a tendency to increase income tax rates, reduce receipts by giving favors through tax expenditures in the income tax, and then make up the difference and raise further necessary revenues through a VAT. Such a distortion of tax policymaking is probably undesirable.

To be sure, some of the political advantages of tax expenditures can be achieved through enactment of permanent mandatory spending programs. As noted earlier, for purposes of support of low- and moderate-income working families, a non-wastable tax credit and a mandatory spending program are close alternatives. And realistically speaking, the difference in merit between the two can be quite small, especially if benefits of whatever form for low-income working families are unlikely to be cut for fiscal consolidation. That would leave associated issues, such as: whether the oversight of mandatory programs is no more rigorous than for tax expenditures; whether program oversight, innovation and improvement are greater or less for tax expenditures than mandatory programs; whether control of fraud is greater or less for tax expenditures; whether beneficiary service (including the availability of payments on a periodic basis throughout the year, or only once per year) is greater or less for tax expenditures; and whether program features such as implicit marginal tax rates for phasing out the benefit, treatment of married couples, and the like are better or worse for a tax expenditure program. It may make little difference, other than perhaps the measured cost of government, which form a “make work pay” program should take.

Still, apart from such “make work pay” policies, there is distinct political attraction to the tax expenditure mechanism as a means to direct public resources toward relative narrowly targeted ends. Therefore, any budget control mechanism must plug the tax expenditure loophole to be fully successful.

Types of budget rules. At a high level of conceptual aggregation, there are two broad types of budget rules. A **deficit rule** sets as its target a level of the fiscal deficit, either in currency or as a percentage of the GDP. Examples of this type of rule are the European Community’s Growth and Stability Pact and the US Gramm-Rudman budget process of the late 1980s. On the surface, a deficit rule would seem to address tax expenditures directly, in that revenue losses increase the deficit. In practice, however, deficit rules can be relatively ineffective against tax expenditures or

any other use of government funds, because such programs can be created or expanded when the economy is strong, and the deficit target is not binding; and then, when the economy is weak and the deficit rises, the weakness in the economy is used as an argument against tightening policy. Thus, a deficit rule is not by its nature an air-tight protection against the enactment or expansion of tax expenditures, and the task under such a rule is to make the rule effective generally. There is a case to be made that this task is extremely difficult.³¹

The second type of rule is a *spending rule*. A spending rule sets a target of levels or changes of spending, rather than using the fiscal deficit as a goal. The advantage of a spending rule is that it can require, and allow, counter-cyclical behavior – restraint in good times, without enforced restraint in bad times.³² When the economy is strong, a spending rule does not allow policy to use any budget windfalls. However, when the economy is weak, there is no requirement for pro-cyclical tightening of the budget, and the budget's automatic stabilizers are allowed to work to cushion the downturn.

On its face, a “spending” rule would seem to allow tax expenditures free rein. And in fact, Sweden has employed a spending rule that imposes no restraint on revenue policy. Such a rule may constrain measured spending, and the measured size of government, but unless those are the sole objectives, its open loophole for tax policies to pursue spending-policy goals but seem to be a fatal flaw. It is unlikely that any deficit rule would be constructed without inclusion of mandatory spending programs in its base; omission of tax expenditures makes no more fiscal sense.

However, the word “spending” can be interpreted broadly, in the sense that such a rule could cover revenues as well as spending narrowly defined. In particular, just as tax expenditures are sometimes referred to as “spending through the tax system,” so a spending rule could easily be implemented to cover tax expenditures as well as outlay expenditures.

The US application of a spending rule included “pay as you go” as a logically complete budget discipline system. In addition to statutory limits on annual appropriated spending, the pay-as-you-go discipline restricted the combined amounts of mandatory spending and taxes, covering both tax expenditures and changes to structural tax parameters. Any change in mandatory spending or tax policies that increased the deficit over an estimation period of up to 10 future years was required to be fully paid for by other changes in the same universe of policies.³³ Violations of the appropriated spending caps, and of the pay-as-you-go restrictions, were sanctioned separately by across-the-board spending cuts in the offending category.

Under such a system, there is no profit to converting an entitlement program to a tax expenditure. Though less likely, converting appropriated spending to a tax expenditure would make room under the appropriated spending cap, but would require an equal pay-as-you-go saving, so the legislative advantage would be unlikely to be significant.

³¹ Barry Anderson and Joseph J. Minarik, “Design Choices for Fiscal Policy Rules,” *OECD Journal on Budgeting*, Volume 5, N°4, pp. 159-208.

³² Anderson and Minarik, *ibid*.

³³ Legislative rules prohibited policies with measurable net costs beyond the ten-year estimation window.

The pay-as-you-go system as applied in the United States was effective prospectively, and such a system is subject to measurement manipulation, either underestimating costs, or legislating unrealistic policy sunsets, or other similar devices. However, a prospective deficit rule would be subject to all of the same manipulations. In fact, one might conclude that a paygo rule would be less vulnerable to manipulations through optimistic misestimation than would be a deficit rule. The reason is that a tax expenditure enacted to dissipate a budgetary windfall could be subject to a more adverse outcome than would a policy package under a paygo discipline, where by nature any error would be around a total estimated to be a net zero impact on the budget. In a separate point, there is no particular vulnerability for tax expenditures under a paygo discipline, because such measurement manipulations could be employed for entitlements and structural tax cuts as to tax expenditures under either a deficit or a spending rule.

It could be argued that paygo, as applied in the United States, is weak in that it restricted only adverse *changes* in policy; then-current policy could continue without sanction, and there was no requirement for any policy steps to achieve deficit reduction. However, the same system could be initialized with a requirement for specified amounts of future policy savings to be achieved from mandatory spending and taxes – including, if desired, a specified amount of budget savings through reductions and reforms or tax expenditures. Of course, within the US context, the enactment and later extensions of the paygo system each included policy steps to reduce the deficit, upon which paygo was superimposed. Along with those policy steps, avoiding further budget costs was sufficient to bring the budget to surplus before the initially specified policy goal. US experience, and the difficulty experience in many countries to evaluate and change the base of policy, suggest that paygo's achievement in avoiding deterioration in the base should not be downplayed.

Some have argued that a spending rule and a deficit rule might be employed in tandem to avoid the limit of the US application to avoiding adverse changes to the budget base, rather than forcing reduction of that base. However, such a combination would raise again the question of whether a worsening of the budget in bad economic times would be allowed to force pro-cyclical restrictive fiscal policy. Other tools would seem to be better suited to requiring active deficit reduction, rather than merely preventing fiscal worsening.

A paygo rule could create an incentive to cut tax expenditures to finance mandatory spending programs or general tax reductions, as well as the other way around. Paygo also could stimulate evaluation of administration and quality improvement of tax expenditures, to achieve better outcomes from the fixed base of available mandatory spending and tax programs.

Experience with a spending rule including restraint on taxes in the United States was highly successful, being arguably instrumental in the progress of the budget from large deficit in the early 1990s to substantial surplus at the end of that decade. However, as yet one more proof of the eternal lesson that sound process without political will is for naught, the spending rule was overridden in the first years of this decade, and substantial fiscal deficit has been the result. Still, it could be argued that a deficit rule, despite its apparent inclusion of tax expenditures, is arguably likely to be generally ineffective. A spending rule that is designed to include revenues, such as through the pay-as-you-go process employed in the United States, can be more successful. The broad consensus of favorable opinion suggests that the spending rule with a pay-as-you-go restriction could be considered best practice for the purpose of controlling tax expenditures.

QUANTITATIVE AND DATA ANALYSIS SECTION

This section describes early quantitative research on the expenditures in a cross section of major OECD countries, along with a beginning of institutional research to put the numbers in context and relate them to the preceding discussion of best practices.

The quantitative research is at an early stage. Tax expenditure amounts have been collected for most countries, with preliminary analysis only for English-speaking countries, and earlier stages of analysis for some countries that present their figures in English. For all of those countries, there remain many questions as to the precise nature of some important tax expenditures. For other countries, there is language translation work to come, followed by substantive analysis of each particular tax expenditure.

The output of this analysis will include detailed numerical tables for each country, and a summary comparative table for all of the countries included. The summary comparison will, of course, be subject to important data and conceptual limitations. Most countries use the revenue-forgone method of analysis, but any differences in this respect from country to country will render the numbers non-comparable. Virtually all countries have unique subtle definitional aspects of their own benchmark tax systems, which even with all else equal could render the estimated costs of otherwise identical tax expenditures different and non-comparable. However, judgmental effort in this regard could provide some important and useful insights about the relative amounts of tax expenditures in different countries across standardized budget objectives. Different countries use different degrees of and variations on accrual accounting.

Conceptual issues. One of the most important issues in the choice of a benchmark system is the taxation of income from capital. Under a consumption tax benchmark, any taxation of capital income would be a negative tax expenditure, and no relief of capital income taxation would be identified as a tax expenditure. Therefore, the handling of the benchmark tax system has significant implications for any comparisons of tax expenditures across countries.

The issues with respect to capital income can become subtle and complex. Different shades of general tax relief, relief for income from particular forms of capital, or relief for specific merit purposes, might be defined in or out of the reference system. Different countries have different interpretations of the appropriate compensation for the effect of inflation. This issue is sufficiently complex in its own right that some countries choose to ignore it. Still, countries might set different degrees of nominal acceleration of depreciation relative to neutral recovery – which itself is an arguable standard – to constitute the benchmark. Taxation of imputed income, such as that from owner-occupied housing, might or might not be considered as a part of the benchmark. Corporate and individual income from taxation might be considered as separate under the benchmark, or some degree of integration of corporate income may be set as the standard. Countries that have schedular systems for capital-income taxation, under which income from capital is taxed separately at its own rates, often a single, flat rate, could choose either the schedular rate or the progressive rates on other income as the reference system.

For reasons identified in earlier sections of this paper, the sums of amounts of different tax expenditures do not necessarily equal the amounts that would be measured if all of those tax

expenditures were considered jointly. Thus, in theory, tax expenditures should not be added. In the real world, there is little alternative to adding tax expenditures if there is interest in their total amounts, because quantitative analysis of any combinations of tax expenditures is rare or nonexistent.

Personal income taxation in general raises its own issues. The benchmark unit of analysis, and of taxation, may be the individual or the family. The borderline between structural provisions that adjust for the ability to pay, and tax expenditures that compensate disadvantaged groups, is not clear. Koiwa argues that the failure to identify ability-to-pay reliefs puts them on a different plane of analysis than outlay programs to the same effect.³⁴ On the other side of the coin, if the point of income taxation is assessment based on the ability to pay, then identification of such provisions as tax expenditures would seem misplaced.³⁵ Some might quarrel even with the acceptance of graduated rates as a part of a benchmark system.

Some countries identify tax expenditures only for their income taxes on individuals and corporations. Other countries also identify tax expenditures for value-added or sales taxes, estate taxes, or specific excise taxes. Clearly, tax expenditures on different types of taxes must be considered separately.

In sum, there will be difficult issues in the cross-country comparisons of tax expenditures. There will be no way to make them unambiguously "right." The point of the analysis will be to make the comparison as useful as is possible.

Institutional research and analysis. A further, difficult goal of this paper will be to assess the accuracy of some of the allegations about the handling of tax expenditures in the OECD countries. What government offices provide the accounting for tax expenditures? What can be said about the quality of the measurements? Are tax expenditures reviewed more or less carefully or often than similar mandatory spending programs? How much of the recent growth of tax expenditures is accounted for by "make work pay" provisions? Are those provisions as effective as would be equivalent mandatory spending programs? To what degree are tax expenditures integrated into the budget process? Is the budget process effective in disciplining the enactment or growth of tax expenditures?

In pursuit of both quantitative and institutional research, data collection is underway to answer all of these questions. The report will use the presentational guidelines set forth in the paper by

³⁴ Koiwa, section 3.2.

³⁵ It might be argued that ability-to-pay tax provisions are different from most spending programs, in that the former apply to persons with income from labor or capital, and the latter generally apply to those with no other means of support. Even that distinction clearly is imperfect, however. All of these issues might suggest that a best-practice system would identify the revenue costs of ability-to-pay reliefs, even if they were not formally categorized as tax expenditures. Such information would undeniably be helpful. However, the world is not to that point yet, and so this recommendation is not helpful in the current analysis. And even if such a practice were accepted universally, the borderline between structural low-income reliefs and tax expenditures still would be material, because it would affect the graduated marginal tax rates against which all other tax expenditures would be evaluated. Considering the graduated rates themselves as a tax expenditure would mean that all tax expenditures would be evaluated against some flat rate, which would be unrealistic and would render all of the numbers much less useful.

Kraan,³⁶ which are discussed in the box below, and will follow upon the general approach of the earlier informal survey paper by Koiwa, which is attached as an appendix.

TAX EXPENDITURE TERMINOLOGY

Following are standards of terminology and presentation set forth in the OECD paper by Dirk-Jan Kraan, which will provide guidance to this report.

Identification of tax expenditures

A tax expenditure can be defined as a transfer of public resources that is achieved by reducing tax obligations with respect to a benchmark tax, rather than by a direct expenditure. It has often been observed that this definition has not led to international comparability of tax expenditures, because of differences of opinion about the benchmark tax.

Tax expenditures may take a number of different forms:

- exemptions: amounts excluded from the tax base;
- allowances: amounts deducted from the benchmark to arrive at the tax base;
- credits: amounts deducted from tax liability;
- rate relief: a reduced rate of tax applied to a class of taxpayer or taxable transactions;
- tax deferral: a relief that takes the form of a delay in paying tax.

The transfer of resources emanating from a tax expenditure may be bound to the purchase of a certain good (in which case the tax expenditure is a tax subsidy) or unbound (in which case it is a tax transfer).

The identification of tax expenditures is a classification exercise: dividing the provisions of the tax laws into a benchmark tax and a series of deviations from that benchmark tax. According to the 1996 OECD report, the benchmark tax includes: the rate structure, accounting conventions, the deductibility of compulsory payments, provisions to facilitate administration, and provisions relating to international fiscal obligations. However, these indications leave open many questions. The problem is more profound than the lack of agreement about the types of provisions that belong to the benchmark tax; it is rooted in different views of **the normative tax base**. The normative tax base is the monetary sum in the hands of private households to which the tax ought to be applied, for instance: income, value added, profit, sales. Views of the

³⁶ Dirk-Jan Kraan, "Off-budget and Tax Expenditures," *OECD Journal on Budgeting*, vol. 4, no. 1, 2004, pp. 121-42.

appropriate normative tax base not only differ between national tax systems, but also between interpretations of the same national tax system by citizens and politicians. If the benchmark for the identification of tax expenditures is equated with the normative tax base, differences of opinion concerning the normative tax base will necessarily translate into differences of opinion about the identification of tax expenditures. Since this approach (equating the benchmark with the normative tax base) has proved to be less fruitful in the past, it is proposed here to distinguish between the benchmark and the normative tax base.

The distinction can be illustrated by the concept of "income" which serves as a normative tax base in many income tax systems. In principle it is possible to define this concept quite precisely. The standard is the Haig-Simons or accretion definition of income which states that income is the difference in wealth of a household between two points in time, plus the value of consumption during that period. However, many citizens and politicians would view income in this sense only as a first approximation of what the fiscal system really ought to tax. Therefore the tax code needs provisions to bridge the difference. The normative tax base may, for instance, take into account:

- Capacity to pay: In this view, special provisions have to exclude everything from the tax base which diminishes the capacity to pay, in particular all costs of necessities for which the taxpayer cannot or should not be held responsible: exceptional health costs, maintenance of dependent family, study costs of children, etc.
- Consumption: In this view, the actual income tax is intended to be a compromise between a comprehensive income tax and a comprehensive consumption tax; in this view special provisions have to exclude certain forms of saving from the tax base (pension premiums, saving plans, etc.) as part of the compromise.
- Analytical income: In this view, income should only be taxed if the tax cannot easily be evaded; this leads to taxation at the source and the application of different rates to different sources of income reflecting the costs of evasion; in this view special provisions concerning rate differences between sources of income have to be seen as inherent to the aims of the tax.

The provisions required to bridge the difference between the comprehensive concept of income and a particular normative tax base are part of the definition of the normative tax base and not exceptions to it. However, if opinions differ about the normative tax base, opinions will also differ about what the exceptions are.

Differences of opinion may also occur with respect to the normative base of other taxes, for instance the VAT. In one view, special provisions are required to ensure that a lower rate is applied to the necessities of life (or to exclude the

necessities of life from the regular tax base and to include them in a special tax base), taking into account the typical composition of consumption packages of family households and based on capacity to pay. In another view, however, the VAT is considered as a tax that has value added by definition as its exclusive tax base. A special provision for the necessities of life is not a part of the definition of the normative tax base but an exception to it.

Similarly, differences of opinion may occur with respect to the normative base of excise taxes. In one view, such taxes not only have allocative effects but are also aimed at these effects (regulatory taxation). In particular, they may be supposed to decrease the demand for goods that have negative external effects on third parties (for instance, the gasoline tax) or on the consumers themselves (for instance, the levies on alcohol and tobacco). In this view, special provisions are required to ensure that a lower rate is applied to a less harmful product (or to exclude a less harmful product from the regular tax base and include it in a special tax base), for instance, lead-free gasoline. A different view is that excise taxes are not considered as regulatory taxes. A special provision for a less harmful product is not part of the definition of the normative tax base but an exception to it.

Apart from the nature of the normative tax base, its interpretation may be controversial. A well-known dispute in this respect is the treatment of mortgage interest. One interpretation of family income says that a family receives a flow of housing services from an owner-occupied home equal in value to the rent that the property could earn in the market. After deducting the costs of earning that income, including mortgage interest, the remainder – an imputed net rent – is part of Haig-Simons income. In this view, exemption of the mortgage interest is not an exception to the normative tax base, but exemption of imputed rent is. Another interpretation of family income says that the purchase of the family home is the purchase of a durable consumption good. In this view, mortgage interest should be included in the tax base, but imputed rent should not. In this view, exemption of mortgage interest is an exception to the normative tax base, but exemption of imputed rent is not.

It appears then that the definition of the normative tax base is a very political exercise. For this reason, attempts in the past to define tax expenditures in terms of the normative tax base ("tax expenditures are exceptions to the normative tax base") have not been very successful. They have led to neither international nor domestic agreement about the concept of tax expenditure. Thus an alternative definition of a tax expenditure abstracts from the normative tax base. The definition uses rather the more neutral yardstick of the "benchmark tax". Tax expenditures in this sense are deviations from the benchmark tax. The benchmark has no normative significance. Deviations from it in order to arrive at the normative tax base may be perfectly appropriate. Tax expenditures may

thus also be appropriate.

Characteristics of the benchmark are that it is comprehensive and unique. Examples of benchmarks are: comprehensive income (the Haig-Simon concept), comprehensive consumption, value added, sales in a certain product class. If an excise is levied on a harmful product (for example, pure alcohol), no exceptions for less harmful products are necessary. In practice excises are almost never levied on the harmful ingredient per se. The normative tax base will then deviate from the benchmark.

Estimation of tax expenditures

Tax expenditure estimates can be made by three different methods:

- Initial revenue loss (gain): the amount by which tax revenue is reduced (increased) as a consequence of the introduction (abolition) of a tax expenditure, based upon the assumption of unchanged behaviour and unchanged revenues from other taxes.
- Final revenue loss (gain): the amount by which tax revenue is reduced (increased) as a consequence of the introduction (abolition) of a tax expenditure, taking into account the change in behaviour and the effects on revenues from other taxes as a consequence of the introduction (abolition).
- Outlay equivalence: the direct expenditure that would be required in pretax terms, to achieve the same after-tax effect on taxpayers' incomes as the tax expenditure, if the direct expenditure is accorded the tax treatment appropriate to that type of subsidy or transfer in the hands of the recipient.

The method of **initial revenue loss (gain)** is based upon the assumption that the introduction or abolition of tax expenditure does not affect the behaviour of taxpayers and the revenues from other taxes. It is therefore the easiest estimation method. In general, taxpayers will change their behaviour in reaction to the introduction of a tax expenditure (increase their demand for the tax-subsidised good or increase/decrease their demand for income). This change in behaviour is often also intended by the government. Furthermore, there may be second-order effects on other sectors or on the economy as a whole. Tax expenditures may for instance lead to increased growth due to a lower general tax level. Behaviour will be affected in the opposite direction when a tax expenditure is abolished. Taxpayers' behaviour should not be confused with interaction of tax expenditures with other parts of the tax system. For instance, some taxpayers may end up in a lower bracket of the income tax as a result of a new tax expenditure and consequently face a lower marginal rate. This will also imply that for these taxpayers the value of existing tax expenditures is reduced. When using the method of initial revenue loss (gain), it is often assumed that the exempted income is taxed at the same marginal rate as the remaining (c.g.

restituted) taxable income, or in other words at the same marginal rate that the taxpayers face after the introduction (c.q. abolition) of the tax expenditure. Furthermore, this also implies that the value of the other tax expenditures is unchanged as a result of the introduction of the new (abolition of the existing) tax expenditure.

The method of **final revenue loss (gain)** takes the behavioural change and the change in tax interaction into account. Of course this makes the method much more complicated to apply in practice. Although the method is superior in principle, many governments seem to assume that the accuracy that may be gained is not worth the efforts required to apply the method.

Outlay equivalence is a measure that leaves the net budget impact (on the surplus or deficit) and the after-tax incomes of taxpayers the same in the situation with tax expenditure and in the situation with equivalent outlay but without tax expenditure. Outlay equivalence takes into account the fact that regular transfers are sometimes estimated gross of the tax paid by the recipient, whereas tax transfers are by definition net of tax. In order to estimate these tax expenditures on the same basis as regular expenditures, it is necessary in those cases to add the tax that is typically levied upon the regular transfer. Otherwise, it appears as if the tax expenditure is a cheaper way to get the same amount of cash into the hands of the recipient than the regular expenditure. In general, tax equivalence only differs from initial revenue loss (gain) in the case of tax transfers (as opposed to tax subsidies). Moreover, both methods only differ if the analogous expenditure transfer is taxed.

APPENDIX

RECENT ISSUES ON TAX EXPENDITURES IN OECD COUNTRIES

Tetsuro Koiwa

1. Purpose and Scope of this Paper

1.1 This paper reports recent trends in the use of tax reliefs in OECD member countries and their implication on the traditional “tax expenditure” control. Section 2 discusses general trends in tax reliefs, followed by Section 3 which explores how to maintain the proper functioning of

budget under the trends discussed in the previous section. Section 4 provides more detailed information for the selected seven countries, namely Australia, Canada, Ireland, Japan, New Zealand, United Kingdom, and the United States, for which sufficient English information was available. It also contains some brief description for three other countries, Korea, the Netherlands and Sweden. Situation in other countries, including several EU countries, is treated as a part of the argument in Section 1.

1.2 For the sake of the argument, the concept of “tax relief” vis-à-vis the widely-used “tax expenditure” concept should be specified. Tax expenditure is usually defined as a deviation from a benchmark or a norm of a given tax system.³⁷ There is no international agreement on what constitute the benchmark, and provisions that are classified as tax expenditures vary significantly among countries. Hence discussion of “tax expenditure” based solely on figures reported by different governments would be misleading, especially when its main interest is about controversial provisions which can be either a part of benchmark or tax expenditures. In order to avoid this pitfall, the concept “tax relief” used in this paper, instead, is a more general term which includes exemptions from the tax base, allowances deducted from gross income, tax credits deducted from tax liability, tax rate reductions, and tax deferrals³⁸. This is a broader concept than narrowly-defined tax expenditure concepts in countries like the Netherlands, and somewhat similar to tax expenditures defined broadly in Canada, for example³⁹.

2. Recent Trends in Tax Reliefs of Member Countries

2.1 In this section, the main focus is on tax reliefs in the income tax system for several reasons. First, noteworthy changes of tax reliefs in the personal tax system occurred in many countries. They are, in many cases, accompanied by considerable increases. On the other hand, reliefs in the corporate tax system have been relatively stable. Second, for most member countries, individual tax reliefs are much more significant than corporate tax reliefs. Third, problems of tax reliefs for the business sectors have been long recognized and addressed in the “traditional” argument on tax expenditures. Although not always successful, many governments have attempted to control business tax expenditures. For EU countries, in addition, the use of business tax expenditures is now constrained: it is standard procedure that tax reliefs that benefit specific categories of businesses must be approved by the European Commission and some of them are forbidden⁴⁰. Forth, although some countries report tax reliefs in VAT, excise duties or other taxes, international comparison is rather difficult due to the large difference in coverage of these taxes among countries.

³⁷ OECD (1996)

³⁸ Although this concept is too vague to conduct international comparison quantitatively with, it suffices for the argument in this paper.

³⁹ Thus, “tax expenditures” in this paper are those defined by a country under consideration.

⁴⁰ The Netherlands, Ministry of Finance (2003).

Vocabularies related to tax expenditures

Tax Reliefs: preferential treatments in taxation. Usually tax reliefs take one of the following forms:

- **tax exemptions** (sometimes referred to as exclusions): those items of income that would otherwise constitute a part of the taxpayer's gross income, but are excluded. For example, in many countries, some social benefits are not included in the gross income when assessing a tax liability.
- **tax allowances** (sometimes referred to as deductions): adjustments of gross income. For example, medical expenses may be deducted from gross income, and a fixed amount may be deducted if a taxpayer has a child under a certain age.
- **tax credits:** reduction of tax liability by a certain amount. For example, a taxpayer may reduce his/her tax liability by the amount of tuition fees paid. The important difference from tax allowances is that tax credits are applied after a tax liability is calculated, where as tax allowances are applied before a tax liability is calculated: it reduces gross income which is multiplied by tax rate.
- **preferential tax rates:** lower tax rate applied on some forms of income such as capital gains.
- **deferral of tax liabilities:** delay recognition of some income or accelerating some deductions otherwise attributable to future years so as to reduce current tax liabilities.

Tax Expenditures: Tax reliefs which are considered to deviate from a benchmark or a norm of a given tax system. The judgment on what constitutes the benchmark or the norm differs among countries. Consequently, there is no international agreement on what kind of provisions should be regarded as tax expenditures. Tax Provisions classified as tax expenditures are tax reliefs, but not all tax reliefs are regarded as tax expenditures.

Non-wastable tax credits (sometimes referred to as refundable tax

2.2 Three aspects of recent trends in individual tax reliefs common to many countries are:

1. tax reliefs have been increasingly used for social purposes, inter alia, support for low income families (with children, in many cases), support for the aged, and healthcare.
2. compared with exemptions, allowances and other measures, tax credits have been more preferred as a tool to deliver social benefits. Not only have various tax credits been introduced and enriched, but also they have replaced existing tax allowances or grants in many countries.
3. with relation to 2, non-wastable tax credits have become more and more popular, thereby obscuring the border between the tax system and the benefit system. Non-wastable tax credits are tax credits whose amounts are not “wasted” regardless of how large a taxpayer’s liability is: if a tax liability falls short of the credit, the amount in excess of the liability is paid by a tax office.⁴¹⁴²

2.3 Two objectives underpin these trends: to increase support for low-income (and sometimes middle-income) groups and to increase employment. One important advantage of tax credits is that they are less regressive than other measures. While tax exemptions and tax allowances provide larger reduction in tax liabilities for high-income taxpayers facing higher marginal tax rate, tax credits guarantee the same amount regardless of taxpayer’s marginal tax rate. Furthermore, if a government is to address remaining unfairness of giving less or no benefits to those paying no or negligible taxes, making tax credits non-wastable is a reasonable solution. Thus, the use of (non-wastable) tax credits is one useful way to provide benefits to targeted recipients.

2.4 In particular, “making work pay” policies (MWP) are quite popular among OECD countries as they appear to achieve both of the two objectives at the same time. In many countries a large wedge between real labor compensation as perceived by employers and real take-home pay for workers caused by the heavy taxation of wage earnings is said to hamper employment. In particular, effective marginal tax rates (EMTR), which take into account the reduction of unemployment or income support benefits, can be considerably high, causing a disincentive for work. In order to reduce this disincentive, it has become common to make the subsidies through the tax system, with the use of employment-conditional (in-work) tax credits, as well as general tax cuts⁴³.

⁴¹ In some cases a term “refundable” is used in lieu of “non-wastable”. Here I choose the latter, for two reasons. First, taxes are usually “refunded” if the amount withheld during a taxation period exceeds the actual tax liability calculated at the end of the period. This is no new phenomena and the term “non-wastable” can avoid confusion. Second, a tax credit can be non-wastable even when they are not refundable. For example, people can transfer or carry-forward/back some tax credits. It is worth discussing these types of tax credit as well.

⁴² OECD (2006)

⁴³ OECD (2004c)

2.5 This trend can be observed in many countries^{44, 45}. The following table summarizes the aggregated costs of tax expenditures in several countries. As it is discussed in the Appendix, since the figures are based on different definitions, coverage, estimation methods and accounting methods in different countries, they are not internationally comparative. Also, care must be taken even in interpreting figures in a given countries independently of other countries. Noting that, one important fact can be seen: tax expenditures are increasing in many countries, and even in countries where tax expenditures are decreasing, those related to social purposes are relatively stable or, slightly increasing. Discussion on each countries are presented below.

Aggrageted Tax Expenditures								
	1995		1998		2001		2004	
	Amount	% of GDP	Amount	% of GDP	Amount	% of GDP	Amount	% of GDP
Australia (in million AU\$)								
Total Tax Expenditures	18,257	3.53%	25,753	4.24%	29,726	4.04%	36,859	4.13%
Social Security and Welfare Tax Expenditures	12,982	2.51%	16,852	2.77%	19,025	2.59%	23,909	2.68%
Canada (in million CA\$)								
Total Tax Expenditures	103,089	12.91%	113,106	12.56%	113,557	10.40%	134,327	10.57%
Personal Income Tax Expenditures	77,645	9.73%	84,236	9.36%	75,444	6.91%	99,951	7.87%
Tax Expenditures for Education, Employment, Family or Health	9,625	1.21%	10,840	1.20%	13,991	1.28%	16,317	1.28%
Ireland (in million euro)								
Total Tax Credits/Allowances and Tax Reliefs	7,404	13.93%	10,302	13.09%	12,528	9.60%		
Japan (in billion yen)								
Total Special Taxation Measures			1,864	0.37%	2,362	0.48%	3,582	0.72%
The Netherlands								
	-	1.53%	-	2.38%	-	2.30%		
United Kingdom (in million £)								
Total Tax Reliefs			143,490	16.67%	163,365	16.39%	197,375	16.95%

Figures are based on what were reported by each governments. See country-specific tables below.

For Australia, Ireland and United Kingdom, tax reliefs are not estimated for calendar years.

For Ireland, estimates for 2002 were used instead of 2001.

For the Netherlands, estimates for 1994 were used instead of 1995.

2.5.1 Both the aggregated revenue forgone of all tax expenditures and that of *social security and welfare* tax expenditure in **Australia** have more than doubled over the last decade (Table 1⁴⁶). Correspondingly, their proportions to the nominal GDP have increased. This reflects several important reforms in individual tax reliefs. Most important is the development of the tax reliefs for families with children. Before 1996, support for families with children was primarily provided via social benefits⁴⁷. Now, the Family Tax Benefit, which replaced twelve tax and welfare benefits in 2000 as a part of *the New Tax System*, provides family assistance either via social benefits or by means of non-wastable tax credits. Also, the government has introduced and expanded various tax credits, some of them non-wastable, which were intended either to benefit

⁴⁴ Since the United States adopt broadly-defined tax expenditure concepts, tax expenditures in those countries are close to tax reliefs, and can be used as a substitute in analyzing tax reliefs. This is true of Australia and Canada. As for other countries like Ireland, Netherlands, and United Kingdom, care must be taken in interpreting the information of "tax expenditures" reported.

⁴⁵ One exception is Japan, which, under its unique economic circumstance of "great stagnation", expanded tax reliefs in the corporate tax system rather than personal tax reliefs. This is described in detail in Section 4.

⁴⁶ Care must be taken in interpreting a figure obtained by summing up estimated revenue forgone of each tax expenditure item. This point is true of all the figures presented in this paper, and discussed in the Appendix.

⁴⁷ Hodgson, H. (2005).

families, to support low-income or elderly people or to promote healthcare (See also Table 11 and 12). As a result of these reforms, five out of twelve largest expenditures in 2005-06 in the Table 2 commenced between 1993 and 2000, with two of them being tax credits for social purposes, and the other two exemptions of non-wastable tax credits.

Table 1 **Aggregated Tax Expenditures in Australia**

	(in million AU\$)							
	1995-96		1998-99		2001-02		2004-05	
	Amount	% of GDP	Amount	% of GDP	Amount	% of GDP	Amount	% of GDP
Total Tax Reliefs	18,257	3.53%	25,753	4.24%	29,726	4.04%	36,859	4.13%
Social Security and Welfare Tax Expenditures	12,982	2.51%	16,852	2.77%	19,025	2.59%	23,909	2.68%

Source: Australia, Department of Treasury (2005, 2004, 2001, and 1998); OECD National Accounts Statistics
GDP are in 2004, 2001, 1998, 1995

Table 2 **Large Measured Tax Expenditures in Australia (2005-06)**

Tax Expenditures	Estimated Costs	Type	Function	Introduced
Concessional Taxation of Funded Superannuation	15,520	Exemption, reduction in taxable value	Social security and Welfare	Before 1985
Capital Gains Tax Discount for Individuals and Trusts	4,390	Exemption	Other economic affairs	1999
Exemption of Family Tax Benefit, Part A and B, including Expense Equivalent	2,470	Exemption	Social security and Welfare	2000
Senior Australians' Tax Offset	1,840	Credit	Social security and Welfare	1996
Tax Offset for Recipients of Certain Social Security Benefits, Pensions or Allowances	1,330	Credit	Social security and Welfare	Before 1985
Application of Statutory Formula to Value Car Benefits	1,140	Discounted valuation	Other economic affairs	1986
Exemption of Certain Income Support Benefits, Pensions or Allowances	900	Exemption	Social security and Welfare	Before 1985
Exemption of 30 per cent Private Health Insurance Refund, Including Expense Equivalent	890	Exemption	Health	1998
Deduction for Gifts to Approved Donees	800	Deduction	Not allocated to function	Before 1985
Concessional Rate of Excise Levied on Aviation Gasoline and Aviation Turbine Fuel	780	Concessional rate	Fuel and Energy	Before 1985
Tax Offset for Low Income Earners	660	Credit	Social security and Welfare	1993
Exemption from Excise for 'Alternative Fuels'	630	Exemption	Fuel and Energy	1985

Source: Australia, Department of Treasury (2005)

2.5.2 **Canada** is also a country where tax credits play a more and more important role in the social domain (see Table 14). In the individual tax system, the estimated revenue forgone of

existing tax credits in 2005 (see Table 11)⁴⁸ amounts to CAD 60 billion, which is 44% of total CAD 135.7 billion. Eight out of them were introduced since 1995, while most of the other tax credits date back to 1970s. This reflects a steady expansion of tax credits in the last decade. The budget line items of these new income tax credits were Education, Family, Health or Income Maintenance and Retirement. Two of them, the Child Disability Benefit and the Refundable Medical Tax Credit Supplement, are non-refundable. Also noteworthy is the substantial enrichment of the Canada Child Tax Credit (CCTC), a non-refundable tax credit whose predecessor, the Child Tax Credit, was introduced as early as 1970. In fact, the amount of CCTC has been increased in almost all years since 1996. In Table 5, while tax expenditures in general have declined over the last decade, some expenditures for social purposes (education, employment, family and health) increased. It may be a part of the move to GDP.

Table 5 Aggregate Tax Expenditures in Canada

	1995		2005		2007		2007	
	Amount	% of GDP	Amount	% of GDP	Amount	% of GDP	Amount	% of GDP
Personal Income Tax Expenditures	47,000	34.7%	47,000	34.7%	47,000	34.7%	47,000	34.7%
Charitable Deductions	1,000	0.7%	1,000	0.7%	1,000	0.7%	1,000	0.7%
Employer's Social Insurance Contributions	2,100	1.5%	2,100	1.5%	2,100	1.5%	2,100	1.5%
GST Expenditures	1,000	0.7%	1,000	0.7%	1,000	0.7%	1,000	0.7%
Total Tax Expenditures	51,100	37.6%	51,100	37.6%	51,100	37.6%	51,100	37.6%
Corporate Income Tax Expenditures	1,000	0.7%	1,000	0.7%	1,000	0.7%	1,000	0.7%
GST Tax Expenditures	1,000	0.7%	1,000	0.7%	1,000	0.7%	1,000	0.7%
Total Tax Expenditures	53,100	39.0%	53,100	39.0%	53,100	39.0%	53,100	39.0%

Source: Statistics Canada, *Canadian Tax Statistics (2000-2003)* and *Canadian Tax Statistics and Expenditures*

2.3.3 In Germany, the tax system has been substantially reformed since 1998 with main beneficiaries being employees and pensioners paid the income tax. The personal income tax has been reduced by an amount that was more than half the basic personal of owners. More importantly, there is significant socialized tax credit for social benefits and the income tax law now includes several provisions for long tax credits that in principle are equivalent to transfer payments. These include among others, the Child Tax Credit, the Tax Credit for the Owner-Occupied Housing, and the Tax Credit for Capital-Funded Old-age Savings. These tax reliefs are granted independent of tax assessment process and, in particular, the Child Tax Credit can be regarded as non-volatile because taxpayers can either receive child benefit or deduct tax credit from their tax liabilities, which means the whole amount is provided to everyone regardless of how large their tax liability is.⁴⁹

2.3.4 Tax policy in Italy in 1990s up until 1997 was almost exclusively focused on raising revenues without taking into account the welfare. From the end of 1990s until the government reduced the tax burden for households and made tax treatment for private pensions more favorable, the government has been introducing and expanding social tax reliefs. Several new tax credits have been introduced for low-income workers, self-employed parents with children

⁴⁸ This excludes the Foreign Tax Credit and the Grandchild and Credit memorandum items. It does not include very limited on transfer of the deceased and Britain for credit separately from the Bildanden and the rest of the world.

⁴⁹ Recent tax policies in Belgium, France, Germany, Italy, Spain, Slovak Republic are based on OECD's (2004a).

below 3 years and one-income earner families with low income. Also, the Tax Credit for Dependent Children was increased. Although Italy is exceptional in that it is now transforming personal tax credits and other tax credits into deductions from taxable income, it shares with other countries the trend of increasing use of tax system to support disadvantaged groups.

2.5.5 **Ireland** recently moved from the tax allowance system to the full tax credit system, increasing the amount at the same time. In order to equalize the value of tax allowances to all taxpayers so that more resources are concentrated on low-income households, in the 1999 and 2000 budgets the Government converted various tax allowances into tax credits at the standard rate of tax. This conversion doubled the amounts of most allowances in order to avoid any losses to those on the higher rate. In addition, as a way to reward work and enterprise, tax burden was reduced thorough the substantial increase in the Personal Tax Credits/Allowances and the Employees Tax Credits/Allowances. The consequence of these reforms as well as expansion of pension reliefs is the rapid increase in the estimated revenue forgone by the tax reliefs in the individual tax system (see Table 15) under the trend of declining aggregated revenue forgone of all tax reliefs (see Table 4).

Table 4 Aggregate Tax Reliefs in Ireland

(in million euro)

1995-96		1998-99		2002	
Amount	% of GDP	Amount	% of GDP	Amount	% of GDP
7,404	13.93%	10,302	13.09%	12,528	9.60%

1995-96 and 1998-99 are the income tax year, which ran from 6 April to 5 April. 2002 is the calendar year.

Since 2001 was "the short tax year", which ran from April 6 to December 31 and thus not comparative, estimated costs in 2002 are shown instead.

euro amounts for 1995-96 is calculated based on the fixed conversion rate between the euro and the Irish pound: 1euro =IR£0.787564

It should be noted that there are many tax reliefs whose costs are not estimated (and thus not included in the aggregate) because they are unquantifiable.

Source: Ireland, Office of the Revenue Commissioners, Statistical Report 1998, 2001 and 2004

2.5.6 Several non-wastable tax credits are now an important component of the Social Assistance System in **New Zealand**. While it abolished a wide range of business investment incentives during the second half of 1980s, it introduced the Family Support, a non-wastable tax credit, which then integrated the Family Benefit (social benefit) in the early 1990s. In more recent years, three in-work non-wastable tax credits have been created to assist families. More than double increase in fiscal costs of family assistance via the tax system is presented in the Table 5.

Table 5 Fiscal Costs of Family Benefit and Family Assistance in New Zealand

(million NZ\$)

Year	Family Benefit	Family Support	Family Tax Credit*	Child Tax Credit	Parental Tax Credit	Total
1986-87	273.2	186.9	-	-	-	460.1
1989-90	284.4	465.0	-	-	-	749.4
1992-93	-	577.3	-	-	-	577.3
1995-96	-	748.3*	-	-	-	748.3
1998-99	-	906.5	8.2	161.9	-	1,076.6
2001-02**	-	888.0	11.0	185.0	22.0	1,106.0

Prior to 1989-90 the year ended 31 March; from 1989-90 onwards the year ended 30 June

*The Family Tax Credit was recorded together with Family Support until 1996-97

**The increase from 1992-93 to 1995-96 partly reflected the shift from cash to accrual accounting after 30 June 1994

***Contained in the 2001-02 Estimates of Annual Appropriations. Actual out-turns may differ from the figures listed

Source: Nolan, P. (2002)

2.5.7 **Spain** is one of the few countries which moved the personal tax system to the opposite direction: from tax credits to tax allowances. In 1999, practically all tax credits were abolished and replaced by a standard tax-exempt income amount, which takes into account certain family characteristics of the taxpayer. However, the tax reform in 2003 suggests similarities with other countries. New allowances were created for taxpayers with children under three years, the elderly, and employees over their official retirement age. At the same time, the family allowances and the work related allowance was increased. In addition, it created a non-wastable tax credit for female employees with children under three years.

2.5.8 Although tax reliefs in the income tax have been well controlled in **United Kingdom** (see Table 6), there have been important changes. Alongside the increase in pension-related tax reliefs and tax reliefs for the capital gains tax, complete restructuring of individual tax credits and some related allowances is the most important recent change in the tax system (see Table 17). In the 1998 budget, two objectives of the tax reform were declared: (1) to support families with children and (2) to provide the greatest support for those who need the most. Since then, the personal tax system has moved to some degree of integration of the tax- and the benefit- system. The reform eventually created two non-wastable tax credits, the Child Tax Credit and the Working Tax Credit, which provide social support to families with children that had been delivered in the form of various social benefits.

Table 6 Aggregate Tax Reliefs in United Kingdom

(in million £)

	1998-99		2001-02		2004-05	
	Amount	% of GDP	Amount	% of GDP	Amount	% of GDP
Income Tax	59,360	6.90%	64,580	6.48%	64,295	5.52%
Tax Expenditures	20,715	2.41%	25,670	2.58%	22,055	1.89%
Reliefs with Tax Expenditure and Structural Components	7,445	0.87%	4,110	0.41%	5,640	0.48%
Structural Reliefs	31,200	3.63%	34,800	3.49%	36,600	3.14%
Corporation Tax	1,800	0.21%	2,630	0.26%	5,070	0.44%
Tax Expenditures	0	0.00%	170	0.02%	480	0.04%
Reliefs with Tax Expenditure and Structural Components	1,500	0.17%	2,060	0.21%	3,790	0.33%
Structural Reliefs	300	0.03%	400	0.04%	800	0.07%
Both Income Tax and Corporation Tax	26,100	3.03%	23,240	2.33%	26,140	2.24%
Tax Expenditures	0	0.00%	240	0.02%	520	0.04%
Reliefs with Tax Expenditure and Structural Components	20,600	2.39%	16,500	1.66%	17,620	1.51%
Structural Reliefs	5,500	0.64%	6,500	0.65%	8,000	0.69%
VAT	31,650	3.68%	36,350	3.65%	48,150	4.13%
Tax Expenditures	19,900	2.31%	20,750	2.08%	27,350	2.35%
Reliefs with Tax Expenditure and Structural Components	6,450	0.75%	7,850	0.79%	10,150	0.87%
Structural Reliefs	5,300	0.62%	7,750	0.78%	10,650	0.91%
Other Taxes	24,580	2.86%	36,565	3.67%	53,720	4.61%
Tax Expenditures	2,160	0.25%	11,840	1.19%	20,740	1.78%
Reliefs with Tax Expenditure and Structural Components	14,410	1.67%	15,005	1.51%	21,980	1.89%
Structural Reliefs	8,010	0.93%	9,720	0.98%	11,000	0.94%
Total Tax Reliefs	143,490	16.67%	163,365	16.39%	197,375	16.95%

Other taxes include: National Insurance Contribution Tax, Capital Gains Tax, Inheritance Tax, Stamp Duties, Petroleum Revenue Tax, and Vehicle Excise Duties.

Figures includes tax reliefs with estimated cost of at least £50 million.

Source: United Kingdom, HM Treasury (1999, 2002, 2005), *Tax Ready Reckoner and Tax Reliefs*

2.5.9 In the United States, a number of tax credits have been recently introduced and enriched significantly (see Table 19). Table 7 shows consequent rapid increase in the number of tax credits and their aggregated revenue forgone since 1995. Most of tax credits introduced recently aim at individual taxpayers for some social purposes⁵⁰, which seems to be one important factor in “*the shift away from business tax expenditures to social tax expenditures—tax expenditures directed at social policy goals*”⁵¹. Among these tax credits are two non-wastable tax credits, namely the Child Tax Credit and the Tax Credit for Health Insurance Purchased by Certain Displaced and Retired Individuals. The Child Tax Credit has been enriched substantially by several tax relief acts, and now, among the 13 largest tax expenditures with more than US\$ 20 billion revenue forgone, it is the only item which was created after 1986 among. In addition, The Earned Income Tax Credit (EITC), which is probably the oldest non-wastable tax credit dating back to 1970s, has almost doubled.

⁵⁰ Table 18 lists tax credits reported in the FY 2006 budget with their estimated costs (revenue forgone) in 1995, 2000 and 2005, budget function, first year reported and “wastability”.

⁵¹ Toder, E. J. (2000)

Table 7 Numbers and Costs of Tax Credits in the United States

	(in million US\$)						
	1975	1980	1985	1990	1995	2000	2004
Number of Tax Credits Reported	8	18	17	18	17	26	29
Aggregated Revenue Forgone	-	-	-	-	17445	45304	62848
% of GDP	-	-	-	-	0.24%	0.46%	0.54%

Source: United States, Governmental Accountability Office (2005); United States, Office of Management and Budget (1997, 2002, 2006); OECD National Accounts Statistics

2.5.10 Similar trends can also be observed in **Belgium** and **France**, whose main objective of tax policy until the late 1990s had been to increase revenue to meet the Maastricht requirement. In the governmental agreement of July 1999, Belgian government decided to reform the household income tax to ease the tax burden. As a part of the consequent income tax reduction, the Tax Credit for Low-income earners was introduced, and an exemption to all single parents was granted. In order to make allowances for taxpayers with dependent children more equal, some tax credits were made non-wastable. In France, the main objective of tax policy has been to ease the taxation of labor income and of low-skilled labor in particular. One important measure is the introduction of *prime pour l'emploi*, an in-work non-wastable tax credit for low-income workers. **Iceland** now has two non-wastable tax credits, one depending on the number of children under 15 and the marital status of the mother, and the other on the amount of interest paid on housing loans. Also, the principle deduction for the personal income tax is given in the form of tax credit. In **the Netherlands**, the fundamental tax reform in 2001 introduced tax credits (*heffingskortingen*) in place of tax allowances. The standard tax allowance was replaced by a single tax credit and the employed person's allowance was replaced by the Earned Income Tax Credit (*arbeidskorting*). In **Slovak Republic**, the tax allowance for each dependent child was more than doubled in 2000, followed by the conversion into non-wastable tax credit more recently.

2.6 As a result of all these reforms, the number of countries which have non-wastable tax credits has increased quite rapidly since the mid-1990s. At least 14 OECD countries have introduced non-wastable tax credits so far (Table 6). Of them, non-wastable tax credits in Canada, New Zealand and United States have a longer history⁵²: Earned Income Tax Credit (EITC) in the United States was introduced in as early as 1975 and Child Tax Credit in Canada, which was a non-wastable predecessor of the current Canada Child Tax Credit, in 1978. New Zealand has a non-wastable tax credit at least since 1986, when it replaced several tax rebates by a non-wastable Family Support. As noted before, all these countries introduced other non-wastable tax credits recently. Australia, Austria, Germany, Iceland and Mexico seem to follow the first group in 1990s. Australia rendered the Dependent Spouse Rebate effectively non-wastable in 1994 by creating its counterpart in the benefit system which taxpayers can choose to receive instead of tax credit. Although the commencement dates for the non-wastable tax credits in the other three countries are unknown, they were introduced at least before 2000⁵³. In more recent years, non-wastable tax credits became a part of the tax system in Belgium, France, Slovak Republic, Spain and Sweden.

⁵² We can add United Kingdom to this group if we regard the Mortgage Interest Relief at Source (MIRAS), which was introduced in 1983 and abolished in 1999, as non-wastable tax credit.

⁵³ OECD(2003)

Table 8 Non-Wastable Tax Credits

Countries	Main Non-Wastable Tax Credits
Australia	Family Tax Benefit; 30% Health Insurance Refund
Austria	Sole Earner's and Sole Parents Tax Credit with Children
Belgium	
Canada	Canada Child Tax Benefit; GST/HST Tax Benefit
France	Employment Bonus (Prime pour L'emploi)
Germany	Family Tax Credit
Iceland	Tax Benefit for Mortgage Interest; Child Tax Benefit*
Mexico	
Slovak Republic	Child Tax Credit
Spain	Tax Credit for Female Employees with Children under three years*.
Sweden	Tax Credit of 75% of the Social Security Contribution
New Zealand	Family Support; Family Plus Tax Credits
United Kingdom	Child Tax Credit; Working Tax Credit
United States	Earned Income Tax Credit; Child Tax Credit

Source: OECD(2003), OECD(2004c). For Germany, Slovak Republic and Sweden, OECD (2006), Tax-benefit Country Chapter-Benefits and Wages. For Iceland, OECD(2001). For Australia, Canada, New Zealand, United Kingdom and the United States, various documents prepared by each government, which are listed in the bibliography.

* the official name of these credits are not certain.

3 Budgetary Control of Tax Reliefs

3.1 Overview

3.1.1 Problems concerning the use of tax reliefs have long been discussed from various perspectives. From a tax policy point of view, for example, it is warned that tax reliefs will render the tax system more complex, with negative effect on efficiency and equity⁵⁴. However, the main concern in terms of the public governance lies in the fact that tax reliefs are much less visible than public expenditures even though they can have the effects similar to spending policies. Due to this characteristic, tax reliefs tend to be subject to less scrutiny by policymakers and assessed less carefully by the public. Also, invisibleness makes tax reliefs, in some cases, an attractive way of “disguised spending” under certain types of fiscal rules⁵⁵. Therefore, it is quite natural conclusion that making tax reliefs more visible and treating them in the same way as spending programs is a key to avoiding such adverse effects of tax reliefs. The “*tax expenditure*” was a concept invented for this purpose, and it has been recommended that tax expenditure, which is composed of tax reliefs, should be under sufficient scrutiny and public attention. In fact, both the IMF and the OECD considers that it is a part of their good/best practices guidelines to provide information on

⁵⁴ OECD(2006)

⁵⁵ OECD(2004b)

tax expenditures so that they can be compared with regular expenditures⁵⁶. In addition, more elaborated and comprehensive guidelines for the treatment of tax expenditures in budgets are discussed in *Best Practice Guidelines—Off Budget and Tax Expenditures* (OECD, 2004b)

3.1.2 The recent trends discussed in Section 2 have important implications on the control of tax reliefs by way of the tax expenditure concept. First, definition of tax expenditures—what kind of tax reliefs are classified as tax expenditures—has become particularly important due to increasing significance of tax reliefs which can elude a certain kind of definition of tax expenditure. Second, the way a government controls tax reliefs classified as tax expenditures is no less important than before. Third, the increasing use of non-wastable tax credits has obscured the boundary between tax reliefs and spending programs. This section discusses these three points.

3.2 Definition of Tax Expenditures

3.2.1 Definition of tax expenditure differs significantly across countries depending on each government's interpretation on which part of its tax system constitutes a "benchmark" deviation from which is considered to be tax expenditure. The major areas whose treatments are widely different include tax units in the personal income system, pensions, imputed income, integration of personal and corporate income taxes, and depreciation allowances⁵⁷. Apart from the lack of international comparability and conceptual inconsistency, though, these issues do not have much practical and contemporary relevance.

3.2.2 With the increasing use of personal tax credits and allowances, however, definition of tax expenditure in relation to the "ability to pay" principle has become important. In some countries, many tax credits and tax allowances are not regarded as "tax expenditures" because they are structural components of the tax system which incarnates the ability to pay principle, and thus a part of the benchmark. For example, in the Netherlands, the benchmark tax structure includes "exemptions, deductions, and tax credits that adjust taxable income in line with the ability-to-pay principle". Accordingly it does not classify various provisions such as the Child Credits and the Single Parent Credits as tax expenditures. Japan also excludes various personal tax allowances from *Special Taxation Measures (STMs)*, a similar concept used in lieu of tax expenditure. Similar definitions of "tax expenditure" are used in Ireland and United Kingdom.

3.2.3 No matter how they are classified, personal tax credits and allowances can costs considerably. The Netherlands has eight personal tax credits, deductions and exemption which are not included in its tax expenditure report. Their estimated total cost, 1482.5 million euro in 2001⁵⁸, is nonetheless large compared with total direct tax expenditures of 8,080 million euro. Similarly, in Japan, four deductions⁵⁹ in the personal tax system amounts to 5,104,700 million yen

⁵⁶ IMF (2001); OECD(2001a)

⁵⁷ OECD(1996)

⁵⁸ These include: Child Credits; Combination Credit; Single Parent Credits; Young Disability Credit; Deduction for Medical, Disability, Chronically Ill or Handicapped Expenses; Child Adoption; Deduction for Support Expenses for Children; Deduction for Child Care Contributions; and Exemption of Certain Sign-in Premiums.

⁵⁹ They are deductions for: dependent family other than spouses; handicapped, survivors and working students; medical expenses; and retirement income.

in 2001, and this is more than twice of 2,362,000 million yen, which is the aggregated revenue forgone due to STMs⁶⁰.

3.2.4 A problem in the use of ability-to-pay principle as a criterion is that most of tax reliefs which are considered to reflect the principle have, at the same time, the same effect with cash transfers which would be classified as social expenditures. This is exactly why these reliefs are regarded as *Tax Breaks for Social Purposes* and included in the calculation of *Net Social Expenditures*⁶¹. Moreover, since it is difficult to objectively calculate how much a condition for such tax relief—having children, being disabled, or having spent for medical care—reduces taxpayers' ability to pay, these reliefs usually remain excluded from tax expenditures no matter how they are enriched in order to deliver social benefits, which has nothing to do with the ability-to-pay principle. In fact, the recent trends discussed in Section 2 suggest that there is increasing use of tax reliefs which have traditionally been considered to be structural provisions under the principle.

3.2.5 In particular, it is controversial to argue that tax credits are solely for the ability-to-pay principle. While tax allowances reduce taxable income taking into account each taxpayer's situation, tax credits reduce tax liabilities by a fixed amount, providing the same amount of tax reduction to all taxpayers (up to their tax liabilities). In this respect tax credits have less to do with the tax assessment process, and thus are much closer to social benefits or subsidies. Therefore, recent expansion of personal tax credits either by conversion from traditional tax allowances considered being a part of a benchmark or by brand-new introduction, requires reconsideration of the use of the ability-to-pay criterion.

3.2.6 In this context, "neutralization" of the tax expenditure concept which is discussed in OECD (2004b) is **informative**. Rather than defining tax expenditures as deviation from some "normative" tax base, it argues that tax expenditure should be regarded as deviation from a more neutral yardstick of "bench-mark" tax, which has no normative significance. The benchmark tax for the personal income tax would be the Heig-Simon concept of comprehensive income which does not include tax provisions to reflect the ability-to-pay principle. This would effectively avoid the conundrum of using the ability to pay principle, and, more importantly, avoid possible exclusion of important tax reliefs based on arbitrary judgment.

3.2.7 When the tax expenditure concept is defined as above, some tax expenditures can be completely appropriate as long as they deviate from the benchmark to reach the normative tax base by reflecting the ability to pay principle. The bottom line of this is to provide as much information on tax reliefs **and** leaving judgment on which items are structural, to the public. Currently, Canada, United States and Australia provide sufficient information on these tax reliefs by using broad benchmarks. In United Kingdom, although various tax reliefs are considered as structural reliefs and not as tax expenditures, they are reported alongside tax expenditures. Ireland also reports various tax reliefs as "tax credits and tax reliefs" even though not all of them are regarded as tax expenditures.

⁶⁰ See Adema, W. and Ladaïque, M. (2005).

⁶¹ Adema, W., Einerhand, M., Eklind, B., Lotz, J., and Pearson, M. (1996).

3.3 Control of Tax Expenditures

3.3.1 As well as appropriate classification of tax reliefs into tax expenditures, control of those tax expenditures is essential. There has been plenty of discussion on how to control tax expenditures as effective as the control of regular expenditures, and several practical guidelines have been proposed⁶². Roughly speaking, the control of tax expenditures can be discussed from three different viewpoints: (1) how to present tax expenditures in a way which enhances scrutiny by policymakers and assessment by the public; (2) how to appropriately evaluate tax expenditures in the executive branch; and (3) how to make tax expenditures subject to effective fiscal rules. They are no less important under the recent trends, so this subsection describes recent developments with regard to the tax expenditure control in member countries. More detailed information for the selected countries is provided in the Section 4.

Presentation of Tax Expenditures

3.3.2 Presentation of tax expenditures has been the most fundamental way to control tax expenditures. Appropriate presentation of tax expenditures has been expected to provide enough information for the legislature and the public to understand overall macroeconomic impact of fiscal policy, significance of each tax expenditure item and trade-offs among different policies. Accordingly, sufficient coverage in terms of taxes and years, provision of *ex ante* estimates, statutory requirements and integration in the budgetary document are regarded as desirable in presenting tax expenditures⁶³.

3.3.3 In general, presentation of tax expenditures has been improved in many countries since the mid-1990s. The Netherlands and Sweden have implemented a practice of providing estimated costs of tax expenditures annually as a part of their budget. Korea started to report tax expenditures to the National Assembly. Nowadays at least 16 out of 30 OECD countries⁶⁴ provide annual report on tax expenditures. In Australia, the *Tax Expenditure Report (TES)*, which was said to have a low political profile⁶⁵, became a statutorily-required document under the Charter of Budget Honesty Act of 1998⁶⁶. Also, Australia and Canada started to include *ex ante* projections in addition to historical estimates, in their tax expenditure reports. As for the integration in the budget, United Kingdom and Ireland started presenting tax expenditure estimates in their budgets since 2000 and 2006, respectively.

⁶² OECD (2004b).

⁶³ Usually, the estimated effects of tax measure proposals—which include tax cuts and tax reliefs—on revenue are included in the budget. However, this is not considered to be presentation of tax expenditures here, because it only specifies changes in revenue due to changes in tax reliefs.

⁶⁴ These countries include: Australia, Austria, Belgium, Canada, France, Germany, Greece, Ireland, Italy, Netherlands, Norway, Portugal, Spain, Sweden, United Kingdom, and the United States. Korea can be added to this list if it not only reports to the National Congress but also publishes it (need to be confirmed). Although Japan provides annual estimation of Special Taxation Treatments, it does not officially publish the list. Hungary reports estimated costs of some of tax expenditures to the Congress. Czech Republic, New Zealand and Poland do not prepare tax expenditure report as of 2004. Situations in Denmark, Finland, Iceland, Luxembourg, Mexico, Slovak Republic, Switzerland and Turkey are uncertain.

⁶⁵ OECD (1996).

⁶⁶ Austria, Belgium, France, Germany, Italy, Portugal, Spain and the United States are other countries which have legal requirement for tax expenditure reporting.

3.3.4 These developments notwithstanding, insufficient improvements have been made with regards to the integration in the budget. It has been recommended that regular expenditures and tax expenditures be shown side-by-side in the budget in order to provide a comprehensive picture to understand and **compare overall fiscal resources allocated to a particular policy area.** **Although some countries, including** the Netherlands and United Kingdom, now include a list of tax expenditures in their budgets, such a list is usually shown separately from regular expenditures, often in an appendix. Moreover, in the FY 1998 budget, the United States started presenting revenue loss sums for tax expenditures alongside outlays for each budget function, but this practice was brought to a halt after the FY 2002 budget. In fact, there is currently no country under survey (i.e. countries treated in the Section 4) which follows the recommendation.

Evaluation in the Executive Branch

3.3.5 Several governments attempted to conduct effective *ex post* evaluation of tax expenditures⁶⁷. **Probably** the most systematic attempt was made in the United States. In accordance with the Government Performance Results Act of 1993 (GPRA), Treasury launched the study on a framework for evaluation of the performance and economic effects of tax expenditures in the mid-1990s. The pilot studies of three specific tax expenditures and performance goals were completed and reported in the 1999 budget. Canada and the Netherlands have provided results of the performance evaluation on tax expenditures in their annual reports on tax expenditures since 2000 and 2002, respectively. Similarly, as tax expenditures has acquired political significance in Ireland in recent years, a full review of tax expenditures was announced in the 2005 budget in particular to evaluate in detail their impact and how they are operating in practice. This review involved external consultancy work and the result was reported in the 2006 budget.

3.3.6 Data availability has become crucial in this context. The pilot studies in the United States highlighted this problem, and additional studies have been underway concerning data required for the performance evaluation. It is now developing a new panel sample of individual tax filers over at least ten years. Similarly, in order to improve information available to evaluate tax expenditures, the Government of Ireland introduced a number of changes to tax returns.

Fiscal Rules and Tax Expenditures

3.3.7 One group of fiscal rules, including the Golden Rule in United Kingdom or the Maastricht Requirement for the EMU countries, articulate an objective and explicit target for an overall governmental fiscal balance. Under such a rule, tax expenditures, in theory, can be effectively constrained as long as effects of tax expenditures on revenue are prudently taken into account in the budgetary process so that the target under the rule is attained⁶⁸. Similarly, in theory,

⁶⁷ Ex ante evaluation in the executive branch is also important, and this requires scrutiny of tax expenditures by the financial staff, and evaluation procedures applied to tax expenditures in the same way as to regular expenditures. However, available information in this respect is quite limited.

⁶⁸ This does not guarantee, however, the quality of public spending. Because usually tax expenditures are subject to different policy-making process from that of regular expenditures, as is discussed in OECD (2004b), constraint under these fiscal rules does not mean that tax expenditures are scrutinized taking into account tradeoffs. Rather, the quality of public spending is attained by measures discussed in the two previous sections.

fiscal rules which explicitly contain tax expenditures can also control them. One example is the previous pay-as-you-go (PAYGO) rule under the Budget Enforcement Act (BEA) in the United States, which expired at the end of FY 2002. PAYGO required that if a law reduces revenue by expanding tax expenditures, another law must be enacted with an offsetting reduction in spending or increase in receipts.

3.3.8 However, experiences in two countries, namely the Netherlands and Sweden, indicate that tax **expenditures** can provide an attractive loophole under certain fiscal rules. First, if a ceiling (either multi-year or single-year) is imposed only on the expenditure side, such a fiscal rule must at the same time have a clearly-defined, specific target of overall fiscal balance. Otherwise, the rule enables the Government to ensure compliance with the (expenditure) ceiling through tax expenditures without regard to their effects on its fiscal balance. This is what happened in Sweden since 2000, with rapid increase in tax expenditures⁶⁹. Second, in the absence of a ceiling imposed on tax expenditures, and with a ceiling on regular expenditures at the same time, an explicit rule on how to deal with windfalls is necessary. In the Netherlands, tax expenditures expanded significantly in the mid-1990s (see Table 9) in part because the coalition government used unexpected windfalls to reduce the tax burdens rather than to reduce its debt level⁷⁰. It was after 1999, when the rules governing the usage of windfalls were introduced, that the use of tax expenditures was constrained.

Table 9 **Expansion of Tax Expenditures in the Netherlands**

	1994	1998	2001	2002
Total Tax Expenditures, as Percentage of GDP	1.53	2.38	2.30	2.39

Source: *The Netherlands, Ministry of Finance (2003)*

3.4 *Treatment of Non-Wastable Tax Credits*

3.4.1 Non-wastable tax credits are tax credits which provide a fixed amount to taxpayers regardless of their tax liabilities. The Earned Income Tax Credit (EITC) in the United States is a typical one, which provides non-taxpayers or those with insufficient tax liabilities with payment instead of reducing their taxes. In countries like Australia, Germany and United Kingdom, some tax credits are effectively non-wastable because a fixed amount is given either by tax credits or by direct payments from governmental agencies—tax offices or social security offices—according to taxpayer's choice (or tax offices' decisions, in Germany). The Family Tax Payment and the Dependent Spouse Rebate in Australia can be considered non-wastable during the periods 1998-2000 and 1994-2000, respectively, because both had their counterparts in the benefit system which non-taxpayers can claim instead. Tax reliefs which involve payments from a government to third parties can also be regarded as non-wastable. Under the Mortgage Interest Relief at Source (MIRAS, abolished in 1999) in United Kingdom, the Government paid a part of mortgage interest to lenders on behalf of borrowers (both taxpayers and non-taxpayers) instead of reducing their tax liabilities.

⁶⁹ IMF (2005).

⁷⁰ There was a rule which restricts the usage of such windfall to increase spending. This is also a reason for the increase in tax expenditures.

3.4.2 In budgets, non-wastable tax credits are treated differently in different countries (Table 10). Some treat them totally as expenditures, and others totally as revenue, showing no figures officially other than in their tax expenditures reports. An alternative treatment is to split between “the transfer component”, which is the part of the credit in excess of taxpayers’ liabilities, and “the negative tax component”⁷¹, which reduces tax liabilities as tax credit. In a budget, the former is treated as expenditure and the latter as revenue forgone. This treatment is in accordance with the interpretative guide §20 and §21 of the OECD Revenue Statistics.

Table 10 Treatment of Non-Wastable Tax Credits

	Split between Revenue Forgone and Expenditure	Expenditure	Revenue Forgone
Australia		○	
Austria*		○	○
Belgium*	○		
Canada**	○		
France *	○		○
Germany*			○
Iceland		○	
Mexico*			○
New Zealand		○	
United Kingdom	○		
United States	○		

Source: For countries with asterisk (*), OECD(2001b); for Iceland, OECD(2001); for other countries, documents provided by each government, listed in the bibliography.

*For countries with asterisk, care must be taken in interpreting the table. OECD(2001b) provides information based on questionnaires, but its main concern is how countries report their tax revenue to OECD, rather than how countries present non-wastable tax credits in their budgets. Although it is natural to think reporting to OECD coincides with domestic presentation, it is possible that these two differs by some accounting adjustments.

**Situation in Canada is a bit uncertain from its governmental documents. Confirmation is necessary.
Situation in Slovak Republic, Spain and Sweden is uncertain.

3.4.3 The expenditure treatment is more appropriate than the revenue forgone treatment in terms of the budgetary control. When treated as revenue forgone, what is essential for the budgetary control of non-wastable tax credits is the same as that of other (wastable) tax reliefs: to appropriately classify them as “tax expenditures” and treat them in the same way as regular expenditures. Thus, how desirable the expenditure treatment is over the revenue forgone treatment depends on how effectively tax expenditures are controlled in a given countries. It follows that, provided that they are treated completely equally with regular expenditures and thus are perfectly controlled, whether they are treated as expenditure or as revenue forgone is irrelevant. Off course, reality is that this is not the case in any country. Therefore, the expenditure treatment is more appropriate, and ironically, it is possible that a country which has no tax expenditure presentation but treats non-wastable tax credits simply as expenditures can control them much more effectively than a country which reports tax expenditures appropriately but implements the revenue forgone treatment for non-wastable tax credits.

3.4.4 The expenditure treatment of non-wastable tax credits is quite reasonable considering their characteristics. When Australia reclassified costs associated with non-wastable tax credits from revenue forgone to expenditures in 2001, the Government explained two reasons:

⁷¹ In OECD Revenue Statistics, this is called “tax expenditure component”. To avoid confusion, here the term “negative tax component” is used instead.

1. recipients can be compensated either through a direct payment or through the tax system as a rebate (tax credit), and these programs provide the same benefit regardless of the choice.
2. the rebate (tax credit) is calculated independently of the normal procedure for determining a tax liability and the amount of the benefit does not depend upon the amount of tax actually paid or a taxpayer's marginal rate of taxation⁷².

3.4.5 A more controversial issue is whether to treat the entire portion of tax credits as expenditures or split them between the transfer component and the negative tax component. Several countries adopt the latter treatment in accordance with the current interpretative guidance of the OECD Revenue Statistics, which was agreed upon in 1980. In 2001, the guidance was supported by the Committee on Fiscal Affairs after having been re-examined and compared with alternative treatments. The primary reason is its relative advantage in terms of international comparability, and the expenditure treatment was rejected because (1) small change from a wastable tax credit to a non-wastable one would cause significant difference in tax revenue, and (2) countries with non-wastable tax credits and countries with wastable tax credits accompanied by spending programs would not be comparable under the expenditure treatment.⁷³

3.4.6 Although this is a reasonable conclusion in terms of international comparability, splitting tax credits can have serious drawbacks in terms of the budgetary control. First, presenting the transfer component and the negative tax component separately in expenditures in a budget and a tax expenditure report makes it quite difficult to understand a comprehensive picture: neither looking into the budget nor reading the tax expenditure report tells how much the government devotes its resources to a certain policy. Therefore, unless a government adopts a practice of presenting tax expenditures side-by-side with regular expenditures in its budget, splitting non-wastable tax credits will hamper scrutiny by policymakers and the public. Second, the total cost of non-wastable tax credits is divided according to government's projection either on how many people have sufficient tax liabilities or on how many people choose tax credit rather than direct payment from the government. This projection can be subjective, creating a room for possible manipulation of the amount included in expenditures. After all, international comparability is of less importance from a viewpoint of the budgetary control, and which treatment is the most desirable should be determined independently of what would guarantee international comparability.

⁷² Commonwealth Government of Australia (2002), *Consolidated Financial Statistics for the Year Ended on 30 June 2002, Note 1*.

⁷³ OECD (2001b).

4. Review on the Selected Countries

4.1 Australia

Characteristics and Recent Trends of Tax Expenditures

4.1.1 Tax Expenditure Statement (TES), which is an annual detailed report on tax expenditures prepared by the Australian Government, contains an overview of trends and aggregates of tax expenditures. According to this report, there have been two distinct characteristics regarding its composition:

1. If we divide tax expenditures by the benchmark against which they are estimated, the retirement savings benchmark and the personal income benchmark occupy a significant portion of tax expenditures. For example, according to TES for the budget year 2004-05, they amount to AU\$ 15,193 million and AU\$ 11,412 million, respectively. Together they account for more than 70% of the total AU\$ 36,859 million.
2. Classification of tax expenditures by functional category shows that the social security and welfare tax expenditures are by far the most significant. In the budget year 2004-05, they amount to AU\$ 23,909 million, approximately two-third of the total.

These characteristics seem to have existed at least since the early 1990s. Most of the major tax expenditures reported since the 1992-93 edition were either against the retirement savings or against the personal income tax benchmark, and they were mainly for the social purposes. Concessional taxation related to superannuation has been by far the most significant tax expenditure.

4.1.2 Changes in the aggregate over time are shown in the Table 1. It can be seen from this table that both the aggregate of all tax expenditures and the aggregate of social security and welfare tax expenditures have more than doubled in ten years. The proportion of the aggregate of all tax expenditures to the nominal GDP also increased, from 3.32% in 1994-95 to 4.29% in 1999-2000. Although it slightly declined to 4.13% in 2005-2006, its current level is considerably higher than the level in mid-1990s.

4.1.3 Alongside possible reasons that do not reflect any actual changes of tax expenditures⁷⁴, this increase reflects important reorganization of several social tax credits⁷⁵. In fact, the list of major tax expenditures in TES 2005 suggests significant change in major social tax expenditures in 1990s: five out of twelve largest tax expenditures in 2005-06 commenced between 1993 and 2000. They are either credits or exemptions, and four of them are for some social purposes (Social Security and Welfare or Health). What is more, two new tax exemptions, the Exemption of

⁷⁴ These reasons may include revisions to data, changes in methodology, identification of formerly unidentified tax expenditures, quantification of previously unquantified tax expenditures, and increased eligible recipients for certain tax expenditures.

⁷⁵ The Australian Government used the term "tax rebate" instead of "tax credit". In recent years, tax rebates have been relabeled as tax offsets.

Family Tax Benefit, Part A and B and the Exemption of 30 per cent Private Health Insurance Refund, are just a reflection of two new non-wastable tax credits which are currently classified as expenses.

4.1.4.1 As noted before, individual tax credits underwent significant changes since 1990s (See Table 11). These changes can be divided into three groups for the purpose of presentation: tax measures for families with children, tax measures for income support, and tax measures related to healthcare. The Table 12 summarizes the recent development of major (estimated annual costs above AU\$ 100 million) tax credits.

4.1.4.2 Tax Measures for Families with Children

3. Before 1996, the support to families with children was primarily provided via social benefits. Although the dependent spouse rebate had provided additional support for families with children since 1982, the Home Child Care Allowance (later to be renamed the Basic Parenting Payment) effectively replaced the dependent spouse rebate (with child)⁷⁶ in 1994. This removed from the tax system the element of child support.
4. The Howard Liberal Government, which took office in 1996, introduced new tax measures in order to support families with children. As a part of the Family Tax Initiative, the 1996-97 budget announced the Family Tax Payment (FTP). Since FTP increased the tax threshold for families with eligible children by additional amount for each dependent child, this was effectively a tax credit⁷⁷. At the same time, for the families which did not have sufficient tax liabilities, the Family Tax Assistance offered direct payments through the welfare system⁷⁸.
5. In 2000, As part of the tax reform package (A New Tax System) to implement a major rationalisation of family assistance, the Government replaced twelve tax and welfare benefits available to families with the Family Tax Benefit (FTB) in order to simplify the structure and delivery of family assistance. FTP, the dependent spouse rebate (with Children) and the sole parent rebate were incorporated into FTB alongside several social benefits such as the Family Allowance and Child Care Assistance.
6. FTB has three components, means-tested FTB Part-A, FTB Part B, and Child Care Benefit (CCB). While CCB, which replaced former child-related benefits, were paid outside the taxation system, both FTB Part-A and Part-B are available as a direct payment from the Family Assistance Office or as a tax credit. As for family assistance, the tax system and the benefit system were integrated, and its three predecessors in the tax system were rendered non-wastable⁷⁹.

⁷⁶ Although the dependent spouse rebate (with child) was not abolished, any payment received as a direct benefit reduced the amount of tax rebate.

⁷⁷ FTP was means-tested credit.

⁷⁸ The Family Tax Assistance does not seem to have been reported as tax expenditures.

⁷⁹ It may be more accurate to understand that FTP and the dependent spouse rebate (with child) had effectively been refundable since 1998 and 1994, respectively, because both had their counterparts—The Family Tax Assistance and the Home Child Care Allowance—in the benefit system which non-taxpayers can choose to claim instead of these tax measures.

7. After the re-election of the Government, it implemented additional support for families with children, in accordance with its election commitment. The First Child Tax Rebate, commonly referred to as the Baby Bonus, was introduced in 2002. This measure provided payments from the Tax Office for parents following the birth, adoption or taking legal responsibility for the first child after July 1, 2001. It was non-wastable tax credit, since it can be claimed regardless of tax-filing status. From July 1, 2004, it was replaced by a maternity payment administered by the Centrelink, a statutory authority responsible for delivering human services on behalf of the governmental agencies
8. The most recently announced incentive for families with children was the Tax Rebate for Child Care. During the 2004 election campaign the Howard Government announced, in its statement *Extra Assistance for Families*, to introduce a non-refundable⁸⁰ tax credit to eligible taxpayers which entitles 30 % of childcare expenses not covered by CCB. This was intended to complement CCB via the tax system. It is to be effective from 2006, when it is estimated to cost AU\$ 280 million annually.

4.1.4.3 Tax Measures for Income Support

1. Taxpayers who receive certain social security benefits have been able to receive wastable tax credits (the Pensioner Rebate and the Beneficially Rebate), at least since 1985⁸¹. In addition, although not all of them are tax credits, various concessional treatments of superannuation has been by far the largest of all tax expenditures.
2. Since 1990s, several new tax credits have been introduced or expanded. The Tax Offset for Low-income Earners was introduced in 1993. This is wastable tax offset available to a taxpayer whose taxable income falls below the threshold. It was enriched in the 2003-04 Budget by increasing the amount and the threshold.
3. The 1996-97 Budget created the Tax Rebate for Low Income Aged Persons, which was a wastable tax credit with the amount equivalent to the level of the Pensioner Rebate, to certain eligible taxpayers who are at or above age pension age. In 2001-02 Budget, both the Pensioner Rebate (for those over age pension age) and the Tax Rebate for Low Income Aged Persons were increased and amalgamated into a new wastable tax credit, the Senior Australian's Tax Offset (SATO). SATO was enriched and extended considerably in the following years.
4. Most recently, the 2004-05 Mid-Year Fiscal and Economic Outlook announced the Mature Age Worker Tax Offset (non-refundable), which workers aged 55 years and over may be entitled. This is to affect revenue from 2005-06, with initial estimated annual cost of AU\$ 430 million.

4.1.4.4 Tax Measures for Health

1. In addition to the wastable Medical Expense Tax Offset which has long been an important tax measure for Health, taxpayers are provided a non-wastable tax credit introduced and expanded recently. With intention to promote private health insurance

⁸⁰ Although non-refundable, the unused amount of tax credit is transferable to a spouse. This further obscures the boundary between tax measures recognized as expenses and those recognized as tax expenditures.

⁸¹ This measure is reported to have been introduced before 1985

schemes, the Government introduced in the 1996-97 budget the Private Health Insurance Rebate. It provided low-income individuals with a certain amount toward the cost of their health insurance premium. People could choose to have the money paid directly to their health fund in return for a guaranteed reduction in premiums or they may choose to receive the payment as a taxation rebate after the end of the financial year. In this respect it was *non-wastable* tax credit.

2. Under *the New Tax System*, the Private Health Insurance Rebate was amended in 1999, and from then on it provides 30% of the cost of private health insurance. This is received in the form of either direct payment, reduced premium, or tax credit.

Recent Development of Budgetary Control on Tax Expenditures

4.1.5 Although The Tax Expenditures Statements (TES) was first published in 1986 and published, in principle, annually since then⁸², the TES was said to have “a low political profile in Australia”.⁸³ This changed in the last decade and presentation of tax expenditures improved in several ways. Two milestones in this change were the National Commission of Audit report and the Charter of Budget Honesty Act of 1998.

4.1.6 The National Commission of Audit (NCA) reported in 1996 on *the Commonwealth's finances, Expenditure and Financial Statements* various problems associated with the use of tax expenditures. In the light of these problems, the NCA made two recommendations. First, comprehensive review should be carried out on all existing tax expenditures against general principles for government involvement and examined the scope for converting tax concessions to outlay programs. Second, tax expenditures should be treated as much as possible like programme expenditures in all published fiscal reports and all budgetary process.

4.1.7 More importantly, the Charter of Budget Honesty Act of 1998 served as a statutory requirement of the publication of detailed information of tax expenditures. In order to improve fiscal outcomes, it requires governments to be explicit about their fiscal policy intentions and ensures that comprehensive fiscal information is released at regular intervals. As a part of this requirement, it articulates:

1. an overview of the estimated tax expenditures for the budget year and the following three financial years must be presented in *the Budget Economic and Fiscal Outlook Report*, which is to be publicly released with each budget.
2. a detailed statement of tax expenditures, presenting disaggregated information on tax expenditures, must be contained in *the Mid-Year Economic and Fiscal Outlook Report* (MYEFO), which the charter requires to be published during each budget year.

4.1.8 In consistency with these requirements, since the 1995-96 report, TES, which had been a tool used as a starting point for the government's advisers in their consideration of revenue raising

⁸² Since the 1995-96, the earliest TES available, TES has been published annually except for the 1998-99 edition. It was not prepared during the transition to accrual budgeting and to *The New Tax System* and *The New Business Tax System*.

⁸³ OECD(1996) p21.

options, served as a statutorily-required document published with MYEFO. Correspondingly, TES modified its presentation in several ways:

1. New tax expenditures announced in the latest budget have been included since the 1995-96 report, even if those measures have yet to be legislated. This is in order to ensure the tax expenditure estimates incorporate all measures included in the revenue estimates contained in the Mid-Year Economic and Fiscal Outlook (MYEFO).
2. In the 1995-96 report, forward projections of tax expenditures were for the first time provided to cover the year 1996-97 to 1999-2000. Since then, TSE has been covering estimates for past four years and projections for following four years.
3. TES contains information on trends, aggregates and a comparison with direct expenditures by function. The 2003 report deleted the information on tax expenditures by taxpayer affected, which had been intended to provide a broad indication of the recipients of assistance through tax expenditures. Instead, the 2005 report began to include a table presenting measured tax expenditures by benchmark. In addition, the 2003 TES started to provide a list of large measured tax expenditures.
4. Consistent with budget reporting, the 2000 edition adopted accrual estimates using the tax liability method of revenue recognition. Under this method, the government is deemed to have accrued revenue the earlier of when an assessment of a tax liability is made or cash payment is received by a tax office. Prior to this, TES provided estimates for the year in which the impact on revenue occurs, which was the practice initiated in the 1990 edition.⁸⁴

4.1.9 Although the budget has presented estimated effects of proposed tax measures on revenue, it contained no information on the magnitude of (existing and proposed) tax expenditures prior to the 1997-98 budget. In accordance with the Charter of Budget Honesty Act of 1998, the 1997-98 budget for the first time included information on tax expenditure aggregates in the *Appendix of Economic and Fiscal Outlook Report*, based on the latest TES. This practise continues since then.

4.1.10 After the introduction of several non-wastable tax credits, such as FTB and the Private Health Insurance Rebate, the government regarded them not as expenses but as revenue forgone, and reported their estimated cost in TES. From July 2001, the government reclassified costs associated with non-wastable tax credits to expenses. Accordingly, those items were excluded from TES and added to expenses in the budget. This reclassification was made due to their two distinct characteristics: (1) recipients can be compensated either through a direct payment or through the tax system as a rebate, and these programs provide the same benefit regardless of the choice; (2) the rebate is calculated independently of the normal procedure for determining a tax liability and the amount of the benefit does not depend upon the amount of tax actually paid or a taxpayer's marginal rate of taxation⁸⁵.

⁸⁴ Prior to the 1990 edition, most tax expenditures were costed on an accrual basis.

⁸⁵ Commonwealth Government of Australia (2002).

4.1.11 Since Australia does not have any legislated numerical rules or annual/multiyear spending caps⁸⁶, increasing use of tax expenditures in lieu of direct spending does not raise the issue of whether tax expenditures cause loopholes in fiscal rules. However, whether tax expenditures are less critically assessed or reviewed than outlay programmes is still an important question. Following a review of existing tax expenditures, first announced in the 1996-97 Budget, the Government has decided to undertake periodic monitoring and evaluation of all tax expenditures through normal budget processes to ensure they deliver Government assistance in an effective manner.

4.2 Canada

Characteristics and Recent Trends of Tax Expenditures

4.2.1 Today, various tax credits occupy a significant portion of tax expenditures reported by the Department of Finance. If we allow for some errors caused by interacting effects among tax expenditures in order to show the significance of tax credits, they amount to as much as \$46 billion (44%) of total \$104.7 billion revenue forgone by tax expenditures in the individual income tax system. Considering that tax expenditures other than tax credits include \$18,900 million caused by measures due to the federal-provincial financing arrangement, a tax credit in effect the most extensively used form of tax expenditures. The Good and Service Tax (GST) also provides a considerable amount in the form of the GST/HST credit, which is estimated to cost \$3.420 million -- the second largest of all the tax expenditures for GST.

4.2.2 Since 1990s, the number of tax credits to Canadian individuals has shown a considerable increase. Of 24 (individual) tax credits⁸⁷ which were reported by the Department of Finance as tax expenditures in 2005, 8 credits have been introduced since 1990s. Before that, introduction of tax credits had been rare. Except for the overseas employment tax credit introduced in 1983⁸⁸, all of the other 16 tax credits effective today date back before 1970s. A list of individual tax credits reported is on the Table 13.

4.2.3 Also, eligibilities and amounts of these tax credits have expanded rapidly, especially since the second half of 1990s. The amount of Canada Child Tax Benefit (CCTB) increased in almost every year from 1996 to 2005, in addition to the indexation which was re-introduced in 2000. Other tax credits like the Medical Expense Tax Credit (METC) or the Education Credit now include new groups of individuals who were not eligible before. They also increased the available amount. Introductions and expansions of these credits are shown in the Table 14.

⁸⁶ Charter of Budget Honesty requires the government to spell out objectives and targets but places no constraints on their nature.

⁸⁷ They report carry-forward and transfer of the education and tuition fee credit separately from them. If we treat the introduction of carry-forward and transfer of those amount as the modification of those credits, there are 23 tax credits recently reported as individual tax expenditure.

⁸⁸ This information may be inaccurate. The overseas employment tax credit may have been created before 1983. Confirmation required.

4.2.4 This trend toward tax credits has almost exclusively been driven by social purposes. Except for the Mineral Exploration Tax Credit for Flow-Through Share Investors⁸⁹, all of recently-introduced tax credits are related to some social objectives—medical care, family, income support, etc⁹⁰. In addition, almost all “traditional” tax credits which have some social purposes have experienced enrichment since 1996 while four non-social “traditional” tax credits, which include the investment tax credit, the overseas employment credit, the foreign tax credit and the dividend credit, experienced no expansion⁹¹, at least since 1996⁹².

4.2.5 Non-wastable tax benefits have increased their significance. The non-wastable Child Tax Credit was introduced as early as in 1978. In 1993, the Canada Child Tax Benefit (CCTB) was implemented by consolidating non-wastable and wastable child tax credits and the Family Allowance into a monthly payment based on the number of children and level of family income. It also included the Working Income Supplement (WIS), which provided an additional benefit to low-income working families with children. Since its inception, CCTB has been significantly enriched, and WIS has been replaced by the National Child Benefit (NCB) Supplement for which all low-income families are eligible. In 2005, the revenue forgone by the CCTB is projected to be as much as \$9,210 million (15% of all tax relief).

4.2.6 The other two non-wastable tax credits were introduced more recently:

1. Child Disability Benefit (introduced in 2003): low- and middle-income families caring for a child with disability are eligible. The amount depends on their income levels. The projected cost in 2005 is \$50 million.
2. Non-wastable Medical Expense Supplement (introduced in 1997): the lesser of \$750 (as of 2005) and 25% of the allowable portion of disability and medical expense is provided to low-income working taxpayers. The projected cost for 2005 is \$2,430 million.

⁸⁹ It was introduced in 2001 in order to promote mineral exploration activity.

⁹⁰ They are classified under the functional categories such as Family, Education or Health, although the Department of Finance states that the grouping is solely for presentational purposes.

⁹¹ Confirmation required

⁹² This is partly because that tax measures for purposes related to business usually take forms other than tax credit -- such as reduction of the general corporate tax rate.

Table List of Tax Credits in Canada, 2005

(in millions CA\$)

Budget Function	Name of Tax Expenditure	Introduced	Estimated Tax Expenditure			Eligibility	Amount in Excess of Tax Liabilities
			2005	2000	1995		
Charities, Gifts and Contributions	Charitable Donations Credit	Before 1995	1670	1495	975	individuals	5 year carry-forward
Charities, Gifts and Contributions	Political Contributions Tax Credit	Before 1995	15	19	10	individuals	Non-refundable
Education	Education Credit	Before 1995	280	140	44	students	indefinite carry-forward, transferable
Education	Tuition fee credit	Before 1995	320	310	195	students	indefinite carry-forward transferable
Education	Carry-forward of Education and Tuition fee credit	1997	255	165	-		
Education	Transfer of Education and Tuition fee credit	1987	460	325	215		
Education	Student loan interest credit	1998	64	66	-	students	5 year carry-forward
Employment	Overseas employment credit	Before 1995	64	55	31	Canadian employees working abroad	Non-refundable
Family	Canada Child Tax Benefit	1993	9210	6610	5240	low & middle income families with children	Refundable
Family	Adoption expense tax credit	2005	5	-	-	adoptive parents	Non-refundable
Family	Caregiver Credit	1996	70	35	-	individuals providing in-home care for elderly or infirm family members	Non-refundable
Family	Infirm dependent credit	Before 1995	6	6	6	individuals supporting an adult infirm dependent	Non-refundable
Family	Spouse or Common-law partner credit	Before 1995	1315	1215	1200	individuals supporting a spouse or common-law partner	Non-refundable
Family	Eligible dependent credit (equivalent to-spouse credit)	Before 1995	680	620	470	individuals supporting a dependent without a spouse or common-law partner	Non-refundable
General business and investment	Investment tax credits	Before 1995	35	28	54	individuals	10 year carry-forward, 3 year carry-back
General business and investment	Mineral Exploration Tax credit for flow-through share investors	2001	56	56	-	individuals investing in flow-through shares	Non-refundable
Health	Child Disability benefit	2003	50	-	-	low & middle income families caring for a child with disability	Refundable
Health	Disability credit	1997	465	275	270	individuals with severe and prolonged disability	transferable
Health	Medical Expense Tax credit	Before 1995	620	550	305	individuals	Non-refundable
Health	Refundable medical expense supplement	1997	85	85	-	low-income working Canadians	Refundable
Income maintenance and retirement	Age credit	1972	1515	1385	1270	individuals with age 65 and over, with income below certain level	transferable
Income maintenance and retirement	Pension income credit	1974	445	425	350	individuals	transferable
Other	Basic personal credit	Before 1995	23370	20905	17650	all individuals	Non-refundable
Other	Supplementary low-income credit	1998	-	-	-	low-income individuals	Non-refundable
Social and Employment Insurance Programs	Employment insurance contribution credit	Before 1995	2625	1845	1320	individuals	Non-refundable
Memorandum Items	Foreign Tax Credit	Before 1995	695	580	280	individuals	Non-refundable
Memorandum Items	Dividend Gross-up and Credit	Before 1995	1420	970	730	individuals	Non-refundable

*Tax credits in the personal income tax system reported in Tax Expenditures. Notes to the Estimates/Projections published in 2004 are shown.

*Estimated costs in 2005 and 2000 are revenue losses reported in Tax Expenditures and Evaluations published in 2005. Estimated costs in 1995 are revenue losses reported in Tax Expenditures and Evaluations published in 2000.

Source: Canada, Department of Finance (2005,2000)

Recent Development of Budgetary Control on Tax Expenditures

4.2.7 These non-wastable tax benefits are technically considered to be tax expenditures and do not show up in expenditure or revenue figures⁹³. However, such non-wastable credits can be rather viewed as program spending delivered, merely as a matter of administrative convenience, via the tax system. In fact, the creation on the Canada Child Tax Benefit in effect replaced the Family Allowance, which was treated as program expenditure, and accounted for \$2,000 million.

4.2.8 The 1995 edition of Tax Expenditure Report covered the personal income tax system for the years 92-93, the corporate income tax system for the years 91-92 and the GST for the years 92-93. It also discusses the tax expenditure concept, calculation and interpretation of the costs of tax expenditures, including key assumptions used in the analysis. It also provides in the appendices information on data sources and methodology, description of each item and information on the recent changes to personal income tax expenditures.

4.2.9 The 1997 report expanded the estimated period. The estimates for the income tax expenditures were provided for three years, 92-94, and the GST tax expenditures for four years 92-95. In the case of the corporate income tax expenditures, the estimates are for the years 92-93. In addition to this, for the first time it provides projections of these tax expenditures, beyond the last historical year, to 1999. These projections, unlike historical estimates which are based on the statistical data and the income/corporate tax model or input-output tables, relies on estimated relationships between tax expenditures and explanatory economic variables, which are based on the 1997 budget forecast or on past trends in tax expenditures. The 1998 reports added information on stated objectives for all tax expenditures contained in the report, as a response to the request from the Auditor General.

4.2.10 Since 2000, the reports were divided into two parts: Part 1 contains usual information on tax expenditure and Part 2 presents *Tax Evaluations and Research Reports* which in each year discusses a few issues, such as evaluation of selected tax expenditures. In addition, in 2000, *Tax Expenditures: Notes to the Estimate/Projections* was published as a reference document by readers who wish to know more about how the tax expenditures/projections are calculated or who seek information on the objectives and descriptions of particular tax expenditures. The revised version was published in 2004.

4.3 Ireland

Characteristics and Recent Trends in Tax Expenditures

4.3.1 Although information on the aggregate cost of all tax expenditures is not available in the annual reports prepared by the Revenue Commissioners, it is reported in the Tax Strategy Group (TSG) Papers in 2002 that tax expenditures represent “a very significant sum.” With a qualification that it would be wrong to conclude that the total amount is an estimate of revenue accruing from dispensing with reliefs, it listed 28 major tax expenditures whose estimated total cost is €7.3 billion⁹⁴. Considering that the total tax revenue for 2002 was about €29 billion, and

⁹³ Canada, Department of Finance (2000). However, confirmation is necessary.

⁹⁴ Department of Finance (2002), *Tax Strategy Group Papers Budget 2003-TSG 02/28*.

that the figure does not take into account some personal tax credits, the magnitude of tax expenditures cannot be overstated.

4.3.2 The 20 largest tax credits/allowances and reliefs⁹⁵ reported in the annual report for 2002 are listed on Table 15 with their estimated costs for 2002 and 1993-94. It shows that in 2002, various personal credits, pension reliefs and tax reliefs for business sectors and investors (e.g. Effective Rate of 10% for Manufacturing and Certain Other Activities) represent a significant portion of tax credits and reliefs. This composition was also true in 1993-94, although the personal credits and pension reliefs expanded quite rapidly between the two years while the increase in tax reliefs for business sectors and investors was, if any, modest.

4.3.3 Important changes in the tax system since 1996 are as follows:

1. Reduction of the Tax Burden on Ordinary Taxpayers
2. In accordance with its principle objective to reward work and enterprise, the Government has substantially reduced the tax burden on ordinary taxpayers since the late 1990s. This reduction was provided through the substantial increase in the Personal Tax Credit/Allowances, the Employees (PAYE) Tax Credit/Allowances and the General Income Tax Exemption Limits as well as by significantly cutting the individual income tax rate⁹⁶ and widening the standard tax rate band. As a result of the continuous enrichment in almost every year, for example, the Personal Tax Allowances (for single) of IR£2,500 in 1995 is now the Personal Tax Credit (single) of €1,630 in 2006, which is equivalent to a tax allowance of approximately £6,418 at the standard tax rate (20%).
3. Conversion of Tax Allowances into Tax Credits and Enrichment
4. In order to equalize the value of personal tax allowances to all taxpayers so that more resources are devoted to those on lower incomes for a given Exchequer cost, the Government converted various personal tax allowances into tax credits at the standard rate of tax. After converting the Personal Tax Allowance and the PAYE Tax Allowance into the Personal Tax Credit and the PAYE tax credit in the 1999 budget, the Government announced the full tax credit system in the 2000 budget, which became effective on 6 April 2001. In standard-rating various tax allowances⁹⁷, it doubled the amount of the allowances in order to avoid any losses to those on the higher tax rate⁹⁸. In addition, these credits/allowances underwent considerable enrichment over the period.
5. Non-wastable Tax Credits

⁹⁵ The Government regards some of personal tax credits as tax expenditures and the others as structural reliefs. In the figures of €7.3 billion, personal tax credits are excluded regardless of whether they are regarded as tax expenditures or as structural reliefs.

⁹⁶ The standard individual income tax rate was reduced by 7% from 27% in 1996 to 20% in 2001 onward.

⁹⁷ Tax allowances which were converted to tax credits include: the Basic Single and Married Personal Allowances, the PAYE Allowance, the Age Allowance, the Widowed Persons Allowances, the Blind Persons Allowance, the Dependent Relatives Allowance and the Incapacitated Child's Allowance.

⁹⁸ The people subject to the marginal tax rate which is higher than the standard tax rate would have been worse off when those allowances are converted at the standard tax rate with the same amount of allowances.

6. In the 2000 Budget, the Deduction at Source for the Medical Insurance Relief and the Mortgage Interest Relief was introduced. It operates in effect as a non-wastable tax credit since the relief is given as all, irrespective of tax liability. As of June 2006, the government does not have any plans to further introduce non-wastable tax credits⁹⁹.
7. Reduction of the Tax Burden on the Elderly
8. The Government has been committed to easing the tax burden on the aged. In addition to the substantial enrichment of the Age Credit/Allowance, it increased the Income Tax Exemption Limits for those aged 65 and over in every year since 1998, from £4,600 in years prior to 1998 to €17,000 (IR£13,389, approximately) in 2006(single, aged 65 to 74).
9. Changes in Tax Reliefs for Business and Investors
10. Compared with the expansion in the field of personal allowances/credits, the changes in tax expenditures for business sectors and investors have been somewhat mixed. While the Government introduced several reliefs such as the R&D Tax Credit (in the 2004 budget), it has substantially capped certain reliefs, and announced the termination of a series of tax incentive schemes (discussed below).
11. Other Changes
12. Other than those described above, there have been various changes in tax credits/allowances and reliefs, many of which relate to some social purposes, that is, health, support for elderly people, and education. They include:
 - Introduction of two new measures to help long-term unemployed (Revenue Job Assistance) in the 1998 Budget
 - Expansion of the Medical Expenses Relief in 1998 and 2001 budget
 - Increase in the Rent Relief in the 2001 and the 2005 Budget

Recent Developments of Budgetary Control on Tax Expenditure

4.3.4 Recently, tax expenditures have gained political profile and attracted much public attention. The intention of the Minister for Finance Brian Cowen to address tax expenditures became clear in the 2003 budget. For the first time in his budget, tax reliefs become an important issue in his statement. He argued that all tax reliefs be subject to on-going review because tax reliefs narrow the tax base, and thus make it difficult to keep tax rate low. His statement also brought up the perspective of equity, noting that some tax reliefs were used by high income earners to reduce their tax burden. Especially, the Minister announced the termination of a series of tax incentive schemes by not extending their expiring date. They include the Urban Renewal, the Rural Renewal and the Car Parks Reliefs. Many of them involve capital allowances. The Minister devoted a considerable portion of the Budget Statement to his argument on tax expenditures in the following 2005 and 2006 budget, presumably responding to intensified debate on tax reliefs.

⁹⁹ The costs of these refundable credits seem to be treated as negative tax other than spending. (Confirmation is necessary).

4.3.5 Proper examination of tax expenditures was also called for by the Comptroller and Auditor General (C&AG). A summery finding of C&AG in 2001 on the Expenditure Review Initiative (ERI) stated that the scope of ERI should be broadened to include tax expenditures. The C&AG followed this up by looking into the question of costing tax reliefs in his Annual Report on the 2002 Appropriation Accounts.

4.3.6 The annual report on estimated costs of allowances/credits and reliefs is prepared by the Revenue Commissioners, as a component of its annual *Statistical Report*. Its structure and contents have not changed much during the last decade. The report is not directly linked to the budget process and there is no statutory obligation to produce them. It lists estimated costs in terms of revenue forgone of the personal allowances/credits and main reliefs and deductions allowable under the income tax system for the most recent tax year for which adequate tax data from tax returns are available¹⁰⁰.

4.3.7 Currently, estimated costs for many tax measures are not provided because they are unquantifiable, negligible or not identifiable within total aggregates. In order to improve the information available to assist monitoring, reviewing and evaluating tax expenditures, government introduced a number of changes to tax returns in the Finance Act 2003 and the Finance Act 2004. These changes were intended to capture more information and data on tax expenditures via tax returns. This will provide better data in this area and enable fuller estimates of the tax forgone to be made over time. More importantly, the 2006 budget provides, for the first time, the estimated cost of tax expenditures classified into several categories such as “Basic Personal Credits” and “Capital Allowances”¹⁰¹.

4.3.8 As for definition of tax expenditure, the terms “tax reliefs” and “tax allowances/credits” are more frequently used. These terms are “neutral” in that they do not have any normative significance. They refer to (1) structural reliefs through which individual tax liabilities are adjusted to reflect relative tax able capacity and (2) tax-based incentives in favour of specific groups or activities which are designed to promote certain aspects of public policy. The annual report by the Revenue Commissioners uses these terms and never uses “tax expenditures”: the scope of the report is “the personal tax credits and main reliefs and deduction allowable under the income tax system.

4.3.9 The term “tax expenditures” are used alongside the term “tax incentives” in Tax Strategy Group (TSG) papers. The Government do not regard structural reliefs as tax expenditures/incentives, but its definition is somewhat vague. There is no formal use of the benchmark tax system. Instead, the tax expenditure is defined as “provisions that represent spending within the tax code, as well as those that aim to provide an incentive to taxpayers.

4.3.10 In recent years the Department of Finance has been reviewing tax expenditures to consider the case for continuing or terminating certain tax expenditure and options to limiting benefit. In the 2005 budget, the Minister announced a full review of tax expenditures in particular to evaluate in detail their impact and how they are operating in practice. A Supervisory Group of

¹⁰⁰ For example, Statistical Report 2004 contains estimated costs for 2001 and 2002.

¹⁰¹ Costs of proposed new tax measures have been contained in the annual budget.

officials from the Department of Finance and the Revenue Commissioners was established in February 2005. The review also involved external consultancy work on the evaluation of the certain tax incentive schemes. Two economic consultants, Indecon Economic Consultant and Goodbody Economic Consultants, were chosen to evaluate the area based schemes (e.g. the Rural Renewal Scheme) and the sectoral property-based tax incentive schemes (e.g. the reliefs for investment in multi-story car parks). The results of these reviews are reported on the 2006 budget.

4.3.11 In addition to the detailed review of various tax reliefs, tax based schemes are kept under constant review, especially in the context of annual Budget and Finance Bill Process, to ensure they continue to meet the purposes for which they are introduced¹⁰².

4.3.12 Estimated costs reported by Revenue Commissioners are used frequently in this process. The Government prepared in 2002 a paper which outlined information on current tax expenditures/incentives for the discussion in the Tax Strategy Group (TSG)¹⁰³. It summarized the significance and characteristics of tax expenditures, and provided a list of major tax expenditures with their estimated costs based on the latest available estimates from the Revenue Commissioners. Since then, TSG regularly discussed papers which described outlines and update of the issue surrounding tax expenditures in accordance with the Minister's intention described above.

4.4 Japan

Characteristics and Recent Trends in Tax Expenditures

4.4.1 According to the estimates, the aggregated revenue forgone due to so-called "Special Taxation Measures (STMs)" amounts to approximately 3.8 trillion yen in FY 2005. This is 0.75 % of its GDP, and 8.6% of its tax revenue¹⁰⁴. Care must be taken that this estimated costs does not include unquantifiable items such as the Tax Relief for Capital Gains or items which are not classified as STMs.

4.4.2 Table 16 shows the amount and composition of STMs. In FY 2006, The Tax Measure to Promote the Acquisition of Dwelling Houses (806 billion yen, 18.2%)¹⁰⁵ is the largest tax measures for the (personal) income tax, followed by the Deduction of Life and Casualty Insurance Premiums (278 million yen, 8.5%) and the Special Tax Measures for Dividend Income (212 billion yen, 6.5%). STMs for the corporate tax include numerous tax measures, the number of which is as many as 68. Among them, three R&D tax credits amount to 597 billion yen, 18.2% of

¹⁰² Department of Finance (2004), *Tax Strategy Group Papers Budget 2005-TSG 04/22*

¹⁰³ The Tax Strategy Group is an interdepartmental committee chaired by the Department of Finance, with membership comprising senior officials and advisors from the Departments of Finance, Taoiseach, Enterprise Trade and Employment, Social Community and Family Affairs and the Revenue Commissioners. Papers on various options for the Budget and for the medium and longer term are prepared for the Tax Strategy Group

¹⁰⁴ This is based on the initially estimated revenue in the FY 2005 budget. Although actual revenue was more than 9 trillion yen larger than the estimate, the initial estimate is appropriate since the amount of STM was also an estimate.

¹⁰⁵ This measure contains several tax provisions including...

the total. There are several large tax measures for small- and medium-sized enterprises (SMEs), including the Investment Tax Relief (tax credit or accelerated depreciation) for SMEs, costing 211 billion yen (6.4%). Most of the other measures are tax credits and tax deferrals (i.e. special depreciation, accelerated depreciation and tax-free reserves (junbikin)) aiming at various activities such as introduction of pollution-control measures.

Table 16 Amounts and Composition of "Special Taxation Measures" in Japan

	1998		2001		2004	
	estimated cost	% to GDP	estimated cost	% to GDP	estimated cost	% to GDP
Tax Measures to Promote the Acquisition of Dwelling Houses	619	0.12%	587	0.12%	624	0.13%
Exemption of Interest Income from Deposits Owned by the Elderly, the Disabled Persons, etc.	85	0.02%	601	0.12%	133	0.03%
Deduction for Life and Casualty Insurance Premiums	359	0.07%	282	0.06%	258	0.05%
Others	249	0.05%	192	0.04%	332	0.07%
STMs for the Personal Income Tax	1,312	0.26%	1,662	0.33%	1,347	0.27%
R&D Tax Credits	-	-	-	-	648	0.13%
IT Investment Tax Incentives	-	-	-	-	506	0.10%
Investment Tax Relief for SMEs	-	-	-	-	145	0.03%
STMs for the Corporate Tax	356	0.07%	490	0.10%	1,733	0.35%
Others	196	0.04%	210	0.04%	502	0.10%
Total STMs	1,864	0.37%	2,362	0.48%	3,582	0.72%

* Source: Japan, Ministry of Finance

* Special Taxation Measures (STMs) in the national tax system are included.

4.4.3 STM is a narrower concept than "tax expenditures" used in many other countries in that it does not include many deductions and exclusions. Their costs are considerably large: in 2002, it was estimated that abolition of the Deductions for Social Insurance Payments, the Deduction for Dependents, and the Basic Deductions for Spouses would generate additional revenue of 2.8 trillion yen, 1.7 trillion yen and 0.7 trillion yen, respectively¹⁰⁶.

4.4.4 In FY 1999, the size of STMs was modest 2 trillion yen, or 0.37% of its GDP. STMs for the corporate tax only accounted for 19.1% of the total, with various accelerated depreciation schemes by far the most important. There was the Tax Credit for Incremental R&D, but its significance was almost negligible, with 29 billion yen. On the other hand, the personal income tax had relatively generous allowances and exemptions, whose entire eliminations was said to generate as much as 30 trillion yen (6 per cent of GDP) with taxpayers' behaviour unchanged (in 1996).

4.4.5 Recently however, Japanese Tax System underwent various reforms. With regard to tax expenditures, two trends can be pointed out. First, reflecting recent economic stagnation, various tax expenditures were introduced and expanded in order to vitalize its economy. These measures are intended to support SMEs, enhance R&D, stimulate investment in housing, and foster financial market. Second, while a considerable amount of general tax reliefs were provided to stimulate its economy, several deductions in the personal income tax were abolished or reduced in

¹⁰⁶ Cabinet Office (2002). "Tax base and tax burden of personal income tax". Policy Analysis Report, No. 15 (in Japanese), Tokyo.

order to correct “hollowing out (shrinking tax base)”. For example, the Exemption for the Elderly and the Special Additional Exemption of Dependent Children under 16 Years Old were abolished.

4.4.6 The fundamental tax reform in 2003 clearly exemplifies these two trends. It provided 1,304 billion (in FY 2003) tax reliefs in the corporate tax by introducing tax credits for investment in R&D and information and communication facilities and enriching STMs for SMEs. Together with the tax cuts in other areas including inheritance taxes, gift taxes and taxation of financial transactions and stocks, tax cuts of 1,713 billion yen took effect in 2003. At the same time, income tax as well as the consumption tax was increased by reducing the Special Exemption for Spouses. This offset some of the reduction of revenue after FY2004.

4.4.7 These reforms resulted in the expansion of STMs and the change in its composition. As can be seen in Table 16, STMs for the corporate tax show a fivefold increase from 356 billion yen in FY 1998 to 1,751 billion yen in FY 2005 mainly due to special deductions aimed at stimulating investment in R&D and IT, while STMs for the income tax had increased only modestly in the same period. Correspondingly, the share of STMs for the corporate tax jumped up from 19.1% to 46.1% and is now larger than STMs for the income tax. Also, with the negligible increase in the nominal GDP over the period, the ratio of estimated costs of STMs to GDP doubled from 0.37% to 0.75 %.

Budgetary Control on Tax Expenditures

4.4.8 Although there is no regular report on tax expenditures, the Ministry of Finance has been annually submitting to the Diet (Congress) the estimated costs of each STM in both the national and the local tax system since 1956. It also provides information on the costs of STMs on its website. It covers not only the income tax and the corporate tax but also other taxes including the gift tax, the registration and licence tax and various excise taxes. In addition to STMs in national taxes estimated by the Ministry of Finance, STMs in local taxes are also calculated by the Ministry of Internal Affairs and Communications.

4.4.9 As noted before, there is no formal use of the concept “tax expenditures”. Instead the Government uses the term “special taxation measures” to refer to and discuss tax reliefs. Although there is no clear-cut definition of STM, it is considered to be a tax relief for a particular group of taxpayers in order to influence its economy or society and thereby achieve a particular policy objective. The scope of STM is limited compared with the tax expenditure concept adopted by many other countries. This is because various tax deductions and exclusions for the personal income tax are considered to be a normal provision which is intended to take into account the individual's ability to pay taxes¹⁰⁷. Some of them, such as the Deduction of Contribution/Donation, the Deduction for Medical Expenses and the Exemption of Specific Dependent, are nonetheless regarded as having an aspect of preferential treatment.

4.4.10 The Tax Commission (the advisory body for the Prime Minister) has continuously been arguing that STMs should be rationalized, streamlined, targeted and prioritized. For example, in its report published in July 2000, STM was regarded as the exception to the principles of taxation (fairness, neutrality and simplicity) and called for careful scrutiny on their necessity. In addition to

¹⁰⁷ OECD (1999), *Economic Surveys: Japan*, Paris.

the violation to these principles, it pointed out several problems: ineffectiveness, higher burden to ordinary taxpayers, and persistent characteristics once legislated.

4.4.11 The Government sets its middle-term fiscal goal of achieving primary balance surplus in early 2010s in the Cabinet Decision, *A Reform and Perspective Programme (revised in 2003)*. Based on this, a more concrete middle-term fiscal framework is articulated in *Basic Policies for Economic and Fiscal Management and Structural Reform 2006*, decided in the Cabinet meeting in July, 2006. Since the fiscal target is on the level of fiscal balance, in theory tax expenditures does not jeopardize the attainment of the goal as long as the projection of tax revenue is conducted appropriately. The budgetary process involves projection of tax revenue taking into account the effect of tax expenditures.

4.5 New Zealand

Recent Trends in Tax Expenditures

4.5.1 Since there is no formal definition of “tax expenditure” or formal “tax expenditure report”, its overall significance and recent trends are unknown. However, there is a shift from business tax expenditures to non-wastable tax credits for social purposes, as many other countries. During the second half of the 1980s, most tax expenditures were removed by abolishing a wide range of business investment incentives, including export incentives and investment allowances.

4.5.2 On the other hand, in the field of family assistance, the Government recently has introduced several non-wastable tax credits. In 1986, Family Support, a non-wastable tax credit available to low-income families irrespective to their work status, replaced several preceding tax rebates¹⁰⁸. In more recent years, reflecting an increasing emphasis on work and independence from the state, the Family Plus Tax Credits were created which are only available to working families. This consists of three different tax credits, namely the Child Tax Credit¹⁰⁹, the Parental Tax Credit and the Family Tax Credit¹¹⁰, which were introduced respectively in 1996, 1999, and 1986. These non-wastable tax rebates can be paid either at the end of the income year or in fortnightly instalments during the year. The fiscal cost of these family assistances from 1986-87 to 2001-02, prepared by the Treasury, is shown in Table 5.

4.5.3 As a result, the current tax system provides the Family Assistance Programs by four non-wastable tax credits. They are important components of the New Zealand Social Assistance System alongside welfare benefits schemes: in 2002-03, forecast expenditure for them was \$1,058 million, accounting for 15.9% of total welfare spending on the working aged.

Budgetary Control of Tax Expenditures

4.5.4 As noted before, there is no formal reporting of tax expenditures. However, in a sense the Government properly adopts itself to the recent trends of tax expenditures: without any usage of the concept “tax expenditures”, it simply treats four non-wastable tax credits as expenditures.

¹⁰⁸ Whether these antecedents were refundable or not is uncertain. Confirmation is necessary.

¹⁰⁹ Before 1999 when it was renamed, the Child Tax Credit was named the Independent Family Tax Credit.

¹¹⁰ Before 1999 when it was renamed, the Family Tax Credits was named Guaranteed Minimum Family Income.

They are reported as part of budgetary documents and included in the annual Estimates of Appropriation for the Inland Revenue^{111,112}. Thus, they are subject to appropriation in the same way as spending programmes. As for other tax expenditures, the amendment of the Fiscal Responsibility Act 1994 now requires the Government to report in the budget forecast information a table of all material tax policy changes and the impact on the fiscal forecasts.

4.5.5 Since its fiscal rule, the Fiscal Responsibility Act 1994 focuses not on the level of expenditures or revenue but on the level of deficit and debt, tax expenditures never create any loopholes to the rule, as long as the Government properly take into account revenue losses from tax expenditures in forming its budget.

4.6 United Kingdom

Characteristics and Recent Trends in Tax Expenditure

4.6.1 Table 17 is a list of major tax reliefs, whose estimated costs were more than £2 billion, reported by the Treasury in 2005, 1999 and 1994. One of the most important changes of tax expenditures is restructuring of tax credits and some related allowances. Some of other important facts and trends, except for the general upward trend presumably due to inflation, are;

1. The personal tax allowances and the various reliefs associated with occupational and personal pension schemes are the most significant. Especially, the substantial increase in pension-related reliefs since the late 1980s¹¹³ continued during the 1994-2005 period, as can be seen in the expansion¹¹⁴ of the Relief for Employer Contributions to Approved Pension Schemes.
2. Tax reliefs for the capital gains tax were expanded. The Labour Government which took office in 1997 introduced the Taper Relief in the 1998 budget, and has significantly improved its rate and availability since then. Taper Relief, in the 2004-05 period, is estimated to cost as much as 3.5 billion. Also, the estimated cost of the Exemption of Gains Arising on Disposal of Only or Main Residence expanded from £850 million to £13 billion over the period¹¹⁵.

¹¹¹ The criterion under which a tax measure is treated in this way rather than as negative tax (and hence not reported at all) is not specified. Probably the Government regard only refundable tax credits as expenditures and the other tax expenditures as negative taxation. Confirmation is necessary.

¹¹² There are also appropriations of refunds for taxes, but it is uncertain whether this represents payments to taxpayers due to other refundable tax credits or this simply means refund of the amount in excess of tax liabilities paid during a taxation period.

¹¹³ Bauld, L. and Judge, K. (1999).

¹¹⁴ The reason for this expansion is not certain. It is possible that the expansion is simply due to changes in estimation methods for these items. According to *Summary of the main tax measures introduced in each Budget since 1979* prepared by The Institute for Fiscal Studies, no tax measure which could cause this expansion has been implemented during the period.

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4.6.2 Tax credits and some of allowances for income tax underwent complete restructuring—abolition, introduction, replacement, integration and enrichment. So far, the restructuring introduced two new non-wastable tax credits which support families with children in lieu of married couples. Two distinct characteristics underlie this change:

1. It was underpinned by two principal objectives: support for all families with children and greatest support for those who need the most. The Chancellor Gordon Brown made clear in the 1998 budget that the Government was determined to increase substantially support for families with children and do so in the fairest way.
2. It was driven toward some degree of integration of the tax and the benefit system. The Labour Government embarked on a fundamental programme to modernize the tax-benefit system, based on the notion that the complete separation of payments made to government through income tax and national insurance contributions and support from government through the benefit system was a key weakness of the system of financial support.

4.6.3 The restructuring had three stages:

4.6.3.1 Creation of WFTC (1999)

The task force set up in May 1997 was asked to examine the interaction of the tax and benefit system so that they can be streamlined and modernized. Specifically, it looked at the advantages of introducing a tax credit drawing upon the American experience of EITC. The report concluded that the EITC had much in its favour, although a UK tax credit would have to be different in a number of respects. Based on this report, the government introduced two new *non-wastable* tax credits, the Working Families Tax Credit (WFTC) and the Disabled Person's Tax Credit (DPTC) in 1999, in place of Family Credit and Disability Working Allowance, respectively. Apart from help with childcare cost, the structure of WFTC was similar to its predecessor. It was means-tested social security benefit for people in full-time work, made up of several elements including a basic tax credit, various tax credits for each child depending on the age, and a childcare tax credit. However, they were quite different in that they were administered and assessed by the Inland Revenue instead of by the Benefits Agency, and hence were payable through the pay packet or directly by the Inland Revenue.

4.6.3.2 Replacement of the Married Couple's Allowance with the Children's Tax Credit (2001)

The Married Couple's Allowance (MCA)¹¹⁶, whose estimated cost was the sixth largest £4,600 million in the 1992-93 period, had been gradually reduced since 1993 and was finally abolished in April 2000, alongside similar reliefs and allowances such as the additional personal allowance (APA). The revenue from this abolition was allocated to funding the Children's Tax Credit, which replaced MCA and came into effect in April 2001. Children's Tax Credit was a wastable tax credit available to families with one or more children.

¹¹⁶ Although this is named "Allowance" in effect it worked in the same way as credits because a fixed rate of 10% (the lowest tax rate) instead of their marginal tax rate was applied to the amount of allowance. In fact, the Children's Tax "Credit" took the same form of "allowance" for which relief is given at 10% against income tax owed. This suggests the arbitrariness of the definition of "tax credit" and "tax allowances".

4.6.3.3 Integration of tax credits (2003)

When the government announced this new credit in the 1999 budget, it also recognized that it would be necessary to integrate the Children's Tax Credit with the child premia in Income Support and WFTC. Two years later, in April 2003, WFTC, DPTC and the Children's Tax Credit were taken place of by two new tax credits with greater generosity: The Child Tax Credit (CTC) and the Working Tax Credit (WTC). CTC replaced the existing, income-related elements of support for children in WFTC, DPTC, Children's Tax Credit, Income Support and income-based Jobseeker's Allowance. Also, CTC was refundable, so that people paying no tax could receive the support. Similarly, WTC replaced the existing elements of support for adults and their childcare costs in the WFTC, DPTC and the New Deal Employment Credit for those aged 50 or over. WTC will also provide support for working households without children where at least one adult is aged 25 or over.

4.6.4 In addition to these changes, the government continuously enriched these tax credits. They were increased in almost every year since the introduction of WFTC. Although their estimated costs reported as tax expenditures are modest—£3,300 million and £1,100 million 2005, respectively—they do not include payments exceeding tax liability. Such payments are currently treated as expenditures and amount to as much as £15 billion in 2004-05 as a whole. At the same time, the mortgage interest tax credit, which “rivalled those for pensions in size and importance”¹¹⁷ in 1980s, has been reduced since 1988¹¹⁸ and abolished in the 1999 budget. As a result of all these changes, MCA and the mortgage interest tax credit, which was large items in the 1993-94 report, have disappeared in the 2004-05 report. Instead, CTC and WTC are on the list.

Budgetary Control of Tax Expenditure

4.6.5 Although there is no statutory requirement to produce report on tax expenditures, the Government has been estimating and reporting major tax expenditures¹¹⁹ every year in *Tax Ready Reckoner* published by the Treasury in autumn. In the annual budget, the *Chapter A: Budget and Policy Decisions* of *Financial Statement and Budget Report* contains a list of estimated effects on revenue of proposed tax expenditures along with effects of proposed spending programs on expenditure, under each functional category. In addition to this presentation of “change” in tax expenditures, since the 2000 budget, a list of major tax expenditures reported in *Tax Ready Reckoner* has been incorporated in the appendix.

4.6.6 Corresponding to the introduction and expansion of two new non-wastable credits with the intention of the tax-benefit integration, the government has changed the way it recognizes the costs of these tax credits. Until recently, the government did not seem to pay much attention to practical outlays via tax reliefs. It simply treated them as tax expenditures. After the Mortgage Interest Relief at Source (MIRAS) scheme was introduced in 1983, the government in effect

¹¹⁷ Bauld, L. and Judge, K.(1999).

¹¹⁸ The Council of Mortgage Lenders(2004).

¹¹⁹ Tax Ready Reckoner includes tax reliefs with an estimated annual cost of at least £50 million. The cost for minor tax reliefs are provided on the Her Majesty Revenue and Customs website.

provided interest subsidies for borrowers by paying some portion of their interest to lenders. Thus people with no tax liability could also receive this credit. However, the Government reported these costs as tax expenditures^{120,121}. After the two non-wastable credits, WFTC and DPTC, were enacted, the Government classified them as negative taxation for the purposes of calculating “net taxes and social security contributions”, as used in the tax-GDP ratio. Consistently, it reported entire costs as tax expenditures in *Tax Ready Reckoner*. At the same time, the Office for National Statistics (ONS) classified them as spending in the National Account, probably due to the fact that they replaced social benefit. However, in the budget, the table of Total Managed Expenditure (TME), which is National Account figure and thus includes these tax expenditures, included them in “accounting adjustments”.

4.6.7 In the 2002 budget, the Government changed this classification. It classified CTC, WTC, WFTC and DPTC as negative taxation to the extent that credits are less than or equal to the tax liability of the household, and as public expenditure where credits exceed the liability. This is consistent with OECD guidance under §20 and §21 of the Revenue Statistics Interpretative guide. As a result, currently the government deducts from receipts only a negative tax component of these tax credits, and add a spending component in its expenditures. Both components are shown in the budget specifically as “tax credits” in the table of current receipt and the table for TME¹²².

4.6.8 The transfer component of tax credits is recognized as Annual Managed Expenditure (AME) alongside social security spending¹²³. AME, together with the Departmental Expenditure Limits (DELs) constitutes TME, which is the Government’s spending envelope set to comply with its two fiscal rules, the Golden Rule and the Sustainable Investment Rule. Therefore, the spending component of tax credits is under these constraints. In fact, AME is reviewed twice a year as part of the Budget and Pre-Budget Report process reflecting the close integration of the tax and benefit system. Although AME is not subject to the same three year expenditure limits as DEL, affordability is taken into account when policy decisions affecting AME are made. The Government has committed itself not to take policy measures which are likely to have the effect of increasing social security or other elements of AME without taking steps to ensure that the effects of those decisions can be accommodated prudently within the Government’s fiscal rules.

4.6.9 By the same token, it seems logical that the negative tax component of tax credit and tax expenditures are under these fiscal rules, as long as necessary adjustments are taken taking into account revenue reduction due to changes in tax expenditures so as to achieve the fiscal rules¹²⁴. As noted before, the budget specifies effects of proposed tax expenditures on receipts. This

¹²⁰ Life assurance premium relief on pre-1984 policies and private medical insurance premium relief for over-60s

¹²¹ It may be necessary to verify that the government did not treat “subsidy portion” as a part of expenditure in the budget.

¹²² However, tax expenditures other than these credits are not presented in the table of current receipt. In this sense, the government seems to recognize the characteristics of tax credits distinct from other tax expenditures, which require different treatment.

¹²³ AME typically consists of programmes which are large, volatile and demand-led, and which therefore cannot reasonably be subject to firm multi-year limits.

¹²⁴ However, the effectiveness of such “indirect” constraint is uncertain. In addition, this does not guarantee that the Government is able to compare the trade off all changes in expenditures and revenues appropriately.

suggest the Government adjusts expenditure or other part of receipts in order to conform to the fiscal rules.

4.7 United States

Characteristics and Recent Trends in Tax Expenditure

4.7.1 The study by Eric Toder (2000) points out the shift away from business tax expenditures to social tax expenditures—tax expenditures directed at social policy goals such as health, education, housing, retirement security, support for low-income families and development of economically depressed areas. He estimated in the late 1990s that “social tax expenditures have increased as a share of Gross Domestic Product over the past two decades, while ‘business tax expenditures’ have declined”

4.7.2 This trend seems to have been continuing. The Taxpayer Relief Act of 1997 created several new tax expenditures for social purposes, which included the Child Credit and the HOPE tax credit. After that, several tax relief acts, most notably the Economic Growth and Tax Relief Reconciliation Act (EGTRRA), provided further expansion of existing provisions (the Child Tax Credit, for example) created of new tax expenditures (tax-favored individual retirement account, for example).

4.7.3 The comprehensive analysis on tax expenditures published in 2004 by the Governmental Accountability Office (GAO) shows a significant increase in tax expenditures for individuals. While the revenue loss due to those tax expenditure expanded from \$363 billion in 1988 to more than \$600 billion in recent years, revenue loss estimates for corporate tax expenditures have been relatively stable, fluctuating about \$100 billion¹²⁵.

4.7.4 Tax credits have recently expanded significantly as a measure of tax expenditure. The number of tax credits reported by the Treasury as tax expenditures had long been stable, around 17 until 1995. However, it jumped up to 26 in 2000 and 29 in 2001. Aggregated estimated revenue forgone due to tax credits correspondingly increased from \$17,445 million in 1995 to \$45,304 million in 2000 and \$62,848 million in 2005. This is shown in the Table 18. Also, the Table 19 provides recent introduction and expansion of tax credits. Toder (2000) notes that recent expansion of tax expenditure relies on tax credits rather than exclusion or deduction. Introduction or modification of tax credits accounted nearly 90% of all increase in tax incentives in the President’s FY2001 budget. In contrast, most of the long-standing and biggest tax incentives in current law are deduction or exclusions.

4.7.5 Although most of tax credits are still wastable, non-wastable tax credits have increased its significance. The Earned Income Tax Credit, which had been the only non-wastable tax credit before 1997, has increased almost two-folds between 1995 and 2005¹²⁶, from \$20,165 million to

¹²⁵ GAO provided information about the aggregated revenue forgone with a warning that simply adding up an estimated cost of each tax expenditure may bring about further inaccuracy due to interaction between provisions and people’s behavioural responses. Noting that, GAO analyzes the aggregate because “summing the estimates provides perspective on the use of tax expenditures as a policy tool and represents a useful gauge of the general magnitude of governmental subsidies carried out through the tax code.”

¹²⁶ This is due to the increasing effect of the credit on outlays. See Table 1.

\$38,770 million. The other two non-wastable tax credits, the Child Credit and the Tax Credit for Health Insurance Purchased by Certain Displaced and Retired Individuals were created in 1997 and in 2002, respectively.

4.7.6 Since its introduction, the Child Credit has been enriched substantially by several tax relief acts. EGTRRA announced to double the amount gradually by 2010, and the following two tax acts, the Jobs and Growth Tax Relief Reconciliation Act of 2003 and the Working Family Tax Relief Reconciliation Act of 2004 accelerated the increase. As a result, among the 13 largest tax expenditures with an annual revenue loss estimated at \$20 billion or more in the FY 2006 budget, the Child Credit is the only tax expenditure which was created after 1986.

Recent Development of Budgetary Control on Tax Expenditures

Presentation of Tax Expenditures

4.7.7 The Congressional Budget Act of 1974 (Public Law 93-344) requires that a list of “tax expenditures” be included in the budget. In accordance with this provision, the Treasury Department compiles a list of income tax expenditures, which is included in the “Analytical Perspectives” volume of the Administration’s Budget prepared by the Office of Management and Budget (OMB) each year¹²⁷. Except for the exclusion of tax expenditures against transfer tax baseline in the 2003 budget¹²⁸, the scope of the list has not changed much since the 1995 budget, which started to cover seven fiscal years. However, the way estimations were presented changed over time. For example, after the 1995 budget, it discontinued providing the total amount of tax expenditures which took into account interactions among provisions.

4.7.8 Integration of tax expenditures in the annual budget presentation underwent some rollback. The recommendation was made by the Government Accounting Office (GAO) in 1994 that tax expenditures be integrated in the budget presentation and incorporated under review process. As a response to this recommendation, the 1998 budget began to present in the “Budget” volume revenue loss sums for tax expenditures alongside outlays and credit activity for each budget function. However, OMB discontinued this practice after the 2002 budget.

4.7.9 As for the costs of three non-wastable tax credits, they are divided into effects on receipts and effects on outlays and shown separately. The latter part is shown as outlays alongside with other mandatory spending. Only the former part of the costs is presented in the list of tax expenditures, with footnotes mentioning the latter.

Evaluation of Tax Expenditures

4.7.10 The Government Performance Results Act of 1993 (GPRA) directs Federal agencies to develop annual and strategic plans for their programs and activities. Based on this, the Report of the Senate Governmental Affairs Committee on GPRA called for a series of analyses to assess the effect of specific tax expenditures on the achievement of agencies’ performance objectives. In

¹²⁷ The Joint Committee of Taxation also prepare each year the list of tax expenditure.

¹²⁸ This is because “there is no generally accepted normal baseline for transfer taxes and this tax has been repealed under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA)”.

order to act on this requirement, Treasury started to develop framework for evaluation of the performance and economic effects of tax expenditures, and the Analytical Perspectives in the 1997 budget summarized the initial work. In 1997, Treasury initiated pilot studies of three specific tax expenditures and performance goals, and the results were reported in the 1999 budget.

4.7.11 However, the pilot studies raised an issue of data availability and difficulty in identification of a clear purpose for some tax expenditures. Since then, the Administration has been undertaking additional studies that focus on the availability of the data needed to assess the effects of selected significant tax expenditures. As a part of this, Treasury's office of Tax Analysis and Statistics of Income Division (IRS) has been developing a new panel sample of individual tax filers over at least ten years.

Re-evaluation of Tax Expenditure Concept

4.7.12 Tax expenditures have been defined as deviation from two baselines: the reference law baseline and the normal tax baseline. Since they deviate from a theoretically appealing measure of a comprehensive income tax in many ways, classification of specific provisions of the tax code cannot avoid a degree of subjectivity. Partly because of this arbitrariness, tax expenditure concept was questioned by a growing contingent of conservative critics, which resulted in the qualification in the Analytical Perspectives of the 2002 budget that "Because of the breadth of this arbitrary tax base the Administration believes that the concept of "tax expenditure" is of questionable analytic value."

4.7.13 Based on this notion, Treasury launched the review of the tax expenditure presentation, suggesting the possibility of reconsidering a comprehensive income tax as a baseline. This effort focused on three aspects: (1)defining tax expenditures relative to a comprehensive income tax baseline; (2)defining tax expenditures relative to a broad-based consumption tax baseline; (3)defining negative tax expenditures.

4.7.14 The results of this review was included in the Appendix of the Tax Expenditure section of the Analytical Perspectives volume in the 2004, 2005 and 2006 budget. While the Administration keeps reporting tax expenditure based on materials and formats developed and included in previous budgets, the Appendix compares major tax expenditure reported with tax expenditure implied by each the two alternative baselines, and classifies them into four categories: a tax expenditure under the alternative baseline; possibly a tax expenditure under the alternative baseline but with some qualifications; uncertain; and (probably) not a tax expenditure under the alternative baseline. It also discusses some "negative tax expenditures" such as the double tax on corporate profits. While most of the items that had been identified as tax expenditures can also be judged so under the comprehensive income tax baseline, just over the half of them are categorised as being "probably" tax expenditures under the consumption tax baseline. In fact, tax expenditures such as savings tax preferences, accelerated depreciation, and tax deferral on foreign income are not considered tax expenditures. These two alternatives provide useful information for those who have different ideological perspectives on tax bases.

Relationship with Fiscal Rules

4.7.15 The Budget Enforcement Act (BEA), enacted in 1990, was intended to constrain legislation which would increase spending or reduce revenue. Instead of capping mandatory spending or requiring certain amount of receipts, it required that all laws that affect mandatory spending or receipts must be enacted on a “pay-as-you-go (PAYGO)” basis. This means that if a law reduces revenue by expanding tax expenditures, another law must be enacted with an offsetting reduction in spending or increase in receipts.

4.7.16 After BEA and thus PAYGO expired at the end of fiscal year 2002, the Administration has been proposing changes to the budget process, including an implementation of a sort of PAYGO rule. However, this new PAYGO rule being proposed is quite different from the old PAYGO rules in that the new rule applies only to mandatory spending changes and does not apply to changes in taxes. Also, proposals included in the most recent 2007 budget states that this rule does not allow mandatory spending increases to be offset by tax increases. Some budget watchdog organizations which call for reinstatement of the old PAYGO rule warns that the new “one-sided” PAYGO rule, constraining only the expenditure side, will lead to further expansion of tax expenditure in order to provide benefits under the constraint.

4.8 Other Countries

4.8.1 Korea

Characteristics and Recent Trends in Tax Expenditures

4.8.1.1 In 2000, tax expenditures amounted to 13,282 billion Won, 2.5 % of GDP. According to its breakdown by purpose (Table20), “Support for employees and farmers” is the largest category, accounting for about half of the total cost. Tax expenditures for economic development are also significant, with 4,246 billion won. Despite gradual reduction, tax incentives for the business sector have been, and still are, considerably significant. Total tax expenditure related to the business sector amounted to around 0.6 per cent of GDP in 1998. These tax incentives include investment tax credits, exemptions, income deductions, low rates for publicly-held companies, accelerated depreciation and tax-free reserves. Incentives are mainly given to SMEs, R&D and overall investment.

4.8.1.2 The government has continuously made effort to broaden the tax base by reducing or streamlining tax incentives deemed to be inefficient, many of which are related to small and medium-sized enterprises (SMEs). For example, the tax deductibility of investment reserves for SMEs has been abolished, and the tax credit ratio to SMEs was lowered. Also, in 2006, several non-taxation benefits and tax reliefs, including the deductions for credit card charges and tax breaks regarding comprehensive savings, have been scaled back. The tax base for VAT has been broadened as well, for example, by abolishing the VAT exemption on services supplied by professional service providers such as lawyers and accountants in 1999.

4.8.1.3 At the same time, however, various tax incentives have been introduced or expanded in recent years, which is attributable to unchanged overall significance of tax expenditures (around 2.2 % of its GDP, Table 21). Large portions of them are incentives given to SMEs, investments

and R&D, with intention to stimulate the economy, support SMEs and beef up competitiveness. Another important objective underpinning recent tax reforms is to support for the middle and working class. They include: deduction for pension contribution and non-taxable savings for the old and the disabled were established in 2000; personal exemption and income deduction for medical expenses were expanded in 2002; the earned income tax credits provided to temporary workers were enriched and tax incentives to support child's birth and childcare established in 2003.

Budgetary Control of Tax Expenditures

4.8.1.4 There have been some improvements in the control of tax expenditures. In 1999, the Government started to report tax expenditures based on direct taxes to the National Assembly, although the figure is historical estimates rather than projections. In the next two years, the coverage of the report was increased by including indirect taxes and customs duties. In the same year, tax incentives provided under the Tax Exemption and Reduction Control Law and the Foreign Investment Promotion Act were consolidated under the new Special Tax Treatment Control Law. One intention is to introduce sunset rules under which most incentives in the act expire automatically within one or three years unless their duration is extended.

Table 20 Tax Expenditures in Korea, by Purpose

	(in billion won)	
	1999	2000
Support for employers and farmers	6,129	6,651
Savings	2,745	2,831
Employees	1,296	1,629
Farmers and fisherman	2,088	2,191
Economic Development	2,571	4,246
SMEs	490	826
Investment stimulus	464	1,074
R&D	428	979
Public Investment	518	499
Financial Sector	168	274
Restructuring	300	439
Regional Development	203	155
Social Welfare	1,326	1,741
Education, culture and health	303	333
Environment	152	200
Social Security	818	1,165
Housing	53	43
Defence	381	486
General Public Administration	109	128
Others	26	30
Total	10,542	13,282
Per Cent of GDP	2.2	2.5

The 1999 data is based on direct taxes, whereas the 2000 data includes both direct and indirect taxes.

Source: OECD(2003c)

Table 21 Tax Expenditures in Korea

	(in billion won)			
	2000	2001	2002	2003
Tax Expenditures	13,282	13,730	14,726	16,883
Tax Expenditures/GDP	2.30%	2.21%	2.15%	2.33%

Source: Korea, Ministry of Finance and Economy

4.8.2 The Netherlands

Characteristics and Recent Trends in Tax Expenditures

4.8.2.1 According to the Annual Tax Expenditure Report, the aggregated cost of tax expenditures (including both direct and indirect taxes) was €13,658 million, accounting for 2.94% of its GDP. Major tax expenditures in 2005 includes: Self-employed person deduction, the reduced wage for low-wage employees, exemption of income from certain company saving schemes, general allowance on income from property, exemption of specific welfare benefits.

4.8.2.2 Other than these tax expenditures, there is a considerable amount of revenue forgone due to tax breaks (personal tax credits, deductions and exemptions). It does not include “B-list” tax expenditures as discussed later, and, more importantly, there are various tax credits which are not regarded as tax expenditures. They are nonetheless quite significant: the Child Credit and the Young Disability Credit, for example, amounts to €1,482.5 million and €472.8 million in 2001, respectively. The estimated cost of the Child Credit is larger than those of any tax expenditures¹²⁹.

4.8.2.3 The Ministry of Finance studied the budgetary significance of tax expenditures between 1984 and 2002. The study shows a rapid increase in tax expenditures in the period. The aggregated tax expenditures (as a percentage of GDP) went up from 0.66% in 1984 to 2.39 % in 2002, nearly a fourfold increase. Care must be taken in interpreting this figure because it does not include indirect tax expenditures which the Government had not estimated until recently. The increased use of tax expenditures was spurred by the Kok-I administration (1994-98), mainly because:

1. Economic policy was specifically aimed at job creation, mostly by reducing the tax burden for small and medium-size enterprises.
2. Expenditure ceilings were introduced for direct expenditures.
3. The coalition parties agreed that a fixed percentage of additional tax revenue over and above long-term estimates could be used to reduce the tax burden.
4. There was a belief that tax provisions were more in line with efficiently functioning market economy than were subsidies. This contributed to the conversion of direct expenditures into tax expenditures.

¹²⁹ OECD (2005).

4.8.2.4 As for personal tax breaks (which are not “tax expenditures”) in Netherlands, the fundamental tax reform in 2001 introduced tax credits (*heffingskortingen*) in place of tax allowances. The standard tax allowance was replaced by a single tax credit and the employed person’s allowance was replaced by the Earned Income Tax Credit (*arbeidskorting*). This was intended to increase incentives for people to look for work.

Budgetary Control of Tax Expenditures

4.8.2.5 Except for in 1987 and 1994, the government had not provided any estimate on the costs of tax expenditures. However, starting in the budget year 1999, the Budget Memorandum now includes a separate annex on tax expenditures known as the Annual Tax Expenditures Report (ATER). In addition to tax expenditures in the wage and income tax and the corporation tax, the ATER for 2003 introduced an overview of tax expenditures for indirect taxes. In addition to quantitative information on tax expenditures, in every year ATER contains an exploration of a special topic of the ongoing tax expenditure discussion. So far, several issues including definition of tax expenditures and the possibility of budgetary ceilings for tax expenditures.

4.8.2.6 It is noteworthy that the report does not include “B-list” tax expenditures, that is, disputable tax measures for which the working group conducting the study could not make unanimous decisions in identifying tax expenditures. As a results, besides reported tax expenditures there are large amounts deducted from taxes for owner occupied housing and tax revenue forgone from not taxing pension fund earnings as they accumulate. The government provides less information on these amounts.

4.8.2.7 As for the definition of tax expenditures, in its report “*Tax Expenditures in the Dutch Wage and Income Tax*” published in 1987, the working group formulated the definition based on the two main elements—reduction of tax revenue and deviation from the benchmark tax structure. The benchmark tax structure includes, among other things, “exemptions, deductions, and tax credits that adjust taxable income in line with the ability-to-pay principle. In general, those provisions relate to personal circumstances, such as being a single parent, having children, having a disability, or being ill”. Consequently, many personal tax breaks are not listed as tax expenditures.

4.8.2.8 There has been an attempt of performance evaluation on tax expenditures. In order to adjust to the new budget system which emphasizes the connection between the means used to achieve policy goals and the results of the policy instruments selected, the AETR for the Budget Memorandum 2002 and onward assigns tax expenditures to the respective departments responsible for policy goals of each tax expenditure. Also, the ATER included a survey of the policy goals to be achieved with the respective tax expenditures and a survey of planned and completed evaluations for tax expenditures.

4.8.2.9 Tax expenditures were used significantly due to its fiscal rules. The current framework of the budgetary policy was, in most part, introduced in the Coalition Agreement¹³⁰ of the Kok-I government created in 1994. This framework has not changed much since then, and it contains

¹³⁰ In order to form a majority government among political parties, coalitions are formed between two or more parties. In this process, they announce their major policy objectives in the Coalition Agreement.

three important elements regarding budgetary control of tax expenditures: fixed real maximum caps for expenditures in each sector, “Firewalls” between revenues and expenditures and explicit rules for windfalls and shortfalls. Ceilings are set only on the expenditure side, and no explicit ceilings are imposed on tax expenditures. Also, fire-walls between revenues and expenditures do not allow windfalls due to unexpectedly favourable economic performance to be used to finance additional spending. As noted before, this is regarded by the current Government as one of the reasons for the rapid expansion of tax expenditures under the Kok-I administration (1994-1998)¹³¹

4.8.3 Sweden

4.8.3.1 According to the Government’s estimates, tax expenditures in Sweden is quite large. Overall tax expenditures for 1996 are calculated at 174 billion SEK (outlay equivalent basis), as much as 10% of its GDP. Although it has become less significant in recent years, it still amounts to around 8% of its GDP. Tax expenditures for Health and Social Insurance are the largest group, with more than 70 billion SEK. Tax expenditures have been also intensively used to support the business sector, and it increased significantly in 1990s: it went up from 31.5 billion SEK in 1995 to 45.8 billion SEK in 1999¹³².

4.8.3.2 There is a non-wastable tax credit of 75% of the social security contribution. Also, a tax credit is provided to everyone whose income is less than a certain amount and this is non-wastable as far as its amount is less than local taxes.

4.8.3.3 Sweden was said to have established a firmer control over central government finances than most other countries. An introduction of a comprehensive review of tax expenditures (perhaps in the late 1990s) enhanced this control. Currently, the Government annually reports tax expenditures to the Parliament in an appendix to the Spring Budget, in order to present the Parliament a more complete picture of the fiscal policies.

4.8.3.4 However, since 2000, there has been increasing recourse to tax expenditures, most notably with further abatement of social insurance contributions in category A development areas and general tax relief for municipalities. IMF Article 4 Consultation in 2005¹³³ reports a rapid increase in tax expenditures. This expansion is due to its fiscal rule which articulates expenditure ceilings for successive three years without a precise anchor. Although it has the 2 percent surplus target, a lack of the clear definition of it makes a room for different interpretation. As a result, it has been possible to ensure compliance with the ceiling through tax expenditures without regard to their effects on budget balance. In fact, in the climate of relatively slow growth, rising demand

¹³¹ The rules governing the usage of windfalls were introduced in 1999. They explicitly stipulate the cases where windfalls can be used to cut tax and the maximum amount of tax cut for each of the cases¹³¹. This constrains extensive use of tax expenditures when revenue grows unexpectedly.

¹³² The tax expenditures for the business sector were estimated to be only 8.9 billion in 1993, which also suggest their rapid expansion. However, this figure is exclusive of tax expenditures for excise taxes, so is not mentioned to avoid inconsistency.

¹³³ It reports that the total cost of tax expenditures has increased from about 2 billion SEK in 2001 to more than 15 billions SEK in 2005. However, the source and details of this figure is not specified. Besides, this figure is quite inconsistent with the figures reported by the Swedish Government: the Government estimates the cost of tax expenditures to be more than 177 billion in 2001.

for social programs has put the ceilings under continuous strain and the Government resorted to increasing use of tax expenditures.

Addendum: Methodologies, Data, and Suggestions

A1 Methodology and Data

A1.1 In general, quantitative analysis on tax expenditure is, at best, quite tentative: any discussion based on those data should be subject to various qualifications. It would be thus useful to provide here main qualifications. Those qualifications can be divided into four groups: (1) qualifications related to cross-sectional analysis (i.e. international comparison); (2) qualifications related to time-series analysis (i.e. trend analysis of one country); (3) qualifications related to aggregation¹³⁴.

A1.2 Due to the difference in the definition of tax expenditures across countries, international comparison can be quite problematic. Other than the important issue of the ability-to-pay principle discussed in the paper, significant difference exists in treatments of tax expenditures related to tax unit in the personal income tax system, pensions, imputed income, integration of personal and corporate income tax system, and depreciation allowances¹³⁵. In addition, difference between cash basis estimation and accrual basis estimation add further difficulty. As a result, simply juxtaposing aggregated tax expenditures reported by different governments is quite problematic: comparison between Japan which does not include major personal allowances whose costs are more than the aggregated costs of items *reported as tax expenditures (special taxation measures)* and Canada which even include the basic personal allowance in its tax expenditures report, is meaningless.

A1.3 Therefore, what we can do is either to compare reported tax expenditures with a margin of errors, or to discuss *the trends* in different countries ignoring the *level* of tax expenditures. Under the latter method, historical trends in each country (e.g. business tax expenditures are increasing) are analyzed first. Then, we can conclude if there have been any similar trends in tax expenditures in different countries.

A1.1.4 Even if this method is used, and thus problems related to international comparison are avoided, trends analysis in a given countries itself requires various qualifications. The most important in this analysis is the consistency over time. First, definition of tax expenditures can change, although it is relatively stable over time in most countries. Second, in interpreting the aggregated figure of tax expenditures, care must be taken when the coverage of tax expenditures report changed. For example, the aggregate can jump up significantly in a year when tax expenditures in VAT come to be estimated. Third, accounting method sometimes changes from accrual basis to cash basis or vice versa.

¹³⁴ In addition, tax expenditure reports usually include various qualifications related to estimations of each items. Although this is important as well, this is not unique to tax expenditures: difficulty also arises in estimation of entitlement programs.

¹³⁵ See OECD (1996)

A1.1.5 Even though definition, coverage and accounting methods remains stable, reasons for increase/decrease of costs of tax expenditures are not always certain. It is true that increase/decrease results from more/less significant use of tax expenditures by a government. However, other reasons are possible as well. They include: revisions to data; changes in methodology; identification of formerly unidentified tax expenditures; quantification of formerly unquantified tax expenditures; and increased eligible recipients for certain tax expenditures. Furthermore, general tax cut can automatically reduce estimated costs of tax allowances and exemptions by lowering marginal tax rate.

A1.1.6 Although sums of tax expenditures estimates are useful for gauging magnitude of tax expenditures, this needs to be interpreted carefully. Problems of aggregation of tax expenditures have been acknowledged¹³⁶. First, aggregated figures do not take into account possible interactions between the individual tax code provisions. If two or more tax expenditures are estimated simultaneously, the total change in revenue could be smaller or larger than the sum of the amounts shown for each item separately. Second, tax expenditure estimates usually do not take into account possible behavioral responses by taxpayers if a tax expenditure is repealed: they may respond by claiming other—although less generous—provisions. For these reasons, many countries (Canada, United Kingdom and the United States) do not provide any aggregated costs in its official reports.

A2 Suggestions

The issues raised in the paper can be explored further to give a more comprehensive picture on what is happening right now.

A2.1 Although the paper provides enough information on current tax expenditures control in the selected seven countries (and somewhat to the lesser extent, other three countries), situations in other countries is uncertain. Although responses to the questionnaire conducted in 2003/2004 give us some information, reading documents related to tax expenditures provided by each government is essential to understand what improvement other countries have made in recent years. In particular, it is good to survey whether there is any country which reports tax expenditures side-by-side with regular expenditures in its budget. In there is no, or only a few, such countries, then integration of tax expenditures into budget should be an important issue which must be addressed from now on.

A.2.2 It is helpful to gather quantitative information on tax expenditures in other countries. It would be relatively easy for countries which have continuously reported estimated costs of tax expenditures¹³⁷. Such additional information will enrich the analysis presented in this paper. More difficult and tedious is to understand definitions and methodologies used in these countries in order to avoid pitfalls discussed above. To do this, examination of original documents provided by the government is essential.

¹³⁶ See, for example, the United States, Government Accountability Office (2005).

¹³⁷ Such countries include Belgium, France, Germany, Italy and Spain.

A2.3 It may be useful to study treatments of personal tax credits/allowances which seem to be related to the ability to pay principle in a country where anecdotal information suggests increasing use of those tax reliefs. To do this, use of questionnaires may be needed because in general it is impossible to know whether there are “tax reliefs” not presented in the tax expenditures report and how large their estimated costs are. Also, Adema, W. and Ladaïque M. (2005) contains some information on the use and significance of personal tax credits and tax allowances for social purposes in each countries. Although not sufficient or exhaustive, this may give us some hint on which countries uses these measures extensively¹³⁸.

A2.4 In this paper, I could not contain sufficient information on the use and treatments non wastable tax credit. The list of countries which have introduced non-wastable tax credits may not be exhaustive due to the data availability. Official names of non-wastable tax credits used for some countries are not known. Moreover, treatments of non-wastable tax credits in several countries are unknown or uncertain. In order to confirm these points, there would be no other way than to use questionnaires.

¹³⁸ They report these tax reliefs as a part of *Tax Breaks for Social Purposes (TBSP)*. TBSP is useful in that it includes tax reliefs which provide social benefits regardless of whether they are classified as “tax expenditures” or not. On the other hand, the TBSP concept has some disadvantages. First, since the criterion of the TBSP is “social purposes”, classification can be arbitrary. Second, it does not include tax reliefs which are usually classified as tax expenditures. For example, tax reliefs for business purposes and exemptions for receipts of social benefits are not included.

Table 11 Major Tax Credits in Australia

(in millions of AU\$)

Function	Tax Expenditures	2004-05	1999-2000	1994-95	Commencement
Social security and Welfare	Senior Australians' Tax Offset	1,880	30		1996
Social security and Welfare	Tax Offset for Recipients of Certain Social Security Benefits, Pensions or Allowances	1 290	2,080	1,365	Before 1985
Social security and Welfare	Tax Offset for Low Income Earners	670	440	530	1993
Health	Medical Expenses Tax Offset	260	130	114	Before 1985
Health	30 % Health Insurance Refund	Not Reported	180		1997, amended in 1999
Social security and Welfare	Tax Offset for dependent spouse, child-housekeeper and housekeeper who cares for a prescribed dependent		430	1,115	Before 1985
Social security and Welfare	Family Tax Benefit	Not Reported			2000
	Tax Offset for Sole Parents		260	183	Before 1985
	Family Tax Assistance		380		1996
	Dependent Spouse Rebate (with Child)		(included in tax offset for dependent spouse)		Before 1985
Housing and Community Amenities	Zone Tax Offsets	190	175	160	Before 1985
Other economic affairs	Off-market share buy-backs	530			1990

Source: Australia, Department of Treasury (2005, 2003); OECD(1996)

Estimated costs are based on: the 2005 edition for 2004-05, the 2003 edition for 1999-2000 and the 1997-98 edition for 1994-95

Major tax credits with estimated cost of AU\$100 million are listed

In addition to this, The Mature Age Worker Tax Offset and Tax Rebate for Child Care, which is yet to be effective, are estimated to cost AU\$ 430 million (in 2005-06) and AU\$ 280 million (in 2006-07)

The Family Tax Benefit incorporated the Tax Offset for Sole Parents, the Family Tax Assistance, and the Dependent Spouse Rebate (with Child) in 2000 and reclassified as expenses in 2001

Table 12 Introduction and Major Expansion of Tax Credits in Australia, 1996-2005

	Social Security and Welfare	Health	Other
2004-05	Family Tax Benefit, Part A and B: increase in thresholds, reduction of taper		
2004-05 Mid-Year Fiscal and Economic Outlook	Childcare Tax Rebate (introduction) Mature Age Worker Tax Offset (introduction)		
2002	Baby Bonus (introduction) Pensioner Tax Offset (for those below age pension age): increased Senior Australians Tax Offset: extend eligibility	Medical Expenses Tax Offset: Threshold Increase	
2001-2002 Budget	Pensioner Rebate (for those over age pension age) and Low Income Aged Persons Rebate: increased and amalgamated into the Senior Australians Tax Offset		Refundable Tax Credit for Large Scale Film Production (introduction)
A New Tax System A New Business Tax System	Family Tax Benefit: Part A and B: replace the Sole Parent Rebate, the Dependent Spouse Rebate with Child and teen Family Tax Assistance Pensioner Rebate and Low Income Aged Persons Rebate: increased	30 Per Cent Private Health Insurance Rebate (replace Private Health Insurance Rebate) (1999)	Refundable imputation credit (introduction)
1997-98			Tax Rebate on Interest Received from Infrastructure Providers (introduction) Tax Rebate for Savings (introduction)
1996-97 Budget	Tax Rebate for Low Income Aged Persons (introduction) Increase in Tax-free Thresholds for Families (Family Tax Assistance) (introduction) Superannuation Low Income Spouse Rebate (introduction)	Private Health Insurance Rebate (introduction)	

Source: Australia, Department of the Treasury (1997-2005); Commonwealth Government of Australia (1996-2005)

From 2001, refundable tax offsets are identified as an expense and are therefore no longer treated as tax expenditures. Thus, the Family Tax Benefit, the 30 Per Cent Health Insurance Rebate, and the Baby Bonus were not reported in the Tax Expenditure Statement in recent years.

Table () Introduction and Major Expansion of Tax Credits in Canada, 1996-2005

	Family	Health	Education	Other
2005	Adoption Expense Tax Credit (Introduction)	Disability Tax Credit: extend to those who face multiple restrictions that together have a substantial impact on their daily lives Child Disability Benefit: increase the maximum amount to \$2,000 from \$1,681 Medical Expense Tax Credit: increase maximum amount of medical and disability-related expenses that can be claimed by caregivers to \$10,000 from \$5,000 Refundable Medical Expense Supplement: Increase the maximum amount from \$571 to \$750 per year		Basic Personal Amount/The Spouse and Equivalent-to-spouse Amount: increase to \$10,000 by 2009 and correspondent increase
2004		Medical Expenses Tax Credit : add medical expenses paid on behalf of other dependent relatives	Education Credit : extend eligible students	Political Contribution Tax Credit : enhanced
2003	Canada Child Tax Benefit: increase the NCB supplement by \$150 in 2003; legislated that it would increase by \$185 in 2005; \$185 in 2006	Child Disability Benefit (Introduction) Medical Expenses Tax Credit: expansion of list of eligible medical expenses		
2001			Education Credit : extend eligible students in 2002	
2000 Statement	Canada Child Tax Benefit: \$100 increase in the NCB supplement per child in 2001; increase the income threshold of the NCB in 2001; legislated that by 2004 the income threshold of the CCTB base benefit will be raised and its phase-out rate will be reduced Infirm Dependent Tax Credit: increase the amount from \$2,386 to \$3,500 Caregiver Credit: amount raised from \$2,386 to \$3,500 in 2001	Disability Tax Credit : amount raised to \$6,000 from \$4,293 in 2001	Education Credit : education amount on which the credit is based doubled from \$200 to \$400 in 2001	Full Indexation of the personal income tax system introduced
2000 Budget	Canada Child Tax Benefit: \$200 increase per child of National Child Benefit Supplement; \$70 per-child-increase (including indexation) for base benefit in 2001	Disability Tax Credit : extend eligibility to individuals requiring extensive therapy; expand the list of relative to whom the credit can be transferred; supplementary tax relief according to child care expenses or attendant care expenses		Charitable Donations Credit : extend applicable donations
1999	Canada Child Tax Benefit: enrich the CCTB by \$300 million in 2000 to enhance benefits for modest and middle-income families	Medical Expenses Tax Credit : expansion of list of eligible medical expenses		Supplementary Low Income Credit: extend to all taxpayers (incorporated in basic total amount and Spouse/Equivalent-to-spouse credits) Basic Personal Amount/The Spousal and Equivalent-to-spouse Amount: \$500 increase due to incorporation of the Supplementary Low Income Credit; plus \$175 increase
1998	Caregiver Credit (Introduction) Canada Child Tax Benefit: replace WIS with NBC by expanding eligibility to all low-income families; increase NBC supplements by \$160 (1998); \$170 (2000); reduction in the income threshold	Medical Expenses Tax Credit : expansion of list of eligible medical expenses	Student Loan Interest Credit (Introduction) Education Credit: expand eligibility to part-time students	Supplementary Low Income Credit (Introduction)
1997	Canada Child Tax Benefit: announce a new Canada Child Tax Benefit by simplifying and enriching the CTB with \$850-million supplement for low-income families; enrich the WIS from announced \$125 million to \$195 million; increasing the maximum WIS	Disability Tax Credit (Introduction) Refundable Medical Expense Supplement (Introduction) Medical Expenses Tax Credit: expansion of list of eligible medical expenses	Carry-Forward of Education and Tuition Fee Credits (Introduction) Education Credit: double the basis for the education expense over two years to \$200 per month Tuition Fee Credit: make ancillary fees eligible	Charitable Donations Credit : change the income limit for donations to 75%
1996	Child Tax Benefit: announced two-step \$250-million enrichment which increase the WIS from \$500 to \$750 in 1997 and to \$1,000 in 1998 Infirm Dependent Tax Credit: increase the amount from \$270 to \$400; raise the threshold		Education Credit : increased the education amount from \$80 to \$100 per month; raised the transferable amount from \$4,000 to \$5,000	Charitable Donations Credit : increase by raising the annual limit of donations

Source: Canada, Department of Finance; 1995-2005; Canada, Department of Finance; 1995-1997-2005.

Table 15 Major Tax Credits/Allowances and Tax Reliefs in Ireland

Tax Relief Provision		(in millions of euro)		
		2002	1993-94	% increase
Married Person's Credit/Allowance		1805.1	966.3	87%
Capital Allowances	*	1595.0	1086.3+	47%
Single Person's Credit/Allowance		1552.8	522.2	197%
Exemption of Net Income of Approved Superannuation Funds (Contributions Plus Investment Income Less Outgoings)	*	1271.6	311.3+	308%
Effective Rate of 10% for Manufacturing and Certain Other Activities	*	1174.1	1369.9	-14%
Employee (PAYE) Credit/Allowance		917.2	277.7	230%
Employers' Contributions To Approved Superannuation Schemes	*	623.1	180.3+	246%
Employees' Contributions To Approved Superannuation Schemes	*	563.3	73.6+	665%
Double Taxation Relief		427.3	115.4	270%
Exemption from Tax of Certain Social Welfare Payments: Child Benefit	*	266.4	74.8	256%
Retirement Annuity Premiums		250.9	54.1	364%
Interest Paid		180.3	274.4	-34%
Group Relief		166.8	165.1	1%
Medical Insurance Premiums		161.7	80.5	101%
Expenses Allowable to Employees Under Schedule E		153.8	37.5	311%
Additional Personal Credit/Allowance for Lone Parent		137.8	21.2	550%
Exemption of Irish Government Securities Where Owner Not Ordinary Resident in Ireland	*	130.1	108.9+	19%
Widowed Person's Credit/Allowance		122.3	68.7	78%
Exemption of Interest on Savings Certificates, National Instalment Savings & Index Linked Savings Bonds		108.8	38.9+	180%
Homecarer Credit/Allowance		73.7	-	-
*20 items whose estimated costs are largest are listed				

*euro amounts for 1993-94 is calculated based on the fixed conversion rate between the euro and the Irish pound: 1 euro = IR£0.787564

items accompanied by an asterisk are particularly tentative and subject to a considerable margin for error.

*estimated costs for 2002 and those for 1993-94 accompanied by a sign + refer to the corresponding calendar year. Figures for 1993-94 without + refer to the corresponding tax year

Source: Ireland, Revenue Commissioners (1997) and (2005)

Table 17 Major Tax Reliefs in United Kingdom, 1994, 1999 and 2005

Tax Reliefs	Type of Tax Relief	Tax	Estimated Costs (£ millions)		
			2004-05	1998-99	1993-94
Relief for Approved Pension Schemes	Tax Expenditure	Income Tax	12,300	11,400	7,400
Child Tax Credit	Tax Expenditure	Income Tax	3,300	-	-
Mortgage Interest	Tax Expenditure	Income Tax	-	1,900	4,300
Relief for Employer Contributions to Approved Pension Schemes	Tax Expenditure	National Insurance Contributions	6,700	-	-
Exemption of Gains Arising on Disposal of Only or Main Residence	Tax Expenditure	Capital Gains Tax	13,000	1,400	850
Zero-Rating of Food	Tax Expenditure	VAT	10,200	7,750	6,800
Zero-Rating of Construction of New Dwellings (Includes Refunds to DIY Builders)	Tax Expenditure	VAT	6,400	2,450	1,850
Zero-Rating of Domestic Passenger Transport	Tax Expenditure	VAT	2,150	1,700	1,100
Personal Allowance	Structural Reliefs	Income Tax	36,600	31,200	25,400
Double Taxation Relief	Structural Reliefs	Income and Corporation Tax	8,000	5,500	2,400
Contracted-out Rebate Occupational Schemes: Rebates Deducted at Source by Employers	Structural Reliefs	National Insurance Contributions	7,500	5,960	7,600
Contracted-out Rebate Occupational Schemes: Personal and Shareholder Pensions	Structural Reliefs	National Insurance Contributions	3,200	1,970	-
Local Authority-type bodies of VAT incurred on non-business purchases under the Section 33 refund scheme (includes national museums and galleries under the Section 33A refund scheme)	Structural Reliefs	VAT	6,650	3,350	3,250
Central Government, Health Authorities and NHS Trusts of VAT incurred on contracted-out services under the Section 41 (3) refund scheme	Structural Reliefs	VAT	3,700	1,750	650
Age-related allowances	Reliefs with Expenditure and Structural Components	Income Tax	2,200	1,100	650
Married Couple's Allowance	Reliefs with Expenditure and Structural Components	Income Tax	-	2,900	4,600
Small Companies' Reduced Corporation Tax Rate	Reliefs with Expenditure and Structural Components	Corporation Tax	3,110	1,500	800
Capital Allowances	Reliefs with Expenditure and Structural Components	Income Tax and Corporation Tax	17,620	20,600	14,900
Taper Relief	Reliefs with Expenditure and Structural Components	Capital Gains Tax	3,500	70	-
Nil Rate Band for Chargeable Transfers Not Exceeding the Threshold	Reliefs with Expenditure and Structural Components	Inheritance Tax	9,400	5,500	4,100
Exemption of Rent on Domestic Dwellings	Reliefs with Expenditure and Structural Components	VAT	2,850	2,550	2,200
Exemption of Finance and Insurance	Reliefs with Expenditure and Structural Components	VAT	3,650	100ha	-
Reduced Contributions for Self-employed not Attributable to Reduced Benefit Eligibility	Reliefs with Expenditure and Structural Components	National Insurance Contributions	1800	3300	1600

*Tax Reliefs with estimated annual costs of more than £2 billion are included.

*Costs of Child Tax Credit include only the negative tax element of the tax credit payments.

Source: United Kingdom, HM Treasury (1999, 2005), Tax Ready Reckoner and Tax Reliefs. OECD(1996)

Table 18 Tax Credits in the United States

(in millions of US\$)

Budget Function	Tax Expenditure	Taxpayer Group	First Year Reported	Estimated Tax Expenditure			Refundability
				2005	2000	1995	
Education, training, employment and social services	Child Credit (effect on receipts)	Individual	1997	32710	19330	-	refundable
	(effect on outlays)			13516	810	-	
	(total)			46226	20140	-	
Income security	Earned income tax credit (effect on receipts)	Individual	1975	4980	4644	4920	refundable
	(effect on outlays)			33790	26099	15245	
	(total)			38770	30743	20165	
General science, space and technology	Credit for increasing research activities	Both	1981	5130	1630	1185	non-refundable
Commerce and housing	Credit for low-income housing investments	Both	1986	3850	3210	2260	non-refundable
Education, training, employment and social services	HOPE tax credit	Individual	1997	3410	4210	-	non-refundable
Education, training, employment and social services	Credit for child and dependent care expenses	Individual	1974	3140	2390	2730	non-refundable
Education, training, employment and social services	Lifetime learning tax credit	Individual	1997	2130	2420	-	non-refundable
International Affairs	Inventory property sales source rules exception	Corporate	1986	1620	2170	1300	non-refundable
Community and Regional Development	Empowerment Zones, enterprise communities, and renewal communities	Both	1993	1120	310	250	non-refundable
Energy	Alternative fuel production credit	Both	1980	1040	970	970	non-refundable
General purpose fiscal assistance	Tax credit for corporations receiving income from doing business in U.S. possessions	Corporate	1977	900	2470	2745	non-refundable
Education, training, employment and social services	Adoption Credit and Exclusion	Individual	1996	500	280	-	carry forward for 5 subsequent years
Energy	New Technology Credit	Corporate	1978	470	40	140	non-refundable
Community and Regional Development	New market tax credit	Both	2000	430	0	-	non-refundable
Energy	Enhanced oil recovery credit			340	310	-	non-refundable
Natural Resource/Environment	Tax incentives for preservation of historic structures	Both	1977	320	190	125	non-refundable
Education, training, employment and social services	Work opportunity tax credit	Both	1978	250	390	395	non-refundable
Health	Tax Credit for orphan drug research	Corporate	1982	210	100	15	non-refundable
Health	Tax credit for health insurance purchased by certain displaced and retired individuals (effect on receipts)	Individual	2002	60	-	-	refundable
	(effect on outlays)			90	-	-	
	(total)			150	-	-	
Education, training, employment and social services	Credit for holders of zone academy bonds	Corporate	1997	110	10	-	non-refundable
Income security	Small business retirement plan credit	Both	2001	100	-	-	non-refundable
Energy	Tax Credit and Deduction for clean-fuel burning vehicles	Both	1992	70	60	65	non-refundable
Transportation	Tax credit for certain expenditures for maintaining railroad tracks	Corporate	2004	70	-	-	non-refundable
Education, training, employment and social services	Welfare-to-work tax credit	Both	1997	60	50	-	non-refundable
Community and Regional Development	Investment credit for rehabilitation of structures (other than historic)	Both	1974	40	30	80	non-refundable
Education, training, employment and social services	Credit for disabled access expenditures	Both	1990	40	40	160	non-refundable
Agriculture	Bio-Diesel Tax Credit	Individual	2004	30	-	-	non-refundable
Energy		Both	1980	30	20	10	non-refundable
Income security	Tax credit for the elderly and disabled	Individual	1974	20	30	50	non-refundable
Education, training, employment and social services	Employer-provided child care credit	Corporate	2001	8	-	-	non-refundable

Tax Credits Reported in the Analytical Perspective of the 2006 budget are shown.

Costs are revenue forgone bases, estimated in the Analytical Perspectives of the 2006 budget for 2005, the 2002 budget for 2000, and the 1997 budget for 1995.

Source: United States Office of Management and Budget, Analytical Perspectives, FY1997, 2002, 2006

Table 19 Introduction and Major Expansion of Tax Credits in the United States, 1996-2005

	Education, Training, Employment and Social Services	Community and Regional Development	Income Security	Others
The American Jobs Creation Act of 2004				Bio-Diesel Tax Credit (introduction) Tax Credit for certain expenditures for maintaining railroad tracks (introduction)
The Working Families Tax Relief Act of 2004	Child Credit: increase the amount to \$1,000 for years 2005-2009; accelerates to 2004 the increase in refundability	Empowerment Zones, Enterprise Communities, and Renewal Communities: extend two tow benefits by two years		
The Jobs and Growth Tax Relief Reconciliation Act of 2003	Child Credit: for 2003 and 2004, the amount increases from \$600 to \$1,000			
The Trade Act of 2002				Tax Credit for Health Insurance Purchased by Certain Displaced and Retired Individuals (introduction)
The Job Creation and Worker Assistance Act of 2002		Empowerment Zones, Enterprise Communities, and Renewal Communities (expansion on Work Opportunity Tax Credit): expand by adding "New York City Liberty Zone"		
The Economic Growth and Tax Relief Reconciliation Act of 2001	Employer Provided Child Care Credit (replace deduction) Child Credit: doubled the amount from \$500 to \$1,000 by 2010 Adoption Tax Credit: makes permanent the credit; increase the amount from \$6,000 (special needs adoption) or \$5,000 (non-special needs adoption) to \$10,000, etc. Child and Dependent Care Expenses: increased the maximum expenditure limit		Low and Moderate Income Saver's Credit (introduction) Small Business Retirement Plan Credit (introduction)	
The Community Renewal Tax Relief Act of 2000		New Market Tax Credit (introduction)		Low-income Housing Credit: increased the per-resident limit, created a \$2 million minimum annual cap for small States in 2002
The Taxpayer Relief Act of 1997	HOPE Tax Credit (introduction) Lifetime Learning Tax Credit (introduction) Child Credit (introduction) Credit for Holders of Zone Academy Bonds (introduction) The Welfare-to-work Tax Credit (introduction)			
Adoption Promotion and Stability Act of 1996	Adoption Credit (introduction)			

Source: Various Documents Listed in the Bibliography

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TAX EXPENDITURES IN OECD COUNTRIES

Barry Anderson
OECD

5th Annual Meeting of
OECD-Asia SBO

Bangkok
January 10-11, 2008

Introduction

- My presentation is based on a draft paper, “Tax Expenditures in OECD Countries”, written by Joe Minarik, Committee for Economic Development, Washington, DC, in response to interests of the OECD Working Party of Senior Budget Officials (SBO).
- Purposes of the paper include:
 - To discuss potential ill effects of tax expenditures;
 - To note a number of important trends:
 - They are pervasive and growing;
 - They are easier to enact and keep;
 - They can be used to avoid fiscal rules;
 - To obtain data on tax expenditures.
- Final paper to be presented at OECD SBO meeting in Vienna next June.

Outline of My Presentation

- **Definition of Tax Expenditures (TE)**
- **Potential Ill Effects of TE**
- **Potential Good Effects of TE**
- **Causes of Growth in TE**
- **“Make-Work-Pay” TE**
- **“Best” Practices for the Process of Considering TE**
- **The Budget Process & TE**
- **Fiscal Rules and TE**
- **Quantitative and Data Analysis**

3

Definition of Tax Expenditures (TE)

- ☐ Provisions of tax law, regulation, or practice that reduce or postpone revenue for a comparatively narrow population of taxpayers relative to a benchmark tax.
- ☐ TE may take a number of different forms:
 - **allowances:** amounts deducted from the benchmark to arrive at the tax base;
 - **exemptions:** amounts excluded from the tax base;
 - **rate relief:** a reduced rate of tax applied to a class of taxpayer or taxable transactions;
 - **tax deferral:** a delay in paying tax;
 - **credits:** amounts deducted from tax liability.

4

Alternative Ways to Measure TE

- **Initial revenue loss (gain):** the amount by which tax revenue is reduced (increased) as a consequence of the introduction (abolition) of a tax expenditure, based upon the assumption of unchanged behavior and unchanged revenues from other taxes.
- **Final revenue loss (gain):** the amount by which tax revenue is reduced (increased) as a consequence of the introduction (abolition) of a tax expenditure, taking into account the change in behavior and the effects on revenues from other taxes as a consequence of the introduction (abolition).
- **Outlay equivalence:** the direct expenditure that would be required in pretax terms to achieve the same after-tax effect on taxpayers' incomes as the tax expenditure if the direct expenditure is accorded the tax treatment appropriate to that type of subsidy or transfer in the hands of the recipient.

Potential III Effects of TE

- **Fairness:** TE can benefit least needy
- **Efficiency & Effectiveness:**
 - Difficult to measure
 - Permanent nature of TE is not conducive to evaluations
 - Tax authorities lack program knowledge which increases the potential for fraud
 - Most budget presentations don't compare TE with direct spending
- **Complexity:** perceived favouritism and unintended interactions
- **Revenue Sufficiency:**
 - Difficult to estimate
 - Tradeoff between general rate reduction and TE
- **Understates Size of Government:**
 - Creates new program with no measured spending & lower taxes

Potential Good Effects of TE

- **Fairness:** for example, TE can bridge the gap between a neutral benchmark tax system, such as one based on income, & a normative tax system, such as one targeted at income above a threshold minus local tax liabilities
- **Efficiency:** TE can reduce or eliminate tax collections &/or check writing

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Causes of Growth in TE

- **Administratively efficient**
 - No need for a new government ministry
 - No need to write checks
 - Utilizes existing reporting requirements
- **Politically attractive**
 - No measured spending AND lower taxes
- **Not subject to regular scrutiny**
 - Not even reported or estimated in some countries
 - The difference between “beans” and “might-have-beans”!
- **Repeal of a TE can be portrayed as a tax increase**

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“Make-Work-Pay” (“M-W-P”) TE

- Payroll taxes, benefit programs, & progressive tax systems can provide disincentives to work.
- “M-W-P” TE—including refundable tax credits for earned income & child care—can help offset these disadvantages.
- “M-W-P” TE also has advantages over increases in minimum wages [they don’t add to employer costs] or in welfare payments [they don’t reward non-work].

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But the costs of “M-W-P” TE can grow rapidly

1. Existing spending programs might be changed to new “M-W-P” TE.
2. New additive “M-W-P” TE might be created.
3. Existing TE might be made more generous.
4. Population growth (including immigration) might increase the population eligible for “M-W-P” TE.
5. Recession might push workers’ incomes down & make them eligible for TE.
6. Secular economic decline might have the same effect.
7. Improved administration & outreach might find more eligible people & encourage them to apply.
8. “M-W-P” TE can be effective because as they increase net pay, more people may work more.
9. *Manipulation and/or fraud might increase costs.*
10. *Estimation & projection error might make the estimates of future costs too low.*

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And there can be some new & unique issues

- Tax authorities are expert in collecting money—not giving it away.
- Innovative techniques [claiming more income, not less] can be used to get larger, but fraudulent, payments.
- Delivery of benefits in real time is critical, but tax reporting is usually done annually.

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“Best” Practices for the Process of Considering TE

- **Sound process and rules can help to fend off an out-of-sight, out-of-mind mentality** that can keep important TE issues from coming to debate.
 - However, once the debate begins, it is up to **political will and compelling analysis** to lead to action.
- One thing that rules can do is **put known important issues on the agenda**.
 - Rules can also **force policymakers to take explicit action** that acknowledges through their votes and statements that they are violating widely accepted “best” practices.
 - Rules and processes can also force advocates of one perspective or another **to articulate the unstated premises** of their arguments.
- So, consider “best” practices for TE in:
 - Reporting TE
 - Review and Oversight of TE
 - Potential Additions to the Legislative Process

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Reporting TE

- **Include in budget** along with similar spending programs in addition to a separate TE section
- **List TE on the basis of the broadest possible benchmark tax (all income, all value added)**
- **Report refundable tax credits** as:
 - Reductions in taxes, or
 - Spending , or
 - Some combination of the above?
- **Subject to same oversight** as spending programs
- **Tax authorities**, working with spending ministries, **should estimate costs of TE**

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Review and Oversight of TE

- Although the ideal of **regular, rigorous analysis of all TE** by governments, feeding back into their policy decisions & proposals, can be difficult to achieve, it is still the goal.
- “As we move forward in shaping government for this century, the federal government cannot accept all of its existing programs, policies, functions, & activities as ‘givens.’ Outmoded commitments and operations constitute an encumbrance on the future that can erode the capacity of the nation to better align its government with the needs & demands of a changing world & society. Reexamining the base of all major existing federal spending & tax programs, policies, functions, & activities by reviewing their results & testing their continued relevance & relative priority for our changing society is an important step in recapturing our fiscal flexibility & bringing the panoply of federal activities into line with 21st century trends & challenges.” US Government Accountability Office.

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Potential Additions to the Legislative Process for TE

- Regulatory Impact Statements
- Reporting of the amount of tax reduction that could be financed by the TE
- Legislative sunsets
- Make line ministers co-responsible with the Minister of Finance for tax expenditure legislation

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The Budget Process & TE

- **Measured** TE are an imperfect target for a budget control strategy.
 - The initial revenue loss method does not account for taxpayer behavior, & the final revenue loss method is very difficult to estimate either before or after enactment of a TE provision.
 - TE interact with each other in varying ways.
 - Faster income growth could push taxpayers into higher tax rate brackets, increasing measured TE even if the underlying law does not change.
 - TE can evolve through changes in taxpayer practice or tax regulations, even without legal action.
- On the other hand, individual TE **policies** should be candidates for action to reduce deficits along with any other government policies, including spending programs & structural tax features.
 - Thus, TE should be a part of efforts for fiscal consolidation.

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Fiscal Rules and TE

- Deficit or Debt-based rules
 - Cover TE but are inherently pro-cyclical
- “Spending”-based rules
 - Inherently counter-cyclical, but to be effective should include revenues [and TE]
 - PAYGO is a method to do so
 - If spending rules don’t include TE, they provide a way to avoid fiscal restraints

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Quantitative and Data Analysis

- Examples of conceptual issues
- Institutional research and analysis
- Next steps
- Sample of Information Sought in the Questionnaire

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Examples of Conceptual Issues

- Benchmark system selected, especially with reference to the treatment of the taxation of capital
 - If a consumption tax benchmark is used, any taxation of capital is a negative TE
- Effect of inflation
- Taxation of imputed income, such as from owner-occupied housing
- Separate benchmarks for corporate & individual or family income

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Institutional Research & Analysis

A goal of the paper will be to assess the handling of TE in OECD countries.

- What government offices provide the accounting for TE?
- What can be said about the quality of the measurements?
- Are TE reviewed more or less carefully or often than similar mandatory spending programs?
- How much of the recent growth of TE is accounted for by “M-W-P” provisions?
- Are those provisions as effective as would be equivalent mandatory spending programs?
- To what degree are TE integrated into the budget process?
- Is the budget process effective in disciplining the enactment or growth of TE?

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Next Steps

- Questionnaire
- Presentation based on grouped responses if possible
 - That is, there will not be an attempt to force all responses together and produce totals
- Emphasis on presentation in budget
- Raise issues of scoring of refundable tax credits & the treatment of TE within budget processes & rules
- Present final paper in Vienna

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Sample of Information Sought in the Questionnaire

- Provide the stated definition of TE & the benchmark tax system, & whether some “structural” provisions (progressive rates or personal exemptions) are included in the benchmark & thus not considered TE, & on what taxes are covered.
- List where the data are reported (in the budget document, or in some other document) & how often TE are reported.
- List what is specified about the estimation methods used, & what levels of government are covered. Also list the estimation & reporting methods of future costs for entitlements.
- Are “M-W-P” TE administered exclusively by the tax authorities & is there only an annual accounting process for the individual taxpayer. Also, is there any evidence from the enactment of such “M-W-P” TE concerning why the TE form was selected, rather than a government outlay program.
- Does the budget process include fiscal rules & TE or revenue amounts.
- Does the budget report on differences of actual revenues from projected estimates.
- Does the budget process allow for use of any unanticipated increase in revenues.
- Must tax reductions be offset (for example, through some kind of PAYGO process).
- Are TE reviewed regularly in the budget process, & is there any data on expirations & required reauthorizations of mandatory and tax law provisions.
- Provide any listing of new TE recently enacted & their cost.

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Tax Expenditures in Korea

January 11, 2008



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Some Background (1)

- Historically, the government has proactively employed tax expenditures as a policy instrument to achieve its objectives
 - 1960s to 1970s
 - Tax exemptions/reductions as policy tools to promote key industries (exports, heavy & chemicals)
 - Since 1980s
 - Industry-specific focus has shifted toward qualified firms and individuals (favoring SMEs and low-income, marginal households/individuals)

Some Background (2)

- This “diffusion of focus,” especially since the 1990s, has made tabulating/managing tax expenditures more difficult
 - 1976 law putting all tax exemptions on 5-year sunset basis has proven to be ineffective
 - 219 tax exemptions/reductions counted in 2007
 - 236 new ones proposed in 2005 (181 up to July, 2006)

Some Background (3)

- National Fiscal Act (2006; NFA) adopted as legal framework for new budget system incorporating the 4 Fiscal Reforms:
 - Multi-year budgeting (similar to Sweden)
 - Top-down budgeting
 - Performance management
 - Program budgeting system

Some Background (4)

- Besides the 4 Fiscal Reforms, NFA requires:
 - from 2011, a tax expenditure report be included in budget documents,
 - from 2007, a 5-year PAYGO principle be applied to tax expenditures (similar to US PAYGO)
 - From 2007, annual increases of total tax expenditures be limited so that:
(tax expenditures) / (taxes + tax expenditures)
remains within 0.5%p of previous 3 years' average

Some Background (5)

- Additionally, recent legislation has introduced EITC as a “make-work-pay” program
 - Eligibility assessments in 2008
 - EITC payments will begin in 2009
 - Initially program scope (eligibility, size of payments) will be quite limited, but may grow quickly in the future

Definition Used in Korea

- MOFE's annual *Tax Expenditure Report* (not available in English) defines tax expenditures as:
Tax expenditures are the tax-subsidy counterpart to fiscal expenditures:
they are the reduction of national tax revenues that result from the application of special provisions, as exceptions to the normal taxation system, for reducing the tax burden of [a specific target subgroup of] taxpayers
- The National Fiscal Act uses a similar definition

Benchmark Tax System

- Korea's benchmark tax system basically follows the outline described in OECD's tax expenditure report (1996)
- Tax expenditures cover not only income taxes, but 12 out of the 14 national taxes (direct and indirect)
 - The 2 national taxes without tax expenditures are surtaxes for agriculture and education
 - "make-work-pay" not included yet (EITC scheduled for implementation in 2009)

Tax Expenditures in Korea (bln. KRW)

	2002	2003	2004	2005	2006	2007*
Tax Exp. (A)	14,726	17,508	18,286	20,017	21,338	22,708
Increase (%)	7.3	18.9	4.4	9.5	6.6	6.4
<i>Direct Taxes</i>	10,168	12,331	13,149	14,924	15,232	16,316
<i>Indirect Taxes</i>	4,432	5,056	5,027	4,926	5,805	6,032
<i>Custom Duties</i>	126	121	110	167	301	360
Tax Rev. (B)	103,968	114,664	117,796	127,466	138,044	158,334
Increase (%)	8.5	10.3	2.7	8.2	8.3	14.7
Tax Exp. Rate A/(A+B) (%)	12.4	13.2	13.4	13.6	13.4	12.5

*Figures for 2007 are estimates, derived by prorating.

Tax Expenditures by Function (bln. KRW)

Function (no. of tax expenditures in 2007)	2002	2003	2004	2005	2006	2007*
Working Class Support (57)	7,040	7,874	8,346	8,896	10,388	12,018
Economic Development (120)	4,847	6,212	6,716	7,476	7,243	6,699
Social Development (36)	2,111	2,587	2,543	2,948	3,371	3,622
Defense (3)	632	585	552	560	228	257
General Administration (6)	65	45	40	47	66	75
Others (2)	30	205	98	90	42	4

*Figures for 2007 are estimates

Working Class Support: special deductions for wage workers, rural workers and proprietors, certain kinds of savings

Social Development: covers education, arts & culture, sports, social security contributions, environment, housing

Tax Expenditures by Tax Item (bln. KRW)

Tax Item	2002	2003	2004	2005	2006	2007*
Personal Income Tax	5,551	6,429	7,398	8,036	9,111	10,638
Corporate Income Tax	4,598	5,870	5,695	6,841	6,081	5,612
VAT	3,027	3,263	3,174	3,078	3,803	3,875
Transportation Tax (special excise tax on petrol.)	911	1,032	1,242	1,251	1,213	1,324
Securities Transaction Tax	213	403	164	139	200	191
Others	427	512	614	672	929	1,068

*Figures for 2007 are estimates

Changes in Tax Expenditures

Year	2002	2003	2004	2005	2006	2007
No. of Tax Expenditures	269	254	220	226	230	219
New				13	9	27
Expired				7	5	38

NB. Details unavailable for 2002-2004.

Virtually all tax expenditure provisions contain a sunset clause (Special Tax Provision Limitation Act (1998))

The majority of new tax expenditure provisions in 2005 and 2006 belong to the "economic development" category. All 5 expirations in 2006 were from the "working class support" category (incentives to encourage savings)

"Economic development" accounted for most of the new tax expenditures and a quarter of the expirations in 2007. "Social development" accounted for another quarter of the expirations.

Tax Expenditure Report (1)

- Compiled annually by MOFE (no formal requirement to do so, and format varies somewhat from year to year)
- Published after transmission of budget proposal to legislature
 - Currently, only includes figures for the previous year and provisional estimates for the current year
 - It does *not* include projections for the upcoming fiscal year (budget year)

Tax Expenditure Report (2)

- New NFA(2006) requires MOFE to produce *Tax Expenditure Budget (TEB)* as one of the budget documents beginning in FY2011 (2010)
 - Must include *projections* for budget year
 - Other budget documents are prepared by MPB (Ministry of Planning and Budget)
 - so budget documents most probably will not show tax expenditures and corresponding outlay items side-by-side

Some Problems

- **Problems with current reporting of tax expenditures stem from an overall lack of interest:**
 - No systematic review/oversight of tax expenditures by legislature
 - The executive (MOFE) has recently strengthened its reviews
 - Recent legislation mandates reviews of mandatory spending programs' future costs, but this has yet to be taken seriously
 - No projections means no need to reconcile actual and projected estimates
(even the annually revised multi-year fiscal plan does not offer such explanations)
 - Tax expenditure information is not used in budget formulation by the executive nor in budget review & approval by the legislature

... And Some Questions

- **Tax expenditures vs. budget outlays**
 - Which is more effective, and for what specific purposes (policy area, target population, political concerns, etc.)?
 - When/for what should governments prefer tax expenditures, and when should it favor spending programs?
- **How should tax expenditure information be integrated into budget documents?**
 - Listed side-by-side with outlays?
 - At what level of detail in budget classification hierarchy?
 - What to do if a tax expenditure corresponds to multiple outlay categories?
 - What to do if there is no good match between a tax expenditure and outlay items?
 - Practical constraints/limits to watch out for?

... And More Questions

- Does tax expenditure information provided together with budget outlays result in any substantive adjustments?
 - Sweden's budget documents
- Regarding forecasting of tax expenditures,
 - Should forecasts cover the same timeframe as multi-year spending plans?
 - Which department is responsible for the forecasts?
Produced with what kind of database and modeling?

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Organisation de Coopération et de Développement Économiques
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English – Or. English

PUBLIC GOVERNANCE AND TERRITORIAL DEVELOPMENT
PUBLIC MANAGEMENT COMMITTEE

OECD-ASIA SENIOR BUDGET OFFICIALS NETWORK

**INTERGOVERNMENTAL TRANSFERS AND DECENTRALISED
PUBLIC SPENDING**

BANGKOK, THAILAND
10-11 JANUARY 2008

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INTERGOVERNMENTAL TRANSFERS AND DECENTRALISED PUBLIC SPENDING
BY
DANIEL BERGVALL, CLAIRE CHARBIT, DIRK-JAN KRAAN AND OLAF MERK*

Intergovernmental grants are used in many countries to finance sub-national spending and to implement national policies. However, the governance of grants is complex, and practices vary widely across OECD countries. The aim of this article is to provide a study of grant design that will be useful to policy makers. The article attempts to integrate both theoretical and empirical insights from the fiscal federalism literature as well as information obtained directly from practitioners concerning their experiences with the implementation of different types of grants. A typology of grant is presented, as well as an overview of the purposes of grants. The article concludes with some principles of grant design and implementation issues.

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1. Introduction

The most important resources of sub-national government are tax revenue and intergovernmental grants. The issue of the efficiency of different types of sub-national taxation was explored in the 2004 meeting of the OECD Network on Fiscal Relations across Levels of Government and will be analysed further in another paper. In this paper the focus will be on grants.

Intergovernmental grants are used in many countries to finance sub-national spending and implement national policies. However, the governance of grants is complex, and practices vary widely across OECD member countries. The aim of this paper is to provide a study of grant design that will be useful to policy makers. For the purpose of this paper a grant is defined as a transfer from central government to a sub-national government. Central government and sub-national governments are defined in accordance with the standard definitions of the national accounts as in *SNA 1993* (CEC, 1993).

The paper attempts to integrate both theoretical and empirical insights from the fiscal federalism literature, as well as information obtained directly from practitioners concerning their experiences with the implementation of different types of grants. For the latter purpose a group of experts from OECD countries was convened and asked to provide case studies about various types of grants.¹ Many of the examples in this paper come from these case studies. This paper also makes use of the answers given by the members of the Network on Fiscal Relations across Levels of Government to a statistical questionnaire distributed at the beginning of 2005, together with a follow-up of that questionnaire in late 2005 and early 2006, and in particular, the answers to the section on grants.

The main findings of the research can be summarised as follows:

- Although there are important differences between countries, the most common way of transferring resources from central to sub-national government is through earmarked grants (according to the data provided by member countries of the network in response to the statistical questionnaire).
- Grants are used for the purposes of financing and subsidisation of services and for equalisation of tax or service capacity.
- An important cause of inefficiency in many countries is the use of the same grant for various purposes, for instance, subsidisation grants that simultaneously attempt to equalise, or financing grants that simultaneously attempt to subsidise.
- Grant reform is a gradual process. The guidelines developed in this paper should therefore not be seen as a prescriptive blueprint. Grant reforms can constitute improvements even if they are not yet fully in accordance with the guidelines.
- Non-earmarked grants are usually more efficient instruments for financing purposes than earmarked grants. Nevertheless, there are some cases where earmarked grants can be used in an efficient way for financing sub-national services. Such cases are particularly likely to occur with temporary risk-sharing and co-operation projects or programmes. In the latter case, earmarked discretionary grants can be used to co-fund projects. This makes it possible to provide guidance

¹ OECD Experts Meeting on Intergovernmental Grants, Siena, Italy, 18-19 April 2005, under the auspices of the Fondazione Monte Dei Paschi Di Siena, the Province of Siena, the OECD Working Party of Senior Budget Officials, and the Territorial Development Policy Committee of the OECD.

to sub-national decision makers in cases of expenditures that are difficult to target on the basis of predetermined criteria.

- Equalisation aims at a more equitable distribution of tax capacity and service capacity, but is in fact often based on indicators of actual tax revenue and actual spending. The latter practice creates incentives to decrease tax rates and to increase spending and consequently interferes unnecessarily with the competence of sub-national government to set tax rates and spending levels as it sees fit. Capacity indicators, on the other hand, measure the size of the tax base and spending needs, independently from actual tax revenues or spending.

The paper is structured around the following questions:

- What does the statistical data tell us about the different types of grants that countries can choose from? (section 2)
- What are the basic principles of grant design?² How does grant design deal with concrete problems? How can problems arising during the implementation phase be solved? (section 3)

Concluding remarks are developed at the end of the paper in section 4.

2. Types of grants and their uses

2.1. Fiscal autonomy and fiscal decentralisation

Intergovernmental grants are one of the revenue sources of sub-national governments. This section aims to explore the empirical significance of this revenue source. First, the role of grants in sub-national public finance in general will be examined. Second, a typology of grants will be presented. Third, the choices of countries will be presented through the actual patterns of grant use as they appear in the statistical data. The findings presented in this section are mainly based on the results of the OECD questionnaire that was distributed at the beginning of 2005.

Grants are an important source of revenue for sub-national governments, complementing their own revenues which include revenues from direct and indirect taxation and non-tax revenues (fees, rents, interest, etc.). The fiscal autonomy of sub-national governments, defined as the share of their own revenues in the total revenue of sub-national government, varies widely among OECD countries. Furthermore, there does not seem to be a relation between fiscal autonomy and fiscal decentralisation (defined as the share of sub-national expenditure in total general government expenditure³, see Figure 1). It would also appear that the constitutional framework of government in a country – federal⁴ or unitary – has little impact on the extent of fiscal autonomy or fiscal decentralisation.

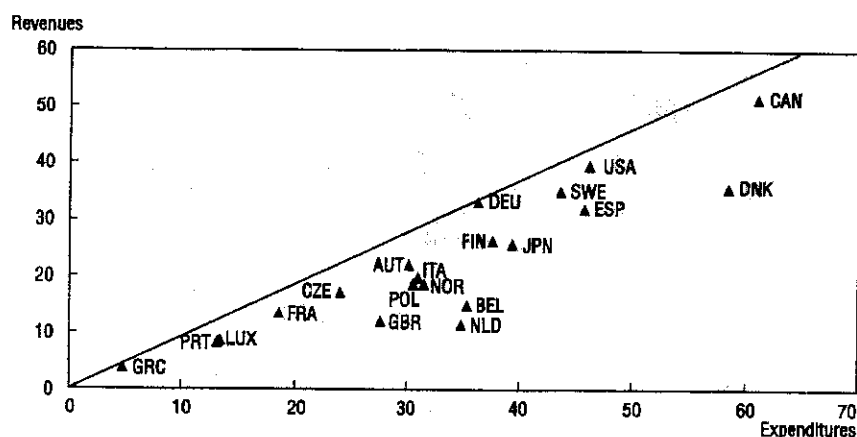
2 This paper will not present institutional specificities of decentralisation in each country. Even if this aspect is important for understanding the choices made in each country, this theme is beyond the scope of this paper, which is devoted to the design of grants and their implementation.

3 Total sub-national expenditure amounts to total consolidated expenditure by sub-national governments (with transfers between levels of government netted out).

4 A federal country is a country in which the constitution guarantees the competences of the highest level of sub-national government and provides sub-national authorities with an appeal to the courts in case of infringement upon those competences.

Figure 1. Indicators of fiscal decentralisation in OECD countries

Sub-national governments' share in general government revenues and expenditures in 2003 (percentages)

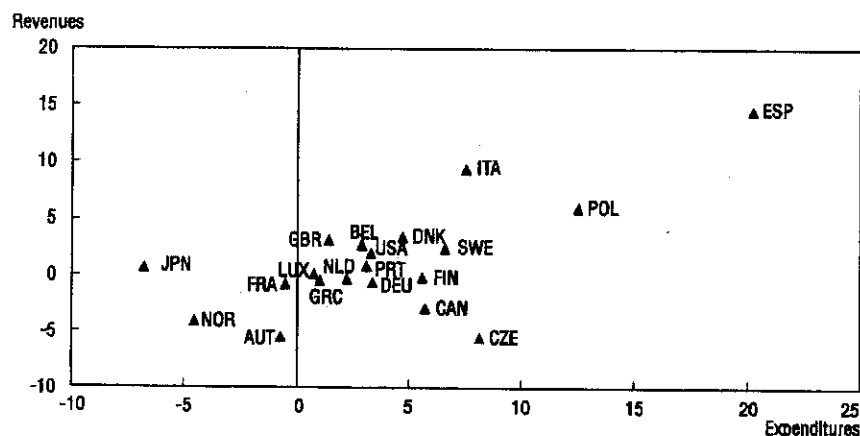


Source: OECD, National Accounts.

The gap between sub-national tax and expenditure shares has widened in the last twenty years. While in most countries the share of sub-national expenditures has increased, sub-national taxing power declined or remained stable (Figure 2). Accordingly, the dependence of sub-national governments on grants has increased. Fiscal decentralisation has led to increased sub-national responsibilities in the area of spending, while at the same time sub-national governments have become more dependent on central governments for their resources.

Figure 2. Changes in the share of sub-national government contributions in total public revenues and expenditures between 1995 and 2003

Changes expressed in percentage points



Source: OECD, National Accounts.

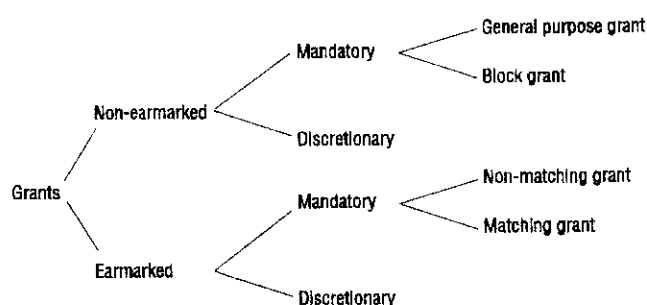
The growth of sub-national expenditure needs in combination with insufficient sub-national tax bases and the unwillingness of central governments to increase the size of sub-national tax bases (vertical imbalance) are not the only reasons why grants have become an important part of sub-national revenue. A substantial share of grants is also the result of disparities in tax bases or financial needs between jurisdictions that central governments want to correct (horizontal imbalances). Finally, a sizeable

proportion of grants are due to central government imposition of service delivery requirements or central government encouragement of sub-national spending through financial incentives. In these cases, the grants are directly related to the initiative of central government concerning service provision by the sub-national governments.

2.2. A typology of grants

This paper uses the typology of grants indicated in Figure 3. This typology is largely identical to the one developed by the Council of Europe (2004). However, the proposed definitions sometimes differ in detail. As will be discussed in section 3, the typology is based on criteria that are important for grant design.

Figure 3. Types of grants



2.2.1. Earmarked and non-earmarked grants

Grants can be either earmarked or non-earmarked. An earmarked grant is a grant that is given under the condition that it can only be used for a specific purpose. Non-earmarked grants can be spent as if they were the receiving sub-national government's own (non-earmarked) tax revenues.

2.2.2. Mandatory and discretionary grants

Both earmarked and non-earmarked grants can be either mandatory or discretionary. Mandatory grants (entitlements) are legal, rules-based obligations for the government that issues the grant. This requires that both the size of the grant and the conditions under which it is given be laid down in a statute or executive decree and that these conditions be both necessary and sufficient. Typically, sub-national governments can also appeal to a court or administrative judicial authority in order to obtain the grant. Most grants that are given to sub-national governments on a regular basis are mandatory. The size of discretionary grants, and the conditions under which they are given, are on the other hand not determined by rules but decided on an *ad hoc*, discretionary basis. Discretionary grants are often temporary in nature and include, for example, grants for specific infrastructural projects or emergency aid to a disaster area.

2.2.3. Matching and non-matching grants

Earmarked mandatory grants can be matching or non-matching. Matching grants complement sub-national contributions. Matching grants are dependent on normative or actual spending for services⁵ for which the grants are earmarked or on local revenue collection related to these services.

5 Throughout this paper the term "services" is used for the outputs of government, regardless of whether these concern immaterial goods (services in a narrow sense) or material goods.

In particular, matching grants may be dependent on:

- Norm costs per unit of service, or norm budget (norm costs times norm volume) per programme of services; or
- Actual costs per unit of service or actual costs (actual costs times actual volume) per programme of services; or
- Revenues from fees or earmarked levies raised by sub-national government to cover the costs of the programme of services.

If the grants are based on norm costs per unit of service, the grant cannot exceed a fixed sum per unit. From the perspective of the grantor there is a fixed money ceiling per unit of the grant. Similarly, if the grant is based on a norm budget for the entire programme (total cost of services), then it cannot exceed a fixed absolute sum for the programme. This amounts to a fixed money ceiling for the programme as a whole (the grant can then be called a “close-ended grant”).

All mandatory earmarked grants that are not given complementary to sub-national contributions are non-matching. Note that mandatory earmarked grants may also be dependent on contingencies other than sub-national contributions, for instance on local circumstances or performance indicators. In such cases, the grants are considered as non-matching. The decisive question is whether the decrease in sub-national spending would automatically lead to a decrease in the grant (this would not be the case if the grant were dependent on a performance indicator, because performance is not automatically dependent on sub-national spending).

One special case worth mentioning is when a mandatory earmarked grant is dependent on normative or actual spending or on revenue collections related to the service but is not given complementary to sub-national contributions.⁶ This is the case when an earmarked mandatory grant covers 100% of the service (cost-covering grants). Because the central government covers the entire bill and there is no mandatory financial contribution from sub-national government, this type of grant is classified as a non-matching grant.

Sometimes discretionary grants are given under the condition that sub-national governments also contribute to the project or programme. These grants will be called co-funding grants. They are not included in the definition of matching grants. The background is that a matching grant is by definition mandatory and thus creates a permanent incentive for increased provision. A discretionary grant is *ad hoc* and does not create a permanent incentive (the co-funding contribution is limited to a concrete project or programme).

2.2.4. General purpose and block grants

Non-earmarked mandatory transfers can be general purpose or block grants. Both types are similar in that they increase the sub-national governments' revenue without changing relative prices in the provision of services. The difference is that a block grant is given by the grantor for a specific purpose (or purposes). However, since the grant is not earmarked, the grantee's actual use of the grant is not controlled. Instead, the output could be regulated through, for example, a set minimum standard that the sub-national government would have to provide. In this case, resources are transferred in the form of a grant to the sub-national governments to cover all or part of the cost for certain sub-national services. The criteria used to

⁶ Note that a non-matching grant can either be independent of service costs or revenues collected or dependent on service costs, but 100% cost-covering.

calculate the level and distribution of the grant are usually connected to the normative cost of providing the goods or services for the sector as a whole, using variables that a specific sub-national government cannot directly control. The rationale for this type of grant is to improve efficiency in the use of resources at sub-national level, whereas the activity is financed, in part or fully, by the central government. If a sub-national unit is able to perform the activity at lower than normative costs, the grant will not be reduced for that unit as a consequence, thereby giving the sub-national government an incentive to fully explore the advantages of decentralised service provision. This kind of grant can be a means of moving away from earmarked grants.

Although non-earmarked grants are generally perceived by the grantors as transfers with no strings attached, one could argue that there are sometimes indirect strings attached. For instance, the central government may impose national minimum standards for service delivery and provide general purpose grants to finance the services partly or entirely. However, since these legal requirements are independent from the grant entitlement, they do not change the character of the grants as non-earmarked.

2.2.5. Capital versus current grants

Earmarked grants may be current or capital expenditures. The distinction is made in accordance with the national accounts. Note that in the national accounts non-earmarked grants are assumed to be current expenditures (although they may be used for investments).

2.3. Countries' decisions concerning the use of different types of grants

To get a picture of how countries actually use different types of grants, a questionnaire was sent to OECD member countries through the Network on Fiscal Relations across Levels of Government during the spring of 2005. The questionnaire was also sent to non-members of the network through the OECD Working Party of Senior Budget Officials. An updated version of the questionnaire was sent out in late 2005 to improve the quality of the answers. The following part of this section is, to a large extent, based on the results of these surveys.

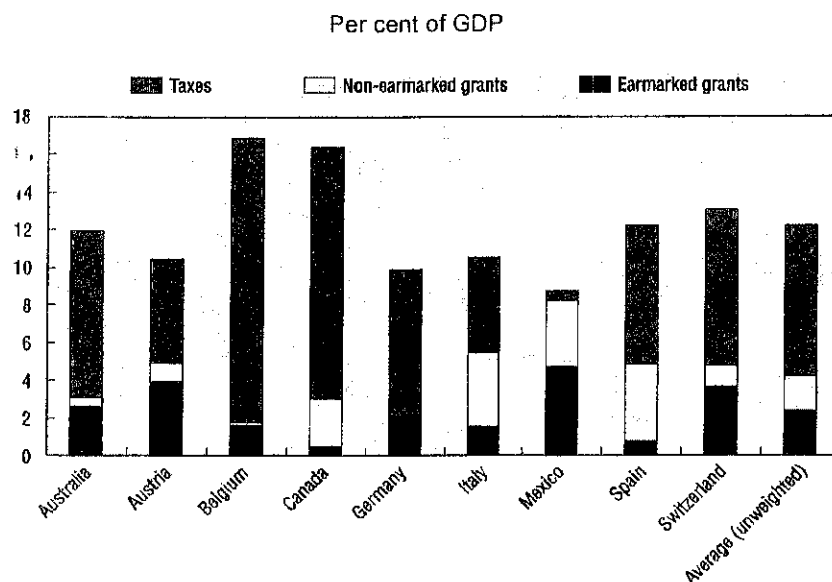
The data provide an overview of the extent to which sub-national governments are dependent on grants to finance their activities, the size of the transfers and the choices countries make concerning the transfer of resources. The data reveal a great deal of variation in the approaches countries have adopted.

The two main revenue sources for sub-national governments are taxes and grants. (Other revenues, such as user fees, generally play a less important role in financing sub-national services.) Of the two main sources of revenue, taxes are the main source of sub-national income, although the use of taxes and grants for financing sub-national governments varies among countries. In the sample, grants represent almost 40% of total tax and grant revenue for states, regions and provinces. For the local government sector, grants amount to just over 40% of total revenue from taxes and grants.

Figures 4 and 5⁷ show state and local revenue from taxes and grants. As can be seen, the size of grant financing varies between countries. States receive on average 4.3% of GDP in grants, ranging from 1.8% of GDP in Belgium to 8.3% of GDP in Mexico. Grants to states in Mexico correspond to 95% of total revenue from taxes and grants, compared to 10% in Belgium.

7. It should be noted that Figures 4 and 5 cannot be added to get total transfers from central to sub-national governments, because that would require a consolidation of transfers between state and local level, which are not available.

Figure 4. State revenue from grants and taxes in federal countries (2003)

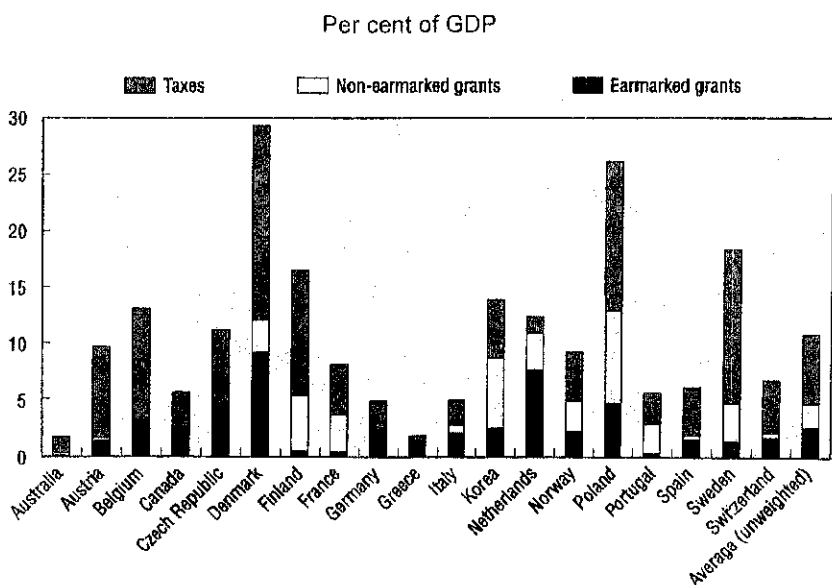


Note: Data for Australia and Italy are from 2002. Grants for Mexico are for both state and local level of government.

Sources: National sources and *OECD Revenue Statistics 1965-2004*, 2005 edition.

For the local government sector, differences are even larger, ranging from Australian local governments which receive 0.3% of GDP, to Polish and Danish local governments which receive 13% and 12.1% respectively. The importance of grants as a source of finance for local governments also differs to a large extent. The percentage of grants in Denmark (12.1% of GDP) corresponds to just over 40% of local government revenue from taxes and grants. In the Netherlands, also a country with large grants to local governments, the percentage of grants (11% of GDP) represents almost 90% of local government revenue from taxes and grants.

Figure 5. Local government revenue from grants and taxes (2003)



Note: Data for Australia and Italy are from 2002. Data for Greece, Netherlands, Poland and Portugal are for 2003.

Sources: National sources and *OECD Revenue Statistics 1965-2004*, 2005 edition.

Sub-national governments receive grants from various sources. Table 1 shows grant flows to states and local jurisdictions from different sectors as a per cent of total grants. The central government is by far the most important source of grant revenue for both states and local jurisdictions. States receive on average over 85% of their grants from the central government, varying from almost 70% in Austria to 100% in Australia and Mexico.

The picture is more varied at the local level, with on average over 70% of its grants from the central government. Canada and Switzerland receive 0.4% and 0.2% of all grants from the central government level whereas the Netherlands and Norway receive 100% of all grants from the central government level. Almost half of the countries report that their local government levels receive 100%, or almost 100%, from the central government.

In countries with a state level of government, the state is usually an important grantor for the local level of government. This is the case especially in Canada and Germany with almost 100% of local government grant receipts from the state level. International or supranational bodies are in general not an important grantor, except in Portugal, with 19% of total grant revenue for local governments. The German and the Italian state levels of government also receive notable amounts from international or supranational sources. Grants from social security funds mainly occur in Austria (both state and local level of government) and Hungary.

Some countries have horizontal transfer schemes. This is the case for Austria, Belgium and Switzerland at the state level of government, and for the local level primarily in Austria, Korea and Switzerland.

Table 1. Receipts of grants by issuing sub-sector (2004)

Per cent of total grants, unconsolidated

	Per cent of total tax revenue	Issued by					Total
		Central government	State, region, etc.	Local government	International/ supranational organisation	Social security fund	
States							
Australia ^a	9.8	100.0	0.0	0.0	0.0	0.0	100.0
Austria	11.5	69.4	5.1	3.8	0.6	21.1	100.0
Belgium	3.9	81.3	13.9	3.6	1.0	0.1	100.0
Canada	9.0	99.8	0.0	0.2	0.0	0.0	100.0
Germany	5.9	79.0	0.0	14.7	6.4	0.0	100.0
Italy ^a	12.7	94.8	0.0	0.0	5.2	0.0	100.0
Mexico ^c	43.4	100.0	0.0	0.0	0.0	0.0	100.0
Spain	14.0	77.7	0.0	16.7	0.0	5.6	100.0
Switzerland	16.1	73.7	5.6	20.7	0.0	0.0	100.0
Average	14.0	86.2	2.7	6.6	1.5	3.0	100.0
Local jurisdictions							
Australia ^a	1.1	67.2	32.8	0.0	0.0	0.0	100.0
Austria	3.8	49.2	16.1	12.7	0.3	21.7	100.0
Belgium	7.1	26.4	73.3	0.0	0.0	0.3	100.0
Canada	8.5	0.4	99.6	0.0	0.0	0.0	100.0
Czech Republic	12.4	99.1	0.0	0.0	0.9	0.0	100.0
Denmark	25.0	99.7	0.0	0.0	0.3	0.0	100.0
Finland	12.1	98.5	0.0	0.0	1.5	0.0	100.0
France	8.6	97.0	0.0	0.0	3.0	0.0	100.0
Germany	7.0	1.4	98.4	0.0	0.0	0.2	100.0

Greece ^b	4.1	100.0	0.0	0.0	0.0	0.0	100.0
Hungary	16.7	67.2	0.0	3.0	0.5	29.4	100.0
Iceland	1.9	100.0	0.0	0.0	0.0	0.0	100.0
Italy ^a	6.4	54.3	45.7	0.0	0.0	0.0	100.0
Korea	34.4	82.6	0.0	17.4	0.0	0.0	100.0
Netherlands ^b	28.3	100.0	0.0	0.0	0.0	0.0	100.0
Norway	11.3	100.0	0.0	0.0	0.0	0.0	100.0
Poland ^b	37.9	99.6	0.0	0.4	0.0	0.0	100.0
Portugal ^b	7.9	79.8	0.0	0.0	19.9	0.3	100.0
Spain	5.5	68.6	31.2	0.0	0.0	2.2	100.0
Sweden	9.4	100.0	0.0	0.0	0.0	0.0	100.0
Switzerland	7.2	0.2	77.6	22.3	0.0	0.0	100.0
Turkey	15.8	100.0	0.0	0.0	0.0	0.0	100.0
Average	12.4	72.2	21.6	2.5	1.2	2.5	100.0

Notes: a: 2002 data; b: 2003 data; c: Including grants to local governments.

Sources: National sources and *OECD Revenue Statistics 1965-2004*, 2005 edition.

The data show that countries use grants in different ways. On average, earmarked transfers dominate with more than approximately 55% for both the state and the local level of government (see Table 2). The picture differs substantially between countries. The Australian state level of government receives just over 10% of its grants non-earmarked, while in Spain more than 85% of the grants are earmarked. For Australia the picture is completely the reverse at the local level, with over 80% of grants non-earmarked.

Earmarked grants are mainly matching, particularly so in Austria, Belgium, Mexico and Switzerland for the state level of government, and for Belgium, the Netherlands and Switzerland for the local level of government.

Table 2. Receipts of earmarked and non-earmarked grants

Per cent of total grants

	Earmarked grants	Non-earmarked grants	Total
		States	
Australia ^a	87.5	12.5	100.0
Austria	79.8	20.2	100.0
Belgium	94.0	6.0	100.0
Canada	18.6	81.4	100.0
Italy ^a	28.6	71.4	100.0
Mexico ^c	59.2	40.8	100.0
Spain	14.8	85.2	100.0
Switzerland	77.8	22.2	100.0
Average	57.5	42.5	100.0
		Local jurisdictions	
Australia ^a	17.2	82.8	100.0
Austria	86.1	13.9	100.0
Belgium	95.9	4.0	100.0
Canada	95.7	4.3	100.0
Czech Republic	100.0	0.0	100.0
Denmark	69.8	30.2	100.0
Finland	9.2	90.8	100.0
France	11.7	88.3	100.0
Greece ^b	100.0	0.0	100.0
Hungary	56.9	43.1	100.0
Iceland	21.0	79.0	100.0
Italy ^a	75.5	24.5	100.0
Korea	27.7	72.3	100.0
Netherlands ^b	70.0	30.0	100.0
Norway	44.9	55.1	100.0

Poland ^b	29.5	70.5	100.0
Portugal ^b	11.4	88.6	100.0
Spain	33.8	66.2	100.0
Sweden	28.7	71.3	100.0
Switzerland	80.4	19.6	100.0
Turkey	77.3	22.7	100.0
Average	54.4	45.6	100.0

Notes: a: 2002 data; b: 2003 data; c: Including grants to local governments.

Sources: National sources and *OECD Revenue Statistics 1965-2004*, 2005 edition.

Non-earmarked grants are mainly general purpose. Only a few countries use block grants, most significantly Finland and Norway.

Table 3. Receipts of grants by type

Per cent of total grants

	Earmarked				Non-earmarked				Total	
	Mandatory		Discretionary		Mandatory		Discretionary			
	Matching		Non-matching		General purpose					
	Current	Capital	Current	Capital	Current	Capital				
States										
Australia	—	—	—	—	76.4	11.2	8.6	—	3.9	100.0
Austria	57.0	1.8	2.0	18.4	—	0.6	12.5	0.2	7.5	100.0
Belgium	67.2	10.9	14.7	—	1.0	0.1	6.0	—	—	100.0
Canada	—	—	18.6	—	—	—	81.4	—	—	100.0
Italy ^a	4.7	—	4.7	—	10.6	8.7	71.4	—	—	100.0
Mexico ^c	53.9	—	—	—	—	5.3	40.8	—	—	100.0
Spain	8.1	5.4	—	—	0.9	0.5	85.2	—	—	100.0
Switzerland	64.8	12.9	—	—	—	—	22.2	—	—	100.0
Average	31.4	4.5	4.4	2.9	11.8	2.6	41.0	—	1.4	100.0
Local jurisdictions										
Australia	—	—	—	—	17.1	0.1	82.8	—	—	100.0
Austria	39.3	3.5	7.4	34.8	—	1.2	13.7	0.1	0.0	100.0
Belgium	71.6	—	0.1	—	0.5	23.8	4.0	—	—	100.0
Canada	—	—	91.4	4.3	—	—	4.3	—	—	100.0
Czech Republic	12.4	—	—	—	74.1	13.6	—	—	—	100.0
Denmark	66.6	—	0.5	—	2.6	0.0	30.2	—	0.0	100.0
Finland	5.7	—	—	—	1.8	1.6	16.3	74.0	0.6	100.0
France	6.5	—	0.1	—	1.3	3.8	81.9	6.4	—	100.0
Greece	61.3	38.7	—	—	—	—	—	—	—	100.0
Hungary	40.1	7.4	—	—	3.8	5.6	41.9	—	1.1	100.0
Iceland	3.0	—	8.4	—	6.5	3.1	79.0	—	—	100.0
Italy ^a	—	—	—	—	39.4	36.1	24.5	—	—	100.0
Korea	6.4	—	—	—	11.2	10.2	69.9	—	2.4	100.0
Netherlands ^b	70.0	—	—	—	—	—	30.0	—	—	100.0
Norway	12.2	—	9.4	—	19.4	3.9	—	55.1	—	100.0
Poland	24.1	5.4	—	—	—	—	70.5	—	—	100.0
Portugal	—	—	—	—	—	11.4	85.0	—	3.6	100.0
Spain	14.3	16.4	3.1	—	—	—	66.2	—	—	100.0
Sweden	—	—	—	—	0.7	28.1	71.3	—	—	100.0
Switzerland	71.7	8.7	—	—	—	—	19.6	—	—	100.0
Turkey	—	—	—	—	—	77.3	—	—	22.7	100.0
Average (unweighted)	24.1	3.8	5.7	1.9	9.1	9.9	37.7	6.5	1.5	100.0

Notes: a: 2002 data; b: 2003 data; c: Including grants to local governments.

Sources: National sources and *OECD Revenue Statistics 1965-2004*, 2005 edition.

The use of earmarked transfers for different functions varies. General public services receive most earmarked transfers, almost 25% of total earmarked grants. After that function, and in descending order, come education, economic affairs, and social protection. In some countries, like Belgium and Italy, earmarked transfers only exist in some areas, while in others earmarked transfers are more widely used. In the Czech Republic earmarked transfers exist for all functions, but with a heavy concentration in education. In Sweden, earmarked transfers are also widespread, but with a concentration in health and in education.

Table 4. Earmarked grants by function (2004)
Functional distribution according to the Classification of Function of Government – COFOG

Per cent of total earmarked grants

	General public services	Defence	Public order and safety	Economic affairs	Environ- mental protection	Housing and community amenities	Health	Recreation, culture, religion	Education	Social protection	Other	Total
	01	02	03	04	05	06	07	08	09	10		
Belgium	–	–	24.3	21.4	–	–	0.1	–	25.3	28.9	–	100.0
Czech Republic	9.3	0.0	0.5	6.0	0.3	7.5	2.2	0.7	54.3	17.7	1.4	100.0
Finland	5.5	–	0.6	17.2	1.8	0.4	12.0	16.9	27.0	18.7	–	100.0
France	16.9	1.7	8.0	13.0	2.3	22.4	–	30.8	5.0	–	–	100.0
Greece	56.6	–	–	18.9	5.6	5.6	–	7.2	–	6.1	–	100.0
Italy ^a	–	16.9	–	–	40.6	3.8	–	31.7	–	7.0	–	100.0
Norway	79.3	0.2	0.1	–	0.0	0.1	14.0	–	4.7	1.7	–	100.0
Poland	3.1	3.5	16.2	4.4	8.9	5.5	10.8	5.2	17.9	24.6	–	100.0
Spain	42.4	–	0.2	35.4	0.6	3.2	4.7	0.9	2.5	10.0	–	100.0
Sweden	3.5	1.1	0.0	6.2	3.8	–	56.3	–	29.1	–	–	100.0
Turkey	43.2	–	–	14.2	19.1	22.2	–	0.9	–	0.5	–	100.0
Average (unweighted)	23.6	2.1	4.5	12.4	7.5	6.4	9.1	8.6	15.1	10.5	0.1	100.0

a: 2002 data.

Sources: National sources and *OECD Revenue Statistics 1965-2004*, 2005 edition.

3. Grant design and implementation issues

3.1. Objectives of grants

Central governments can have three objectives in providing grants to sub-national governments (Oates, 1990):

- **Financing sub-national services and investments:** If the central government wants to control sub-national taxation, it can constrain the local tax base and provide grants to sub-national units with the objective of improving their general capacity to finance the provision of services.
- **Subsidisation:** When the sub-national provision of services has cross-boundary or spillover effects, sub-national decision making may not lead to the optimal nationwide provision of services. If that is the case, the central government could affect sub-national provision by subsidising the services.
- **Equalisation:** The central government may want to enable sub-national governments to provide the same basic bundle of services with roughly the same tax effort. This often requires a redistribution of resources to equalise tax capacity and/or service capacity.

In practice, grants often have various objectives at the same time. This can easily lead to inefficiencies, when a single grant is used to accomplish several objectives simultaneously. It is therefore important that the objectives of the grants be clearly stated and that the grant design allows for a separation of objectives and independent steering and control of grant characteristics that contribute to each of these objectives.

Box 1. Grant reform in Switzerland

Switzerland formerly had a system in which equalisation between the different cantons was mostly achieved via earmarked grants. In 2002, the amount of money devoted to financial equalisation was CHF 2.4 billion. Only part of that amount (CHF 0.9 billion) came from the non-earmarked general purpose grant; the rest was collected via earmarked grants and contributions to the social security system. This meant that specific purpose financing and equalisation were often strictly tied together: financing, subsidisation and financial equalisation could not be carried out independently. This posed considerable efficiency problems, especially because intergovernmental transfers play an important role in Swiss public spending. Among other effects, the poorer cantons were usually the ones suffering most from central government spending cuts, because almost all grants had equalising components. In the new grant system, implemented in 2004, financing, subsidisation and equalisation are separated: no equalisation takes place by means of the earmarked grants. Earmarked matching grants have largely been abolished. Earmarked non-matching grants have been sharply reduced (from more than 50 to 17). All equalisation is carried out by the non-earmarked grants and by horizontal grants (from rich to poor cantons). In this way, the instruments for financing, subsidisation and equalisation can be controlled independently. Furthermore a number of perverse incentives have been removed from the grant system.

3.2. Financing of sub-national services

Financing grants aim to provide sub-national governments with a source of revenue in addition to the sub-national tax base. The central government may choose to provide financing grants, rather than to

extend the sub-national tax base or tax-sharing arrangements,⁸ either because of the distortionary effects of sub-national taxes or the high administrative costs of sub-national tax collection, or because it wishes to control sub-national spending. Furthermore, financing grants are perceived as necessary if the central government imposes new programmes or extends the legal minimum standards of sub-national service delivery (the alternative being that sub-national jurisdictions would have to cut back on existing services or increase tax rates, which is commonly seen as unfair or counterproductive).

As indicated in Figure 2, sub-national revenues have tended to decline in the OECD area over the last decades, so that sub-national governments have become more dependent on grants to finance their services. In most countries, the taxing competences of sub-national governments are decided, or subject to approval, by the central government, and the choice between adjustment of the sub-national tax base and grants is an important policy variable at the central level of decision making. Some OECD countries have opted to limit sub-national tax bases. For instance, in France municipal taxation has been curbed. The choice between the extension of the sub-national tax base and general purpose grants is a subject that merits separate treatment and is not addressed in this paper. It should be emphasised here, however, that this choice is not only a matter of spending control⁹ and/or the technical or allocative efficiency of sub-national taxation. It is also a question of sub-national autonomy concerning the service level in general. If sub-national jurisdictions are deprived of any substantial tax base, they will no longer be in a position to vary the overall level of sub-national services. Of course, they can still vary the mix of services financed by general purpose grants. Allocative efficiency in the sense of equal marginal benefits remains possible in the public domain, but marginal benefits in the public and private domains may diverge. However, since allocative efficiency remains possible in the public sphere, the basic idea of decentralisation – namely that sub-national government is closer to the people and thus better informed about their needs and preferences – is thus still entirely applicable. The minimum sub-national tax base required to avoid divergence between marginal benefits in the public and private sectors equals the difference that would exist between the costs of the lowest and highest average sub-national service levels if every jurisdiction had a substantial tax base.

The first aim of financing grants is to enable sub-national jurisdictions to finance a basic package of services. Since the basic package should reflect sub-national preferences, it is in general not completely uniform. Consequently, non-earmarked general purpose grants are required. In principle, earmarked grants undermine allocative and technical efficiency if used for this aim, because resources or efficiency gains cannot be transferred to spending areas that constitute sub-national priorities. The grant should not extend to “fringe benefits” that reflect additions to the basic package of services. The decision about what constitutes a variation in the basic package and what constitutes a fringe benefit has to be made at the central level.

8. A tax share flowing from a tax-sharing arrangement is not a grant. A grant is fully determined by the central government whereas tax sharing implies some degree of autonomy or co-decision on the part of sub-national government with respect to the tax base or the tax rate.

9. Curbing the sub-national tax base can be an indirect means of spending control, but for this purpose there are alternatives such as fiscal rules for sub-national governments and stability pacts. This topic has been explored by the OECD Network on Fiscal Relations across Levels of Government.

Box 2. Earmarked versus non-earmarked grants in the Netherlands, Sweden and the United Kingdom

Although the non-earmarked grant can be spent according to sub-national preferences, central governments sometimes try to control it. Central governments may start by financing a certain activity with an earmarked grant, at the same time promising to change the funding into a non-earmarked grant in a few years – hoping that by that time sub-national governments will continue the existing spending pattern after the change. This has been the case in Sweden, for example, with the financing of child care. In the United Kingdom and the Netherlands, the central government has tried to reach an agreement with the sub-national governments to target the yearly increase of the non-earmarked grant for central government priorities: education policy in the United Kingdom; health, education and police in the Netherlands. Although policy co-ordination like this can be effective, it runs counter to the objective of a non-earmarked grant to provide sub-national governments with a source of funding they can spend freely.

Most countries that use general purpose grants to finance the basic service package of sub-national jurisdictions use fixed distribution formulas, which are enacted in legislation or government regulation. These formulas reflect the average or normative costs of the basic package (averaging out variations in the basic package) and, in most cases, subtractions or additions following from tax and service capacity equalisation.

In countries where the basic package of sub-national services is mostly financed by sub-national tax revenue, there may be a relatively small general purpose grant that is intended to cover only administrative costs. The number of criteria for distributing the grant will then be small and mainly related to the number of inhabitants. In countries where the general purpose grant is supposed to cover a wide array of sub-national responsibilities for imposed social spending, such as in Sweden, the number of cost-related criteria (e.g. number of children, unemployed, immigrants, elderly people) will be large.

Box 3. Grants for administrative costs in the Czech Republic

The Czech Republic has over 6 000 municipalities in 13 regions. The central government provides a grant that finances 60-80% of sub-national administrative costs. The grant allocation was reformed for 2005 because the old system was not consistent across municipalities, did not provide enough funds, and was not adjusted for inflation. The new model uses a formula that places a 0.95 weight on population. While this is an improvement over the old system, two problems are likely to arise. First, administrative costs probably do not increase one-to-one with population so that real administrative costs will not be reflected in the formula. It seems difficult to believe, for instance, that a town with a population of 50 000 needs five times more money for administrative costs than a town of 10 000. Second, it gives the municipality little incentive to economise on administrative costs.

A second aim of financing grants is to provide the resources needed to supply the service delivery programmes imposed by central government or to reach imposed minimum standards for service delivery. In general, imposed obligations do not necessarily have to be financed by central government. Again, the government will have to choose between extending the sub-national tax base and using financing grants. However, assuming that the choice between adjustment of the sub-national tax base and grants is made on its own merits (spending control, efficiency of sub-national taxation), new obligations generally have to be financed by grants. Financing grants are generally based on average or normative service costs. If the grant is non-earmarked, sub-national jurisdictions that are able to provide the service at less than average or normative cost can use the profits for other purposes. If the grant is based on average costs, the profits are temporary, because the average costs change when all jurisdictions become more efficient. If the grant is based on normative costs, most jurisdictions will make profits after a certain period of time. Therefore normative costs may have to be adjusted periodically. In principle, basing the grant on normative costs is the preferable policy option (taking average costs assumes that the average costs provider is efficient).

However, determining the normative costs is difficult for the central government because of asymmetric information. Therefore, average costs are often used as a temporary proxy, particularly in the first few years after new programmes or minimum standards have been imposed. Once the central government has learned more about the cost structure of the service, it can, at a certain point, move to normative costs.

In general, financing grants for imposed programmes or minimum standards, like those for basic sub-national services, should be given in the form of non-earmarked grants (general purpose or block grants). This creates the best incentives for sub-national jurisdictions to seek opportunities for cost savings. However, in the case of newly imposed programmes or minimum standards, earmarked grants (non-matching) sometimes cannot be avoided as a temporary solution. In some countries, periodical integration operations can be observed in which earmarked grants are added to the general purpose grant. This requires not only an increase of the general purpose grant but also an adjustment of its distribution formula. Since it is important to keep the distribution formula as simple as possible, this will often cause redistribution effects between jurisdictions. In general, such operations can be conducted more easily if many earmarked grants are integrated at the same time, because then the redistribution effects as a consequence of simplified distribution formulas will even out.

In general, it is difficult to find good criteria for the distribution of financing grants (whether non-earmarked or earmarked). Criteria used in distribution formulas may not reflect the real service costs and may not give incentives to economise on costs. Population is often one of the criteria used, and this can make sense for the costs of publicly provided private goods that increase with the number of inhabitants. However, this is not a good criterion for the costs of public goods which decrease with the number of consumers.¹⁰

The formulas used in financing grants often do not work in the most efficient way because they are not based on normative or average costs per unit of service but on costs per unit of production factor or intermediate product. They thus affect the production process and prevent sub-national jurisdictions from seeking the optimal combination of inputs.

Box 4. Austrian and Mexican grants for education

In Austria the central government gives earmarked non-matching grants to states for teachers' salaries. The states are responsible for recruiting teachers and negotiating teachers' salaries, but the central government is responsible for funding the salaries. The grant effectively reimburses the states for teachers' salaries. This structure creates two inefficient incentives for states. First, the state has an incentive to employ too many teachers. Second, the state has an incentive to negotiate salaries that are too high. In both cases, the state bears only a small part of the cost (its share of national taxes). Austria recognised the problem and negotiated a national limit on the student-teacher ratio in 2000. This limits the number of teachers that can be employed in a given state. According to Austrian state data, the limit has been largely successful in controlling costs, as education spending in terms of euros per pupil was rising rapidly before 2000 and has flattened off significantly since that time.

Mexico has a similar problem with respect to grants for education. Mexico gives states grants for education, based primarily on the number of teachers they employ. One difference with Austria is that salaries are negotiated through a strong national teachers' union. In addition, the large income inequalities in Mexico mean that spending per pupil is unequal across states and is higher for wealthier states.

10. Pure private goods may exhibit economies of scale but even then total costs increase with the number of consumers. Pure public goods (defined in the Samuelsonian sense of non-rivalry in consumption) exhibit constant total cost (proportionally decreasing average costs and zero marginal costs for the additional consumer). For impure public goods that exhibit costs of congestion (local public goods), total costs (defined as production costs plus congestion costs) may start to rise after a certain point.

Since every distribution formula that takes differences in spending needs into account is to some extent subjective, it is an illusion to think that extensive fine-tuning will make the formula more effective. In general, it will just make it more complex, less easy for the sub-national authorities and the general public to understand and, as a result, less open to accountability. To facilitate accountability, a simple and easily understandable distribution formula is preferable.

There is no essential difference (in the way they can be spent) between block grants and general purpose grants, but new obligations are often financed by block grants for reasons of transparency. However, overall transparency may deteriorate if there are many block grants. Therefore, it is recommendable that established block grants that function appropriately be eventually integrated into the formula of the general purpose grant.

Box 5. Financing social assistance in the Netherlands

The social assistance law was introduced in the Netherlands in 2004 to create incentives for municipalities to reduce the number of people on social assistance. Before this reform the central government largely reimbursed municipalities for the social assistance benefits they paid. This procedure gave municipalities little incentive to constrain expenditures. Since the reform was introduced, municipalities have borne the full responsibility for social assistance and are reimbursed for the cost through a block grant. The level of the block grant is decided by macroeconomic variables that municipalities cannot control (if the general economic situation worsens it increases and vice versa). The grant is no longer based on actual expenditures but, depending on the size of the municipality, on either a set of relevant criteria (large municipalities) or on historical cost data (small municipalities). The criteria used for large municipalities give larger transfers to municipalities with higher levels of "risk" (low income, low education level, migrants, regional unemployment, etc.). If expenditures for social assistance are lower than the grant, the profits can be used freely. This gives municipalities an incentive to move people off social assistance and into employment.

Central governments often feel the need to collect performance information about imposed programmes of service provision or imposed minimum standards. This is particularly the case when the financed services are seen as an instrument which is supposed to contribute to a more general central government objective. In principle, performance information can be collected and used to improve the imposed programme or the minimum standards in a process which is independent from the attribution of the financing grants, for instance, in periodical evaluations of the regulation that imposes the programmes or in benchmarking exercises. However, central governments generally feel the need to link the monitoring of performance closely to the grant attribution process (which is part of the annual budget cycle). A close linkage is often considered necessary to make sure that funds are used as intended and that central government authorities can be made accountable for the results obtained. If a close linkage is in place, information about unsatisfactory results can be used not only to adjust the programme or the minimum standards but also to adjust the financing grants themselves (for instance, by extending them to cover new services or by limiting them and reallocating the funds).

Box 6. Denmark: Block grant for improved old-age care

During the election campaign in Denmark in 2001 the government party proposed an increase in old-age care spending of DKR one-half billion. The instrument of implementation was part of the annual agreement between the central government and the municipalities. The purpose of the grant was to improve old-age care services, and the agreement between the central government and the municipalities was that the grant should be spent to improve old-age care. The new grant exhibits key features of a block grant. It was distributed among municipalities according to the demographic composition, and it was the government's expectation that the grant would cover the municipal cost of the reform. Municipalities received the grant in 2002 and 2003 and after that it became a permanent annual addition to the general purpose grant to municipalities. In 2004, a number of critics questioned whether the grant had actually been spent according to its purpose. The use of non-earmarked grants is generally hard to trace, but calculations showed that municipalities had actually spent the funds mostly on the purposes of the reform.

A further advantage of performance information is that it provides a good base from which to involve local or regional actors. This can help in many ways, from obtaining local information on problems and ideas for solutions, to giving local actors a stake in the outcome. If local governments have revenue-raising power, co-funding grants linked to performance targets can help to obtain sub-national commitment to the objectives set by the central government. Co-funding can be helpful in fostering responsible behaviour since people will generally take better care of funds to which they have contributed themselves. The European Performance Reserve scheme is an example of a co-funding grant linked to performance targets.

Box 7. The European Performance Reserve of the structural funds

The European Union has one of the most innovative performance funds. The EU Performance Reserve sets aside 4% of resources (EUR 8.25 billion) to reward projects that achieved pre-defined goals. To gain access to these additional reward funds, receiving governments are required to monitor and evaluate projects and achieve their pre-defined goals.

The EU Performance Reserve Fund has made important contributions to capacity building and has led to the adoption of good management practices. For example, as a result of the Fund certain regions incorporated monitoring and evaluation methods into their projects for the first time. However, a number of problems have also been associated with the Fund. For instance, since targets are set by the grant-receiving government, it has an incentive to set easily achievable targets, and in fact a very large percentage of projects were awarded additional funds. The EU is proposing new targets that are well-defined and based on increases in GDP and employment, but member states have complained that such objectives are too restrictive. Moreover, it is difficult to control for factors other than the project that might be having an impact on employment or GDP. Nevertheless, the EU example shows that reward incentives do work.

Cost-covering grants are sometimes used to finance imposed programmes. Since sub-national governments may influence the service level, this might easily lead to overspending. Such grants should only be used if cost and volume levels are fixed (norm budget financing) or bound by a ceiling. In such cases, cost-covering grants would resemble block grants. However, block grants are often conditioned on the circumstances that cause the need for services, rather than on the normative service level itself. Furthermore block grants are non-earmarked and thus contain better efficiency incentives. Therefore it remains important to search for opportunities to replace cost-covering grants by block grants.

Box 8. Multi-year agreements in the United Kingdom, France and Italy

In the United Kingdom, public service agreements (PSAs) have been used to improve public service delivery across government. PSAs are essentially targets for a period of four years, negotiated between spending departments and the Treasury. In the same vein, local service agreements are meant to improve the quality of decentralised public services. The agreements are based on measurable outcomes and multi-year budgets, which facilitate planning.

France negotiates contracts for certain services with regional and municipal governments called state-region planning contracts (CPER). They were created in 1982 and last seven years. The current contracts cover the period 2000-06. However, there are no legal consequences if the contract is not fulfilled. Because of budgetary problems, the central government has recently reneged on some of the promised funds. This harms the credibility of the procedure.

In Italy, territorial pacts aim to stimulate territorial development through a bottom-up approach. The central government negotiates programme contracts with regional partners. These contracts include grants for infrastructure investments and incentives for companies to undertake integrated projects in the fields of industry, agro-industry, services and tourism.

In practice, volatility of non-earmarked grants is a major concern for sub-national authorities. Since, in most OECD countries, non-earmarked grants constitute a considerable share of sub-national revenue, predictability of these grants is essential for planning purposes. For a separate jurisdiction, predictability depends on two elements: first, the predictability of the total non-earmarked grant that is available for all jurisdictions; and second, the predictability of the distribution of the grant over the separate jurisdictions.

The total annual amount of a non-earmarked grant can be based on certain rules (formulas) or on a discretionary decision. The discretionary method is not *per se* less predictable: it can, for example, take the form of a long-term agreement with sub-national governments. One problem is that agreements may be terminable or conditional upon external circumstances. This might imply that renegotiation has to take place as soon as the budgetary perspectives worsen or ameliorate, which introduces unpredictable patterns.

Rules-based systems, although more objective, can turn out to be quite volatile and unpredictable over a longer period of time. In many countries the total amount of the grant is linked to (a part of) the national revenues or the national budget. For example, the rule may be that a certain percentage of revenues from the value-added tax be designated for sub-national governments, as is the case in Germany. When the total amount of the non-earmarked grant is linked to a part of the tax base, the central government has an incentive to expand other parts of the tax base in order to be able to keep more of the revenues at the central level. Linking the level of the non-earmarked grant to total central government revenues (or expenditures) will generate less undesirable incentives. However, the precise definition of the concept of total revenues or total expenditures could become the subject of debate. The sub-national governments will prefer a definition that favours them; the central government may prefer another definition. In 2003, for example, the central government in the Netherlands changed the definition of the total expenditures concept to which the non-earmarked grant was linked (excluding interest payments), in the expectation that this would reduce the non-earmarked general purpose grant.

All formulas can result in volatile outcomes. The development of a non-earmarked grant is usually not very stable. Annual fluctuations of the total general purpose grant can be as high as 35% (as was the case in Greece in 1998). Grant increases can usually be accommodated by sub-national governments (although they may result in inefficient spending, especially if grants cannot be carried over to subsequent budget years as is the case in Mexico, for instance). Downward adjustments are more problematic, especially if they are large. The total non-earmarked grant in Canada, for example, decreased in 2004 by 13%. For separate jurisdictions, volatility can work out to be even more extreme (because of simultaneous volatility

of distribution): the province of British Columbia suffered a decrease in the non-earmarked grant of more than 50% in the same year.

Fluctuations of this kind can only be anticipated to a certain extent. In the Netherlands, there is an average difference of a few percentage points between forecasts and actual total grants. The difference between forecasts and actual total grants in Canada in 2003 was 14.3%, with differences for individual provinces as large as -76% (Saskatchewan) and -149% (British Columbia).

Central government behaviour can also compromise predictability for sub-national jurisdictions. This is the case, for instance, in Turkey where the debts incurred by sub-national governments can be deducted from the non-earmarked grants they receive.

Box 9. Predictability of municipal income: The tax-dependent general purpose grant in Turkey

An important part of the revenues of municipalities in Turkey consists of a general purpose grant linked to central government tax revenues: municipalities get 6% of the total tax revenues. On average, this makes up 50% of the municipal revenues, but for some municipalities this percentage can be as high as 70%. Municipalities are free to spend the grant as they see fit. The grant is distributed to municipalities on the basis of the size of their populations and paid on a monthly basis via the Bank of Provinces.

This grant provides most municipalities with a simple and predictable source of revenue, even though the central tax revenues are subject to cyclical effects and are not always predictable. For some municipalities, however, the revenue shares are less predictable due to the system of debt reduction. The Bank of Provinces can deduct a municipality's outstanding debt to the central government from its grant parcel. Municipalities can incur these debts because they do not always pay the compulsory contribution to the central government for pensions, income tax, etc. In addition, some municipalities borrow from the Bank of Provinces, but do not always pay back in time. This deduction may be so substantial that nothing much is left from the municipal grant parcel. In some cases, large municipalities lost nearly half of their grant parcel due to this deduction. The deduction is an arbitrary decision by central government, which makes the general purpose grant an unpredictable revenue source for certain municipalities. The system could be improved if the central government would agree to negotiate with the indebted municipalities on payment plans.

Source: Sagbas and Bagdigen, 2003.

The fluctuations in general purpose grants may have pro-cyclical effects. This may be undesirable from a macroeconomic perspective and might involve financial risks for sub-national governments: during recessions the non-earmarked grant might decline, whereas the need for social assistance would rise. Solutions that have been proposed in Canada to smooth the cyclical effects in tax-linked general purpose grants include using moving averages and reducing time lags in the feedback of actualisation data into the projections.

Conclusions on the efficiency of financing grants

If the central government wants to control sub-national taxation, it can limit the sub-national tax base and provide grants to finance imposed programmes or minimum standards and basic sub-national services. Non-earmarked general purpose and block grants are the most efficient instruments to finance sub-national services. However, earmarked discretionary grants are a good instrument for the co-funding of temporary projects or programmes if the commitment of sub-national authorities to performance targets is sought. In the case of newly imposed programmes or minimum standards, earmarked non-matching grants cannot be entirely avoided (in the initial stage).

3.3. Subsidisation

Subsidising grants aim to compensate for spillover effects. From an economic point of view, spillover effects are external effects or discrepancies between the tax prices paid by citizen-consumers and the benefits from the services financed by those taxes.¹¹

Box 10. Matching grants in the United States

Matching grants only provide a positive incentive for service provision, if the grants are paid on condition that the services are actually provided. This was not the case when the US federal government paid matching grants to the states for Medicaid services in the 1980s. In 1986, West Virginia did not have state funds to pay hospitals for Medicaid services and thus could not draw federal Medicaid matching dollars. Hospitals helped by “donating” money to the state. The state then immediately paid back the hospitals with the acquired matching funds. Thus, West Virginia was able to receive the federal match, without in fact having to spend any state dollars (Coughlin and Zuckerman, 2002). The same principle underlies the provider tax programmes, in which states collect tax revenues from providers, often hospitals, to use these funds as the state share for making Medicaid payments. In both cases the amount actually spent on medical services was lower than the grant plus the state share. Congress restricted the use of these schemes in 1991, but afterwards many states turned to intergovernmental transfer programmes (IGTs) which, since then, have led to similar problems.

Traditional grant theory recommends earmarked, matching grants to internalise positive spillover effects.¹² A matching grant alters the relative price of a service at sub-national level. If the tax price is lowered and if demand is downward sloping so that the lower tax price stimulates spending, provision of that service will increase. Because of the price effect, it is generally cheaper for the central government to stimulate a unit of spending on a sub-national service through a matching grant than through a non-matching grant. While both matching and non-matching grants stimulate spending by effectively increasing a community’s income (or ability to spend), the matching grant provides an extra stimulus through the lower tax price while a non-matching grant does not (the matching grant has an income effect and a price effect, a non-matching grant only has an income effect).

A number of researchers have attempted to estimate the impact of matching and non-matching grants on decentralised spending. When the sub-national government has the power to raise its own taxes to increase spending, one would expect that a non-matching grant would be equivalent to the increase of income of the citizens of the sub-national government. However, widely duplicated empirical research commonly finds that one currency unit of non-matching grant money stimulated much more public spending than one currency unit of average private income.¹³ This has been dubbed the “fly-paper” effect because grant money tends to stick to the local politician’s hands rather than returning to the local

11. Spillover effects of services should be distinguished from “fiscal externalities” flowing from tax incidence. In the latter case, outsider non-beneficiaries pay for the services of inside beneficiaries (tax exporting). Tax exporting lowers the price of sub-national services and leads to overprovision at the local level, for instance the taxing of tourists for the use of local assets (McLure, 1967). Grants are, in general, not a suitable instrument to remove this externality.
12. Given that externalities result in non-optimal tax prices faced by decentralised governments, a natural solution is to follow the Pigouvian prescription for solving externalities and change the tax prices faced by decentralised governments so that tax prices reflect resource costs including any external costs or benefits.
13. Perhaps the most widely cited early study is that of Gramlich and Galper (1973), though many studies followed. A typical study finds that an additional currency unit of average private income stimulates 0.10 currency unit of additional spending, while an additional currency unit of non-matching grant generates about 0.40 currency unit of additional public spending.

taxpayer.¹⁴ The existence of the fly-paper effect does not contradict the central conclusion of traditional grant theory that earmarked matching grants are more effective in stimulating spending than earmarked non-matching grants.

Spillovers vary with respect to their reach. Some may affect the nation as a whole and others mainly affect neighbouring communities. National spillovers may occur, for example, in research and development, health, infrastructure and tourist attractions of national importance. Regional spillovers may apply to cultural services that attract a regional audience or educational establishments that recruit students from the region.

Earmarked matching grants can be efficient instruments to internalise national spillovers, but not to internalise regional spillovers, as they force the national taxpayer to pay for services that only benefit sub-national taxpayers. Regional spillovers often occur because the appropriate size of sub-national jurisdictions is different for different services, making it hard to create optimal jurisdictions. One way to solve the regional spillover problem is to increase the size of sub-national jurisdictions so that they can provide a larger bundle of services. Another way to internalise regional spillover effects is to charge non-residents for the use of services. This requires excludability.¹⁵ A third way is to facilitate or impose interjurisdictional fiscal contracts. Voluntary contracts are preferable, but in general such agreements have to be supported by regulatory instruments at the national level, because jurisdictions that benefit from positive spillover effects may lack incentives to contribute (free riders). If contracts can be imposed, voluntary contracts will arise more easily than otherwise.

Grants can be designed to encourage co-operation between sub-national units of government, as demonstrated by the LEADER programme of the EU and the French support for intermunicipal co-operation.

14. The fly-paper effect can only be explained by studying the collective decision-making process in the sub-national government. While the traditional median voter model of sub-national democracy would predict an equal reaction to an increase of average private income and a non-matching grant (Bradford and Oates, 1971), the fly-paper effect has been explained by a number of alternative models, for instance models in which sub-national bureaucrats get political credit for increasing service levels without increasing taxes and voters are unaware of the source of the funds.

15. A service is excludable if it is technically and economically possible to exact a price for accession to the service.

Box 11. The EU LEADER Programme and French support for co-operation

The LEADER (*Liaison Entre Activités du Développement de l'Economie Rurale*) Programme of the European Union aims to bring an integrative approach to rural development. It attempts to use subsidies to encourage public-private and intergovernmental co-operation and private initiative in a particular geographic area encompassing many municipalities through innovative multi-sectoral projects. It has gone through three stages: LEADER I which started in 1991, LEADER II which was carried out from 1994-99, and the current LEADER +, from 2000-06.

Intermunicipal co-operation has been and remains an important element of most national programmes. This is especially true in France where there are more than 36 000 municipalities and where mergers are resisted by local politicians and citizens and are not promoted by the central government. In order to increase the scale of local service provision, the French authorities have favoured the use of incentives to encourage co-operation. These incentives were systematised in 1999 with central support for "*structures à fiscalité propre*" (intermunicipal structures with their own tax), even if other types of intermunicipal structures remain. The principle is the following: the intermunicipal bodies continue to be voluntary structures; the parent communes have 10 years to progressively converge towards the same business tax rate (the most important local tax) and the "losers" in this converging process receive compensatory payments; the tax rate is decided by the intermunicipal body which will also directly receive the tax revenue. In order to stimulate local authorities to participate in these structures, the French government pays a supplementary grant to the EPCI (*établissements publics de coopération intercommunale*) in addition to the general purpose grant to all sub-national levels, the DGF (*dotation globale de fonctionnement*). This supplement is called the "*dotation d'intercommunalité*" (intermunicipal grant), and its size depends upon the type of EPCI. Six years after the launch of this new programme, 84% of the French population lives in an area covered by an EPCI with its own tax revenue (88% of French municipalities are located in these areas).

Matching grants are not necessarily open-ended. The central government may fix the norm cost of the service it wants to subsidise, in which case the price component of the grant is not open-ended. The central government may also fix the quantity of the service it wants to subsidise, in which case the volume component of the grant is not open-ended. In the latter case, the central government may either maintain the per unit character of the grant, in which case the grant is a variable sum with a fixed ceiling, or it may give the grant as a lump sum, in which case the grant is independent of the number of units that are actually provided, but still dependent on sub-national matching of resources.

A specific type of externality that could be internalised by a matching grant is the "information externality" that has figured in valuable experiments conducted by a number of sub-national governments (Oates, 1999). Various types of institutional innovation that can be applied nationwide originate in individual sub-national jurisdictions (in environmental policy, social security policy, etc.). The knowledge provided by such experiments travels relatively fast and is not costly for other jurisdictions. As is usual in innovation theory, the innovator pays for the others, but in this case it is impossible to protect the institutional innovation and, above all, if it creates greater efficiency in public spending, it will not be in the collective interest to do so. Central government has to support institutional innovation in order to internalise the positive effects for "free rider" regions. For that purpose, the central government can use matching grants in which the costs and the risks of new programmes put in place locally are shared. A matching grant is a better support for experimentation, since it allows a better sharing of information with central powers than a non-matching or non-earmarked grant.

Conclusions on the efficiency of subsidising grants

Earmarked matching grants can be an efficient instrument if the central government wants to stimulate the provision of a sub-national service because of national spillover effects. If regional or local spillovers occur, central government intervention is often required as well, and should, in general, take the form of stimulation or imposition of local or regional co-operation. Matching grants can also be used for temporary projects or programmes in case of stimulation of institutional innovation.

3.4. *Equalisation of tax and service capacity*

Equalisation grants aim to enable sub-national governments to provide an average package of services at roughly the same tax effort. Equalisation of tax capacity is directed at compensating jurisdictions with a relatively small tax base; equalisation of service capacity is directed at compensating jurisdictions that are facing relatively high costs for basic services.

Equalisation can, in principle, proceed entirely via horizontal grants. The central government then imposes the obligation on jurisdictions with a large tax base or low service costs to transfer a part of their revenues to jurisdictions with a low tax base or high service costs. This is the case, for example, in Germany. In practice, however, equalisation often proceeds through vertical grants from central government. This is particularly likely if sub-national governments are, to a large extent, dependent on vertical grants for financing purposes anyway. Tax capacity equalisation then takes the form of differentiation of the non-earmarked general purpose grants that are available for financing purposes (subtracting the payments to be made by rich jurisdictions and adding these payments to the grants for poor jurisdictions). Combinations of both methods occur as well, for instance in Switzerland where tax capacity equalisation between the cantons proceeds partly by horizontal grants and partly by vertical ones.¹⁶

Equalisation can, in principle, take place via earmarked as well as non-earmarked grants. The equalisation component in a non-earmarked general purpose grant covers an average package of services, namely a package of average costs (mainly the basic sub-national services and imposed programmes or minimum standards). The equalisation component in an earmarked grant will apply exclusively to the earmarked services. The equalisation component in earmarked grants can be as efficient as the equalisation component in non-earmarked grants, but this observation should not detract from the earlier conclusion about the efficiency advantages of general purpose grants for financing purposes (see section 3.2).

It has been observed that, from an economic point of view, both tax capacity equalisation and service capacity equalisation are forms of redistribution. Equalisation is also often primarily motivated by redistributive considerations (solidarity). However, in the fiscal federalism literature much emphasis is placed upon the fact that tax capacity equalisation can also be justified by increased allocative efficiency. In particular, it has been noted that decentralisation often disturbs horizontal equity (equal tax prices for equal services). General purpose grants can serve to restore horizontal equity between jurisdictions. This rationale for grants was adopted early on in the fiscal federalism literature (Buchanan, 1950; Musgrave, 1961).

In general, decentralisation will lead to the unequal treatment of citizens in equal positions, even if both the central government and the sub-national government treat citizens in equal positions equally. This is the case for three reasons. First, in so far as sub-national services have public good characteristics (decreasing marginal costs with respect to the number of consumers¹⁷), tax prices of services will be lower to the extent that the tax base of a sub-national jurisdiction is larger. In other words, citizens pay less for their services if their fellow citizens are more numerous and richer. Second, in so far as sub-national services are not pure public goods, the production of these goods may be subject to economies of scale, implying that citizens pay less for their services if their jurisdiction is more populous. Third, in so far as sub-national taxes are not levied strictly in accordance with the benefit principle, but contain an element of redistribution on the basis of ability to pay, and expenditures are neutral in respect to distribution, individuals with equal ability to pay and similar needs in different jurisdictions will experience an unequal fiscal residuum (the net benefit of taxes paid and services received). This is the case because in a poor

16. For a comparison between the vertical and horizontal grant methods see Lotz and Mochida (1999).

17. This includes both pure public goods that accommodate additional consumers at zero marginal cost and local public goods that are susceptible to congestion.

jurisdiction redistribution is more costly to the rich and less beneficial to the poor than in a rich jurisdiction. For instance, assuming that sub-national taxes are roughly proportional to income and benefits are equal per citizen, a poor person living in a rich jurisdiction will experience a larger fiscal residuum than a poor person in a poor jurisdiction and a rich person living in a poor jurisdiction will experience a higher negative fiscal residuum than a rich person living in a rich jurisdiction.¹⁸

The deviations from horizontal equity introduce inefficiencies in the economic system.¹⁹ All other things being equal, an individual will have an incentive to locate in a jurisdiction with a relatively large tax base, where he or she can consume services at relatively low tax prices and where redistribution is large if he or she is poor and where redistribution is small if he or she is rich.²⁰ This incentive does not reflect differences in real costs or other considerations relevant to efficient resource utilisation.²¹ The practical relevance of inefficient migration may differ between countries. In the Nordic countries the services provided by sub-national jurisdictions are important (education, health) but hardly exhibit public good characteristics. Economies of scale for these services may not exist (and have not been proven).²² In spite of substantial differences in tax and service levels between jurisdictions, migration in these countries is not a problem.

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18. One could argue of course that sub-national government should not interfere with income distribution to begin with, but this is a rather theoretical argument in a time when, given the nature of sub-national services, taxation according to the benefit principle would lead to strongly digressive rate structures. For instance, in the Nordic countries most sub-national services are social services (mostly benefiting low income groups).
 19. However, Scott (1950) has argued that these inefficiencies are the price to be paid for freedom of residential choice.
 20. In more recent literature, the emphasis is placed on another possible effect, namely that sub-national governments (or more generally governments in open economies) that use taxes on mobile factors tend to underprovide public services because they fear an exodus of their tax base (tax competition). Consequently, the sub-national governments tend to tax the mobile factors less than is commensurate with the benefits these factors receive from the services provided (Zodrow and Mieskowski, 1986; Wilson, 1986).
 21. Apart from the horizontal equity argument, there exists another efficiency argument in favour of equalising grants (Boadway and Flatters, 1982). In a Ricardian model in which the rents generated in a region (from factors such as agglomeration, a unique location or natural resources) accrue only to residents of that region, a mobile factor that moves into a jurisdiction will add to the tax payments but (eventually because of diminishing marginal product) subtract from per capita rents (the value of output after labour costs). Efficient migration patterns that maximise overall welfare should equate net benefit of a worker across jurisdictions. To correct for disparities in net benefits, jurisdictions that have large per capita rents should receive lower grants. The central government essentially taxes away any rent advantage and redistributes it so that all jurisdictions have equal rental income; a worker will then decide whether to migrate by comparing his/her marginal product in one jurisdiction versus another. To the extent that rents are capitalised into land values, average rent discrepancies will disappear. In practice, not many countries have tried to actually estimate average rent differences and to use such estimates in the design of their equalisation systems. However, according to Boadway and Flatters (1982), rents generated from natural resources have been a main historic catalyst for the evolution of the Canadian intergovernmental grant system. Note also that even if capitalisation does not occur, the argument by Scott (1950) implies that inefficient incentives may be the price to be paid for freedom of residential choice (and for economic growth through migration to the areas that have the jobs and natural resources).
 22. Cost differences may also be capitalised in land values. Although this does not remove the inefficiency (unlike the capitalisation of natural endowments), it does remove the inefficient incentive for migration.

Horizontal equity can be restored through horizontal or vertical non-earmarked general purpose grants.²³ Such grants compensate for differences in the tax base between jurisdictions and will remove the largest interjurisdictional inequities and thereby largely prevent inefficient patterns of migration.

Tax capacity equalisation requires the calculation of a tax capacity measure. For that purpose the tax base of each of the jurisdictions has to be estimated. If sub-national jurisdictions can, for instance, levy taxes on income and real estate property, the total income and the total value of real estate in the jurisdiction has to be estimated. This requires the availability of accurate statistical data. Subsequently, the average weighted jurisdictional tax rate for each tax can be determined as the sum of all jurisdictional tax revenues divided by the sum of all jurisdictional tax bases. The tax capacity measure can now be defined as the jurisdictional tax base times the average tax rate. This is the revenue that the jurisdiction would collect if it depleted its tax base at the average rate. Note that this measure is independent from the actual tax rate in the jurisdiction, which means that it is a pure capacity measure. By equalising tax capacity in this sense the grant fully respects the autonomy of sub-national governments in the level of taxation and benefits. Also, all incentives to increase or decrease the jurisdictional tax rate in order to receive a higher grant will be removed.²⁴

Box 12. Incentives of the Canada equalisation scheme

Canada has an extensive equalisation scheme. It takes into account all 33 tax bases in all 10 Canadian provinces. A province gets an equalisation transfer when its tax base per capita is lower than the standard (average) tax base per capita. Seven provinces are net gainers, three provinces are net payers. This standard tax base is calculated as the weighted average of five predetermined provinces. The turnover in the system is CAD 8 billion per year.

For many taxes the exact tax base cannot be established. Instead, the actual tax revenues are used as a proxy. This creates a disincentive for provinces to collect tax revenue. There is another way in which the fiscal behaviour of a sub-national government can affect its equalisation grant: for a large province (one of the five provinces in the calculation) an increase in its tax rate will increase the standard tax rate used to calculate the grant for that base and thereby reduce the province's grant if it has a high relative fiscal capacity with respect to that base. This will affect the province's choice of tax rates.

It has been noted that full equalisation removes the incentive to increase the jurisdictional tax base by attracting new economic activity. In order to maintain this incentive, central government could opt for less than complete equalisation, so that the gap between the jurisdictional and average tax base is only partially compensated. The grant system could, for instance, be designed in such a way that the tax capacity of the poorest jurisdiction after equalisation is within a range of 10% or 20% of the average tax capacity. Another possibility is that equalisation aims to reduce the difference between a minimal guaranteed tax capacity and

23. In principle, a more ideal method for restoring horizontal equity is through discriminating income taxes. By levying higher rates on residents of relatively wealthy jurisdictions, the central government could in effect compensate for the lower tax prices of sub-national services as well as the lower contributions of the rich to the sub-national services consumed by the poor (Buchanan, 1950). This method equalises tax prices and redistributive contributions at the level of the individual taxpayer. However, as Musgrave has pointed out, this method is beset by many practical problems (Musgrave, 1961).

24. Musgrave has suggested that central governments may want to maintain an incentive to increase the sub-national tax rate, especially in poor jurisdictions (Musgrave, 1961). This may be achieved by measuring tax capacity by tax base times jurisdictional tax rate (rather than average tax rate). However, this suggestion does not entirely restore horizontal equity. Moreover, the suggestion is not neutral in respect to the budget (poor jurisdictions might receive more than rich jurisdictions pay or the opposite).

actual tax capacity. For instance, the Swedish equalisation grant (for municipalities) aims at equalising 95% of the difference between a guaranteed tax capacity (set at 115% of the average) and the actual tax capacity of low capacity municipalities (this percentage will be lowered in 2006). The Dutch general grant equalises 80% of this difference. No country studied in this paper used full equalisation or 100% compensation of the difference with a set minimum tax capacity. To maintain the incentive for tax base expansion, partial equalisation must not lead to a change in the rank order of tax capacities.

The “base taxback rate” is the share of additional revenue from tax base expansion that a sub-national government loses through the reduction of the equalisation grant (Courchene and Beavis, 1973). High taxback rates may discourage sub-national governments from investing in the development of economic activity associated with particular tax bases.²⁵ In order to encourage the Canadian provinces to develop their natural resources, for example, some researchers have argued that natural resources should be removed from the equalisation formula (Boessenkool, 1998). This could, however, lead to an ineffective allocation of resources if some regions have large rents from natural resources.

Intergovernmental grants are also an efficient instrument to compensate for differences in service capacity that result from cost differences (also called equalisation of spending needs). Cost differences may have to do with natural circumstances (mountainous areas, areas prone to flooding, islands) or with socio-demographical circumstances (demography, population density, urbanisation), depending on the expenditure responsibilities assigned to sub-national governments.

From an economic point of view, service capacity equalisation cannot be justified by the efficiency argument of horizontal equity. Indeed, migration from high-cost to low-cost areas could be beneficial from an efficiency point of view. However, many governments give priority to the redistributive argument of vertical equity, implying that similar sub-national services must be available in every jurisdiction at roughly the same tax price. This is a solidarity argument which must be applied with some care, because it can harm allocative efficiency and economic growth if applied on a large scale.

Service capacity equalisation requires the calculation of service cost indicators; these indicators can refer to actual costs or assumed norm costs. The indicators measure the difference between the average or norm costs and jurisdictional costs of a bundle of services to which the measure applies. Equalisation can also take the form of an assessment by the central government of the spending needs of a sub-national jurisdiction, as is the case in the United Kingdom. Service capacity equalisation does not necessarily apply to all jurisdictions, but may be limited to those that have extremely high costs for certain services.

25. Denmark has a legal limit to the taxback rate of 90% (so that jurisdictions will always gain by developing their tax base).

Box 13. Service capacity equalisation in Japan

Sub-national authorities should not be able to influence the criteria for service cost equalisation. This requirement is not entirely met in Japan, where at least part of the borrowing by sub-national governments (and consequently the worsening of Japanese public finances) can be ascribed to the fact that road construction volumes and interest payments are important distribution criteria for the non-earmarked grant (the LAT, local allocation tax). Each of these criteria creates an incentive for Japanese prefectures to borrow and overspend on roads. Other OECD member countries where road construction volumes constitute an important distribution criterion for the equalisation grant are Portugal, the Slovak Republic and Denmark. In the latter country, the number of local road kilometres was a criterion for the need for road spending during the 1980s. Local authorities then began to turn small, private dirt roads into public roads. This led to much more equalisation compensation than the costs of maintaining the dirt roads (which only involved a truck and some gravel every second or third year). The criterion was later abandoned. The reason for the wrong incentives is that the grants do not equalise service capacity (the need for roads or borrowing) but the actual level of road construction or borrowing.

Conclusions on the efficiency of equalising grants

Equalising grants aim to enable sub-national governments to provide an average package of services at roughly the same tax effort. Equalisation can be directed at compensation of low tax capacity or high service costs. Equalisation can be achieved in an efficient way via horizontal grants between sub-national jurisdictions and additions or subtractions from general purpose grants that are given for financing purposes. Full compensation of differences in tax or service capacity may compromise the incentive to expand the tax base and should be avoided. High taxback rates should also be avoided.

3.5. Collective decision making

The approach to grant design followed thus far is basically the traditional approach in the fiscal federalism literature. It treats the central government as a unitary, completely informed actor that aims to maximise social welfare for the national community as a whole. This approach offers useful insights, but is limited in scope because it ignores several dimensions of management and governance of grants that are important in OECD countries. Over the last decade, a number of new approaches have focused on new and different aspects of intergovernmental grant management and governance, and constitute what Oates (2004) has called a “second generation” set of models. The new models draw on public choice theory, principal agent theory and the economics of information. Since the results of these approaches are mostly positive and empirical, they cannot easily be translated into normative conclusions that are useful for practitioners involved in grant design. Nevertheless, there are some new insights which are applicable to policy making.

The traditional approach assumed that central government was a unitary actor that maximised the social welfare of the nation. That is, it did not address the political environment at the central level. Politicians at the central level have loyalties at the sub-national level and they will attempt to direct grants in the direction of their regional or local constituencies and to influence decisions on distribution formulas of general purpose grants. Discretionary grants are often the subject of negotiation between central and sub-national authorities in which central authorities may be more or less inclined to favour the particular regions or localities to which the grants apply. Furthermore, central government is not completely informed about the policy options of sub-national governments. Indeed, the whole idea of the decentralisation of execution of centrally imposed programmes is based on the assumption that sub-national policy makers have better insight in the adoption of policies to local or regional circumstances. But if central governments are not informed about these circumstances and the policy options available, sub-national authorities may choose non-optimal courses of action from the central point of view.

The main critical points in grant design that are subject to lobbying and log-rolling practices, which may compromise the efficiency of grant design, are the following:

- The choice between non-earmarked grants and earmarked grants;
- The determination of the distribution formulas of non-earmarked general purpose grants covering basic service packages (including the demarcation of basic service and fringe benefits, the latter to be covered by sub-national revenues),²⁶
- The determination of the tax capacity of sub-national jurisdictions and the extent to which differences in tax capacity should be equalised;
- The determination of the service capacity of sub-national jurisdictions and the extent to which differences in service capacity should be equalised; and
- The choice between mandatory grants and discretionary grants.

There is a large amount of academic literature about collective decision making in these areas.

It is important that proposals for the revision of grant systems that concern the general principles – including the choice between earmarked and non-earmarked grants, distribution formulas, the determination of tax capacity and service capacity, and the choice between mandatory and discretionary grants – be decided without the undue influence of sub-national lobbying groups. Decision making about the general principles should be reserved to national authorities on the basis of neutral expertise. The views of sub-national authorities are important, but should be developed in a setting that encourages objective debate – for instance, in a consultative council that is informed by neutral expertise. Also, the advice of sub-national representatives should focus on the technical aspects of the grant systems, such as the estimation of relevant variables and the quality of statistical data, rather than on principles.

26. For instance, politicians may use the distribution of grants as a means to ensure their re-election by providing swing states with relatively more grants. It has been shown that not only earmarked discretionary grants are used in this way (Dahlberg and Johansson, 1999), but also non-earmarked grants with a formula-based distribution mechanism (Johansson, 2003). Although the Swedish non-earmarked grant has formula-based distribution criteria – and thus seems to be quite objective – in practice it turns out that swing states get relatively more of the non-earmarked grant, corrected for all other factors.

Box 14. Grant committees in the Australian states and in Canada

Every state in Australia has its own local government grants commission. These bodies are independent, and their task consists of calculating the non-earmarked grants for their local jurisdictions. They have to take certain conditions for granted, such as the level of overall funding provided by the central government, the need for horizontal equalisation, and the requirement to provide each sub-national government with at least a minimum grant. But apart from that, each commission can decide how it will assess needs and thus how it will distribute the non-earmarked grant to the sub-national governments in the jurisdictions concerned (Travers and Esposito, 2004). Since evidence for the political-tactical distribution of grants has been found in countries as diverse as Albania (Case, 2001), Austria (Worthington and Dallery, 1998), Sweden, and the United States (Grossman, 1994), but not in Australia (Bungey, Grossman and Kenyon, 1991), it might be assumed that the independent body in Australia actually manages to achieve an impartial distribution.

A somewhat different case is provided by Canada, in which the evaluation of the allocation system is left to an independent technical commission. These kinds of solutions could avoid situations of stalemate, as was the case in Italy, where no political compromise could be reached on revision of the allocation criteria of the non-earmarked grant, resulting in a situation where the criteria has not changed since 1976 (Emiliani *et al.*, 1997).

As far as financing of imposed programmes is concerned, sub-national resistance to block grants or general purpose grants may be mitigated by allowing for a certain degree of matching, at least in an initial stage. In the principal agent model, such modalities of risk sharing are known as “low-powered” incentive schemes. They can be justified if sub-national jurisdictions are risk adverse and do not want to take the responsibility for the risks connected to the execution of centrally imposed programmes. Under these circumstances, block grants could be considered a “first best” solution because they transfer the execution risk entirely to the sub-national jurisdiction (“high-powered incentive schemes”). If the consequence of block grants is that sub-national governments refuse to take on the task, matching may be an acceptable solution if the price elasticity of the service is low (so that the risk of overspending is low).

Discretionary grants are especially prone to undue sub-national influence. Although they are necessary in the case of unique or temporary projects, such as the construction of infrastructure or the improvement of the regional or local economic structure, it is important that the central level choose the procedures of project selection and design and the role of negotiations and contracts with sub-national authorities. In general, discretionary grants should not be used if law-based grants are a viable alternative.

Conclusions from insights into collective decision making on grant design

Decision making about the general principles of grant reform should be reserved for central authorities on the basis of neutral expertise. The views of sub-national authorities are important, but should be developed in a setting that encourages objective debate, for instance in a consultative council that is informed by neutral expertise. As far as financing of imposed programmes is concerned, sub-national resistance to block grants or general purpose grants may be mitigated by allowing for a certain degree of matching, at least in an initial stage.

4. Conclusion

4.1. Principles of grant design

In many OECD countries, grants systems are beset by numerous inefficiencies. The most common are:

- Earmarked matching grants that are (partly) used for equalising purposes and thus encourage sub-national jurisdictions to provide higher than optimal service levels.
- Earmarked matching grants that are (partly) used for financing purposes and thus encourage sub-national jurisdictions to provide higher than optimal service levels.
- Earmarked non-matching grants (including cost-covering grants) that are used for financing purposes; these grants lack incentives for technical and allocative efficiency and could, in many cases, be replaced by general purpose or block grants.

Modernisation of grants systems should start with a reflection on the objectives of the central government and a separation of the grant instruments so that independent steering of the various instruments becomes possible. In general, the only feasible combination is between non-earmarked general purpose grants aimed at financing and at equalisation. The equalising elements then take the form of additions and subtractions from the financing grants, so that horizontal grants (grants given by rich or cheap jurisdictions to poor or expensive jurisdictions) become wholly or partly unnecessary.

Table 5 summarises the efficient use of the various types of grants. The headings of the last five columns indicate the concrete aims that can be distinguished under the general purposes of subsidisation, equalisation and financing. These concrete aims can be distinguished according to whether (a) the central government takes the initiative to impose or influence sub-national service provision, or (b) the sub-national government itself takes the initiative to provide the service. The second column is the instrument column and indicates the various types of grant instruments that are available. Because the table aims to provide a general overview of efficient instrument use, the instrument column also contains some regulatory instruments (imposition of co-operation and extension of the sub-national tax base) that are efficient for reaching aims for which grants are often used in practice (in a non-efficient way). A mark in one of the columns of the table indicates that the grant instrument can be used in an efficient way to attain the concrete aim.

Discretionary grants are mentioned as a possible instrument for co-funding purposes. Co-funding arrangements are used in some countries to finance projects with objectives that are hard to achieve using matching grants and where both central and sub-national governments have to be committed (see section 3.2).

Earmarked non-matching grants (including cost-covering grants) are mentioned in Table 5 as a possible instrument for financing purposes because they cannot be entirely avoided (see section 3.2). However, in many countries there are still numerous opportunities for replacing them with more efficient general purpose or block grants. Table 5 also mentions matching grants that are given as risk-sharing arrangements (see section 3.5).

Table 5 should not be seen as a prescriptive blueprint. Countries have different traditions of decentralisation, which are sometimes rooted in culture or history. Theoretical distinctions are not always easily applied to grants in practice. Furthermore, reform of grant systems is a gradual process in which separate (groups of) grants are revised sequentially and for different reasons. For instance, an earmarked grant may be reformed to improve the distribution formula or to remove wrong incentives. This is different from trying to integrate it into the general purpose grant, which is a more fundamental reform. Integration of earmarked grants into a general purpose grant is a reform that can be more easily achieved if more grants are integrated at the same time. Redistributive effects then tend to even out. Partial reforms can constitute improvements even if the guidelines implied by the table are not (yet) entirely followed.

Table 5. Efficient use of grant instruments

Purpose	Efficient type of grant or regulatory instrument	Central government initiative			Sub-national government initiative	
		Imposed programmes or standards	Compensation of spillovers	Temporary projects and programmes	Basic services	Fringe services
Financing	Extension of sub-national tax base	X			X	X
	Non-earmarked general purpose grants	X			X	
	Non-earmarked block grants	X				
	Earmarked discretionary grants			X (co-funding)		
	Earmarked matching and non-matching grants	(X)		X (risk sharing)		
Subsidisation	Earmarked matching grants		X (national spillovers)	X (experiments)		
	Imposition of co-operation		X (regional spillovers)			
Equalisation	Imposition of horizontal grants	X			X	
	Non-earmarked general purpose grants	X			X	

4.2. Implementation issues

General purpose grants that are dependent on criteria such as total tax revenue or total expenditures of central government tend to be volatile. They are influenced by central government fiscal policy and are subject to macroeconomic cyclical effects. In order to enable sub-national jurisdictions to plan their activities on a multi-annual basis, it is important that a mechanism be put in place that constrains volatility. In general, such a mechanism would link the size of the general purpose grants to trend estimates (for tax revenue or expenditures), rather than to real estimates or realisations.

In designing grants, governments need to take into account the implementation steps that will follow after the choice of instrument has been made. As has been illustrated by various case studies in the paper, interaction among different levels of government opens the door to strategic behaviour, which in turn can produce complex situations.

Grant reform has to take place in a context of institutional, historical and cultural circumstances that are unique to each country. Financing, subsidising and equalising grants have to take into account the nature of fiscal decentralisation, the degree of local financial autonomy, the competences of the various levels of administration, the willingness of the political elite to proceed with reforms, the principles of regulation (more or less consensual), the degree of disparity between regions and the lock-in aspect of these disparities, the extent to which sub-national governments have succeeded in forming a coalition, and the specific challenges faced by the countries. Thus, even if this aspect has not been dealt with in this paper because the focus has been on grant design, the institutional, historical and cultural background is a key factor in designing the grants, implementing them, and evaluating their performance. These factors explain the absence of a “one-size-fits-all” grants system.

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9

Intergovernmental Transfers and Decentralised Public Spending

5th Annual Meeting of OECD-ASIA Senior Budget Officials
Bangkok, Thailand
10-11 January 2008

Claire Charbit, OECD GOV Directorate
Regional Competitiveness and Governance

OECD  OCDE

The need for multi-level governance in decentralised contexts

3 economic paradoxes in OECD countries:

1. **Increased sub national responsibilities in spending *while* growing dependency on central governments for resources**
2. **No convergence of GDP among regions *call for* central government interventions: equalisation and customisation**
3. **Central governments devolve responsibilities to sub national governments *while* growing central concerns for the control on standards of local public services and on performance of local delivery**

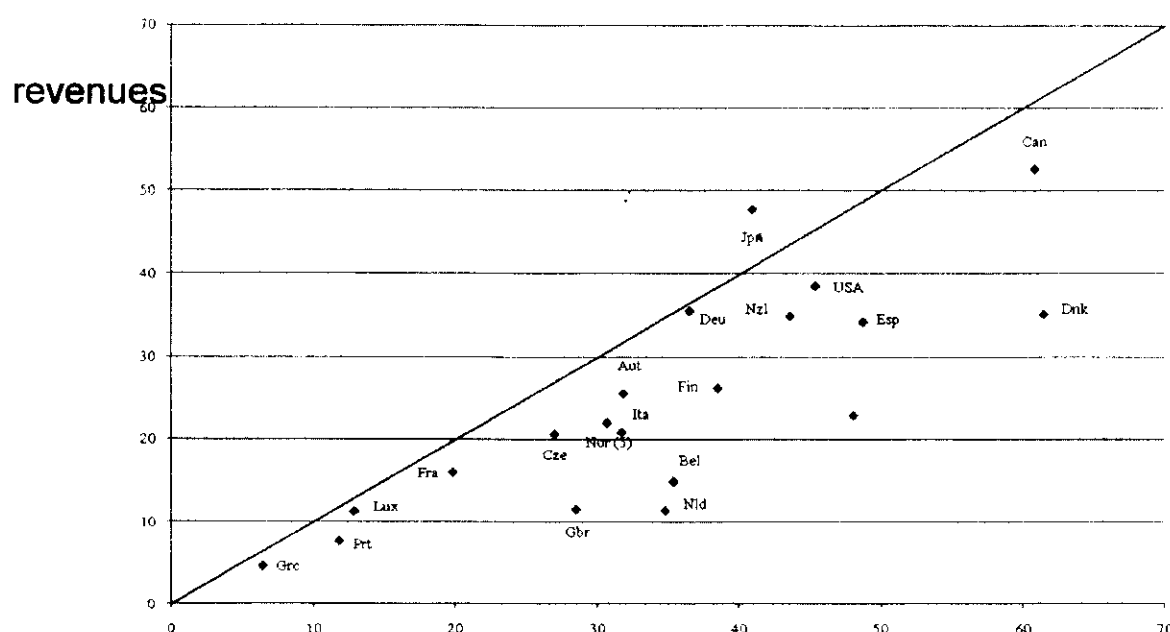
OECD  OCDE

Fiscal autonomy and fiscal decentralisation

- Fiscal autonomy (the share of sub national own revenue in the total revenue) and fiscal decentralisation (the share of sub national expenditure in total public expenditure) vary widely among countries.
- Fiscal decentralisation has led to increased sub national responsibility in the area of spending, while at the same time sub national governments have become more dependent on central governments for their resources.
- How to identify good practices?

OECD  OCDE

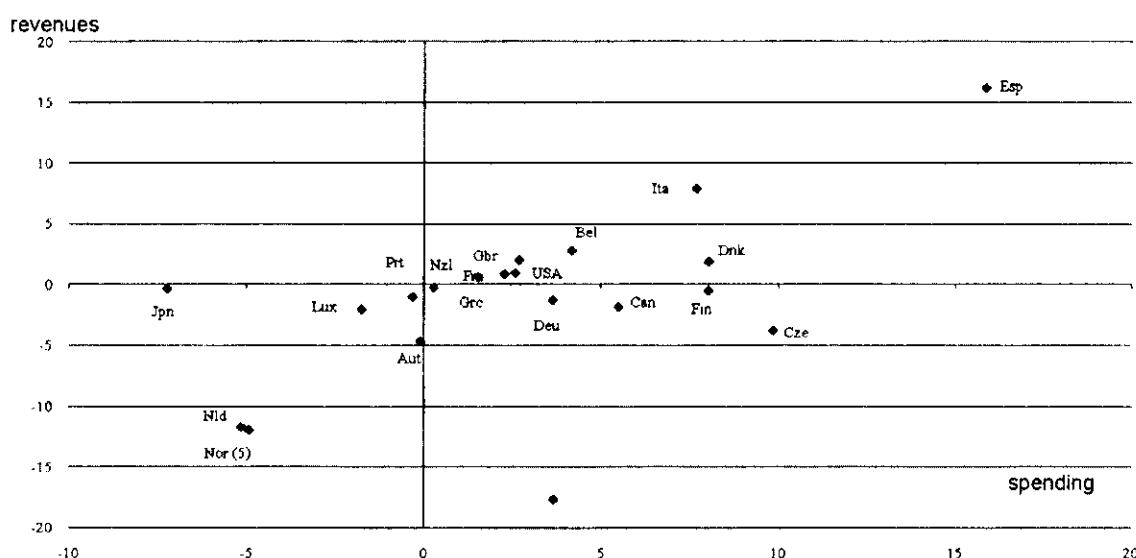
Decentralisation in OECD countries (1/2) share in general government revenue and expenditure, 2005



Spending  OCDE

Decentralisation in OECD countries (2/2)

Changes expressed in percentage points 1995-2005



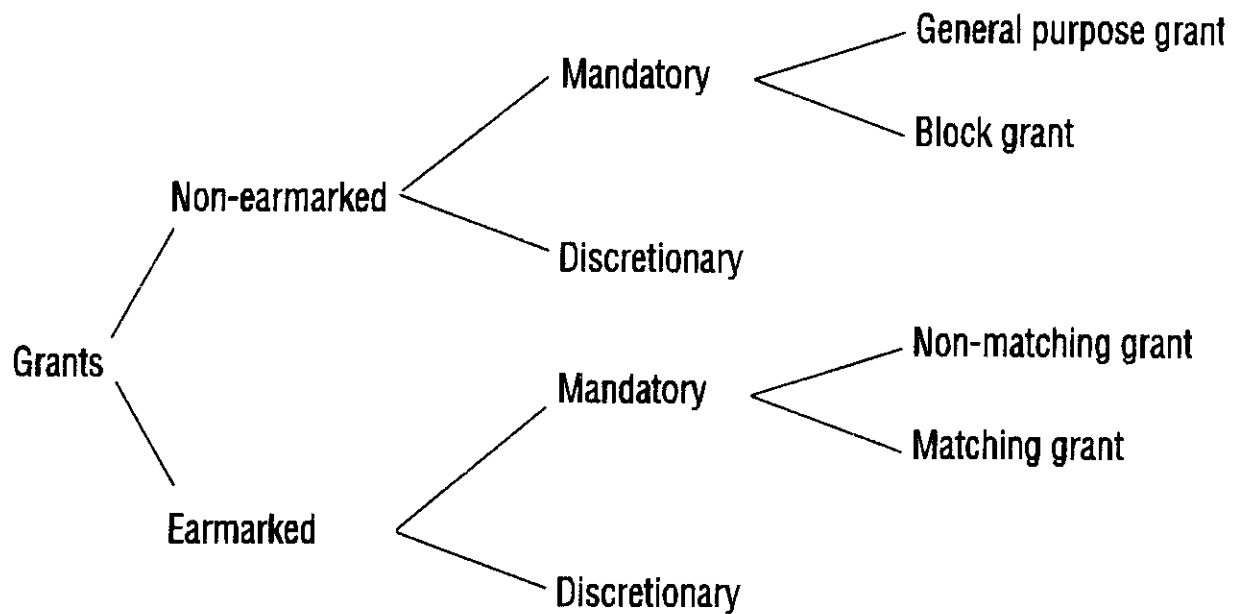
OECD  OCDE

OECD Network on Fiscal Relations across Levels of Government

- 2005-2006: Intergovernmental transfers;
Subnational taxes; Fiscal discipline
- 2006-2007: Equalisation policies
- 2007-2008: Efficiency in public services delivery:
the use of indicators systems; the use of market
mechanisms
- 2008: Choice between taxation and grants

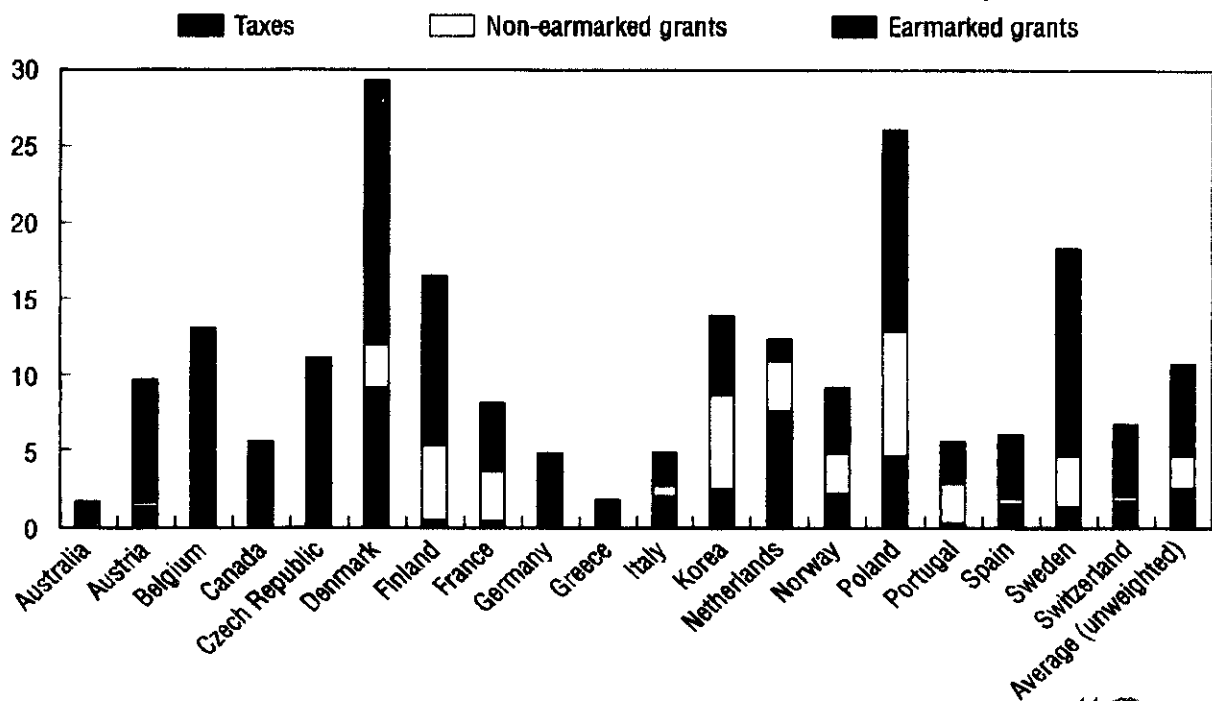
OECD  OCDE

A typology of transfers



OECD  OCDE

Country choices on different types of grants – Local government revenue from taxes and grants



OECD  OCDE

Country choices on different types of grants – Receipts of earmarked and non-earmarked grants

	Earmarked grants	Non-earmarked grants	Total
States			
Australia ^a	87.5	12.5	100.0
Austria	79.8	20.2	100.0
Belgium	94.0	6.0	100.0
Canada	18.6	81.4	100.0
Italy ^a	28.6	71.4	100.0
Mexico ^c	59.2	40.8	100.0
Spain	14.8	85.2	100.0
Switzerland	77.8	22.2	100.0
Average	57.5	42.5	100.0
Local jurisdictions			
Australia ^a	17.2	82.8	100.0
Austria	86.1	13.9	100.0
Belgium	95.9	4.0	100.0
Canada	95.7	4.3	100.0
Czech Republic	100.0	0.0	100.0
Denmark	69.8	30.2	100.0
Finland	9.2	90.8	100.0
France	11.7	88.3	100.0
Greece ^b	100.0	0.0	100.0
Hungary	56.9	43.1	100.0
Iceland	21.0	79.0	100.0
Italy ^a	75.5	24.5	100.0
Korea	27.7	72.3	100.0
Netherlands ^b	70.0	30.0	100.0
Norway	44.9	55.1	100.0
Poland ^b	29.5	70.5	100.0
Portugal ^b	11.4	88.6	100.0
Spain	33.8	66.2	100.0
Sweden	28.7	71.3	100.0
Switzerland	80.4	19.6	100.0
Turkey	77.3	22.7	100.0
Average	54.4	45.6	100.0

OECD  OCDE

Different grants for different purposes

- **Financing** *To enable sub national governments to finance a basic package of services for which they have competencies (or to reach imposed standards)*
- **Subsidisation** *To compensate for spillover effects*
- **Equalisation** *To allow sub national governments to provide their citizens with « similar » sets of public services at roughly « similar » tax burden*

Efficient use of grant instruments

Purpose	Efficient type of grant or regulatory instrument	Central government initiative			Sub-national government initiative	
		Imposed programmes or standards	Compensation of spillovers	Temporary projects and programmes	Basic services	Fringe services
Financing	Extension of sub-national tax base	X			X	X
	Non-earmarked general purpose grants	X			X	
	Non-earmarked block grants	X				
	Earmarked discretionary grants			X (co-funding)		
	Earmarked matching and non-matching grants	(X)		X (risk sharing)		
	Earmarked matching grants		X (national spillovers)	X (experiments)		
Subsidisation	Imposition of co-operation		X (regional spillovers)			
Equalisation	Imposition of horizontal grants	X			X	
	Non-earmarked general purpose grants	X			X	

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Fiscal Equalisation in OECD countries, main findings

- 2 main distinctions: horizontal vs. vertical equalisation transfers; equalisation of revenue disparities vs. cost disparities
- Fiscal equalisation makes up around 2.3 % of GDP (between 0.5 and 3.8 %; between 1.2 and 7.2% of government expenditures; between 110 and 1200 US\$ per capita)
- Equalisation reduces fiscal disparities: by 2/3 on average; horizontal systems seem to show a slightly stronger equalising effect per GDP
- Equalisation can pose a problem for budget stability (less likely for horizontal systems)
- Revenue equalisation can reduce tax and development efforts (risk of poverty trap)
- Cost equalisation is prone to rent seeking
- The choice of standardised revenue or cost bases can mitigate disincentives; as well as having an independent body that allocates equalisation transfers

Performance indicators, main findings

- An "indicator system" refers to the systematic collection of information to measure and monitor the activities of government
- Indicators are tools for 1) revealing information and reducing information asymmetries and 2) encouraging performance improvements by altering incentives to SNG
- The choice of the objectives the systems will serve is crucial; countries aim to achieve multiple objectives which leads to no "optimal solutions"
- Top down approach often perceived as an ex post substitute for ex ante control...intergovernmental cooperation is essential
- Incentives are inevitable, the choice is to rely on implicit (ex. Kostra system in Norway) or explicit (ex. Italy) incentives to achieve objectives
- Indicator systems should be seen in a dynamic and collaborative context

Conclusions

- **The constitutional framework of government in a country – federal or unitary – has little impact on the governance of sub national fiscal autonomy**
- **Reforming multi level governance is a complex process with institutional inertia and political economy aspects**
- **The OECD Network on fiscal relations across levels of government can help in building statistical information and identifying pros and cons of various arrangements, instead of providing "optimal" (normative) solutions.**

10

OECD-ASIA SENIOR BUDGET OFFICIALS - 5th MEETING
Bangkok, 10-11 January 2008

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