

## COMMENTS BY T. TER-MINASSIAN ON PROFESSOR R. GORDON PRESENTATION

I am pleased to be able to attend this Workshop of the Growth Commission on Fiscal and Monetary Policies, and in particular to discuss Prof. Roger Gordon's interesting presentation, aptly titled: It's Mostly Fiscal (which of course stands for IMF .....). I am especially glad to do so because Prof. Gordon's provocative key messages have forced me to stand back and reflect on some strategic issues of tax policy and institutional reforms, and on the advice that the Fiscal Affairs Department provides on them.

Let me begin by saying that I certainly agree with Prof. Gordon that **economic development poses challenges, as well as opportunities, for revenue mobilization**. I also agree that revenue mobilization is needed to finance in a fiscally sustainable manner efficient and growth-enhancing public spending on social programs and infrastructure. None more than the IMF is conscious of the risks of inflationary financing, excessive public debt accumulation, or even excessive dependence on foreign aid. This is why the Fund devotes substantial resources, in its surveillance and technical assistance, to promoting as efficient and equitable as possible revenue mobilization, especially in developing countries.

That said, I have a number of **disagreements with Prof. Gordon's analysis and prescriptions**.

- First of all, **I think this analysis is perhaps unduly influenced by the experiences of China and India**, two continental-size countries, which have undergone over the last twenty or so years a fundamental transformation, from mostly closed, tightly-controlled (indeed a command-type in China) to more open and market-based economies. The reality is that nowadays most developing countries already have largely market-based economies; are increasingly integrated, through trade and financial links, into the world economy; and are undergoing (albeit at a different speed) sectoral diversification. Thus, the experiences of China and India in terms of the impact of economic reforms on revenue performance are of limited relevance to such countries.

- Moreover, **there is no consistent empirical evidence that the implementation of market-oriented reforms has led to a collapse, or even a sustained decline, in revenue ratios worldwide.** Indeed, data collected by FAD staff suggests that such ratios have increased significantly in many lower-income and emerging markets in Latin America, as well as in the lower-middle income countries in Sub-Saharan Africa (even when resource revenues are excluded) over the last decade, when these economies have become more market-oriented and more open.
- It is true that in many countries, **revenues from customs tariffs** have already declined as a result of trade liberalization, and, in some countries, **revenues from corporate taxes** have been pressured by rate cuts, or by erosion of the base through competition for FDIs. But, the evidence mentioned above suggests that **total revenues** have been supported by a combination of tax policy reforms; improvement in tax administration; and the beneficial impact of the reforms of economic growth. In what follows, I will elaborate briefly on each of these points.
- Prof. Gordon's presentation largely ignores the important role that the **adoption of VATs** around the world has played in sustaining or raising revenues in the face of trade integration. To be sure, many countries are still not tapping the full VAT potential, due to weak design features of their taxes (too many rates; too many exemptions; inadequate credit or refund systems; and administrative weaknesses facilitating fraud). Nevertheless, empirical work in FAD suggests that VATs have proven very effective money-making machines for governments around the world (including in LICs), and could become more so, with the right policy reforms. In this context, I would also note that VATs help address the problem of informality in developing countries, to which Prof Gordon rightly calls attention, since informal businesses at least pay the tax on the inputs imported or purchased from VAT-compliant firms.
- Moreover, as countries move up the development ladder, and in many cases well before the \$10,000 per capita income is reached, **there is some scope to increase**

- revenue mobilization through the personal income tax (PIT)**, by reforms aimed at streamlining the rate structure; reducing exemptions thresholds, as well as deductions; and perhaps by moving towards a dual income tax model. FAD has been closely involved in advising some lower-middle income countries in revenue-enhancing reforms of their PIT in recent years.
- Prof. Gordon also seems to ignore the important role that **tax and customs administration reforms** can play, and indeed have played, in supporting revenue mobilization, as well as addressing wider governance issues, in developing countries. This is certainly true in a number of emerging markets (Brazil, India, Indonesia, as well as China, to mention just a few), but also in several LICs (Ghana, Tanzania, Bolivia, and more recently Guatemala come to mind). I would note here in particular that the focus of FAD's advice on tax administration reforms has evolved in the more recent years from the implementation of large taxpayer units, to the facilitation and control of voluntary compliance by small and medium enterprises, reflecting the changing structure of economies, and in particular the growing importance of the services sector.
  - In summary, I agree with Prof. Gordon that the **appropriate pace of market-oriented economic reforms** is inevitably country-specific, reflecting the economic, political and institutional realities of each country. However, I do not believe that such pace should be significantly slowed down, or even more that such reforms should be halted half way to preserve captive revenue bases. Instead, the focus of policy makers (and of their international partners, donors and TA providers) should be on identifying and implementing the tax policy and institutional reforms that can best assist developing countries in realizing the revenue payoff of market-oriented growth and development.

Thank you

