Tax **INCENTIVES**

A Burden On Public Finances

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INTRODUCTION

The recent coronavirus crisis has put public finances at the forefront of popular discourse. Though most of the discussions revolve around the resources allocated to health sector, the scarcity of public funds can equally be felt across all sectors. Through this, it is important to find out whether this scarcity in resources is an inevitability of our current economic context, or merely an outcome of decades of harmful public policies.

This paper aims to dissect one aspect of public finances: tax expenditure. It evaluates whether policy-makers are making adequate use of this tool to encourage inclusive growth and increase public funds, or a burden on tax payers and a waste of public resources.

Tax incentives or tax expenditures are essentially preferential treatments afforded to entities by the state in matters of tax and fiscal responsibility, usually to encourage a certain economic or social behavior. Because these tax incentives are associated with lower tax rates or postponed tax collection, they lead to a loss of revenue for the government, which is why they are considered indirect public spending, hence the name tax expenditure. They come in different forms and can target different actors. In Tunisia, almost all tax incentives are directed towards businesses, not people. The types of incentives include:

- Exonerations: a total suppression of taxation, usually limited in time.
- Reduced tax rates: companies might benefit from a lower corporate income tax rate than the general one, which in Tunisia, stands at 25%.
- Exemptions: companies are not subject to specific taxes.
- Deductions: amount that companies can deduct from their taxable base.
- Credits: amount that tax payers can deduct from their tax due.

This public policy tool is rather popular among law-makers who use it to accomplish diverse objectives.

For instance, incentives given to the agricultural sector are considered necessary for Tunisia to achieve self-sufficiency in terms of food[1]. Other incentives relate to encouraging renewable energy to promote a healthier, safer environment for citizens and future generations. Others still aim are incentives for investors that supposedly aim at addressing crucial issues such as unemployment through encouraging job creation by offering tax incentives to investors. They can also be given for social reasons such as narrowing down economic inequalities, as is the case for the incentives given to encourage regional development in under-privileged areas, or the exonerations offered to new companies set up by young college-graduates.

All these objectives fit well with the successive governments' vision of Tunisia's future. Nonetheless, it remains a question, whether these policies have achieved their announced objectives, considering their cost to the taxpayer.

One perceived advantage is that tax incentives can be used to encourage actors to follow a certain behavior while minimizing public administrative costs, especially when compared with financial incentives[2]. In terms of implementation, tax incentives are cheaper than other types of incentives such as financial incentives. For the latter, the administration has to assess the company soliciting the incentiv e, the requested amount, and annually renew it. It also involves the redundancy of first collecting tax revenue then giving it back to the taxpayers after going through all the aforementioned procedures. However, for tax expenditures, one-time processing of the incentive is enough for that company to benefit from it for whatever period the incentive is valid for. At least theoretically, this allows the state to accomplish specific objectives with minimal costs, e.g.

[1] Chebbi, Houssem Eddine, J-P. Pellissier, W. Khechimi, and J-P. Rolland. "Rapport de synthèse sur l'agriculture en Tunisie." (2019). P 10
[2] International Budget Partnership, Guide to Transparency in Public Finances Looking Beyond the Core Budget: Tax Expenditure, Page 5

changing behavior and encouraging investment in a certain sector that is emerging, in difficulty, or that is seen as critical to the Tunisian economy.

In Tunisia, this policy tool dates back to well before the country's independence. In September 1946 for example, an incentive was passed through decree to exonerate capital gains coming from concessions from tax[3]. Since then, this tool was increasingly used to guide economic behavior. The number of fiscal incentive measures rose steadily through the 60s and 70s, notably with the passing of the law 72[4]. This law was aimed at inciting foreign direct investment by exonerating them from corporate tax and was supposed to be slowly rolled back as investors entered and settled in Tunisia. Except that over 45 years, it was rarely reviewed.

Tax incentives increased dramatically during the 1980s as Tunisia enrolled in Structural Adjustment Programs (SAP), notably the one of 1986, led by international financial institutions, Tunisia constructed its 1993 Investment Code that solidified and fortified incentives within the Tunisian fiscal system, specifically those intended to promote investment. The new Investment Code adopted by the Tunisian parliament in 2016 continues in the same vein as its predecessor, by using tax incentives as the preferred method for attracting investment to achieve such goals as regional development, promoting exports, helping agricultural development, job creation, etc.

In all of the decades of their use in Tunisia, tax incentives have never been re-evaluated. This is a dangerous oversight, especially considering that their impact on investment is unclear and their cost in terms of lost revenue for the state, as will be demonstrate, is quite significant.

This lapse led to the passing of a particular article in the new Ordinary Budget Law[5](Article 46) that obliges the government to prepare a yearly report on the cost of these measures and to annex it to the yearly Finance law. This report was further detailed in Article 18 of the recent law on reviewing tax incentives (Law 2017-8) that explicitly states that this report should include a cost benefit analysis of these expenditures and that it should be made available to the public through the website of the Finance Ministry. Additionally, the article requires that the report present the method used in the calculations, the loss of revenue for the state analyzed by economic sector, governorate, and delegation, the number of jobs created, revenue from exports coming from companies benefitting from tax incentives, as well as the state of business continuity within these companies.[6]

This paper comes to support the elaboration of this report by evaluating the current situation of tax incentives in Tunisia and discussing whether or not the measures taken recently to increase their transparency and accountability are enough and what they should include.

To achieve this, the paper will first offer an overview on the cost of tax expenditures. Second, it will look into their efficiency and whether or not they reach their declared objectives and at what cost. The paper will then discuss how they fit into the scope of fiscal justice and the vision of an inclusive economy, especially in light of the Sustainable Development Goals[7], and finally, evaluating the accountability and transparency measures that surround this fiscal policy.

[3] Pro Fiscal, Avantages Fiscaux, April 2002, http://www.profiscal.com/Etudiants/Avantages_fiscaux/afci.pdf
[4] Loi 72-38 sur la création d'un régime particulier pour les industries exportatrices
[5] Law n° 2019-15 dated 13 February 2019, relating to the budget
[6] Law n° 2017-8 dated 14 February 2017, relating to the revision of the system of tax advantages
[7] Especially in relations to Goal 8 "Decent Work and Economic Growth" and Goal 10 "Reduce inequalities within and among countries"

COST OF INCENTIVES

Tax expenditures in Tunisia represent the vast majority of incentives offered for companies (Figure 1). In 2011, Tax expenditure cost the state over 1115 million dinars. In 2003, 80% of the public aid to investment afforded to the private sector came from fiscal incentives. In 2009, that number has jumped to 92%. This proves that tax incentives are a Tunisian legislator's favorite tool to encourage investment and economic prosperity.

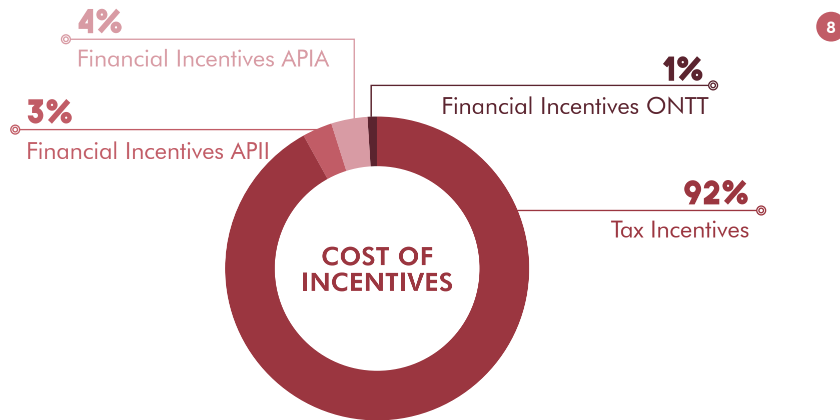

Figure 1: Tax incentives as % of all incentives aimed at companies (World Bank)[9]

Despite or because of their popularity with legislators, fiscal expenditures are found to have drained public money throughout the years. Between 1994 and 2003 alone, fiscal expenditures more than doubled with an increase of 153%.[10]
It has continued its rise, peaking at 1573 million dinars in 2008 (Figure 2). Between the years 2003 and 2011, in less than a decade, their cost has tripled in volume. These are considered astronomical costs on the state budget, especially when looking at Tunisia's current budget deficit.

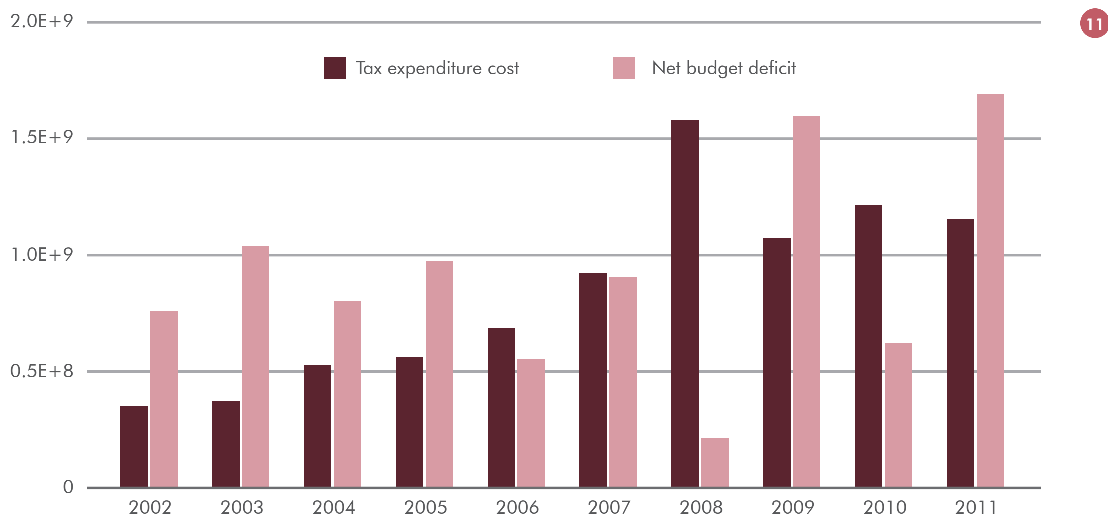

Figure 2 : Tax expenditure cost Vs. The budget deficit (Author)

[8] APII : Agency for the Promotion of Industry and Innovation, APAI: Agricultural Investment Promotion Agency, ONTT: Office National du Tourisme Tunisien

[9] World Bank. 2014. The unfinished revolution : bringing opportunity, good jobs and greater wealth to all Tunisians (English). Washington, DC : World Bank Group. Page 143

[10] L'institut d'économie quantitative, LE SYSTEME D'INCITATION AUX INVESTISSEMENTS EN TUNISIE, MARS 2008, Page 15

[11] AMINE BOUZAÏENE. "Les avantages fiscaux une perte de revenu pour un bénéfice incertain" Observatoire Tunisien de l'Economie, 2019

Despite or because of the high cost of tax incentives landed Tunisia at the top of the ranking in terms of countries that spend the most on tax expenditures, ranking 20th internationally (Figure 3). This high cost comes with very serious consequences that will be addressed throughout the report.

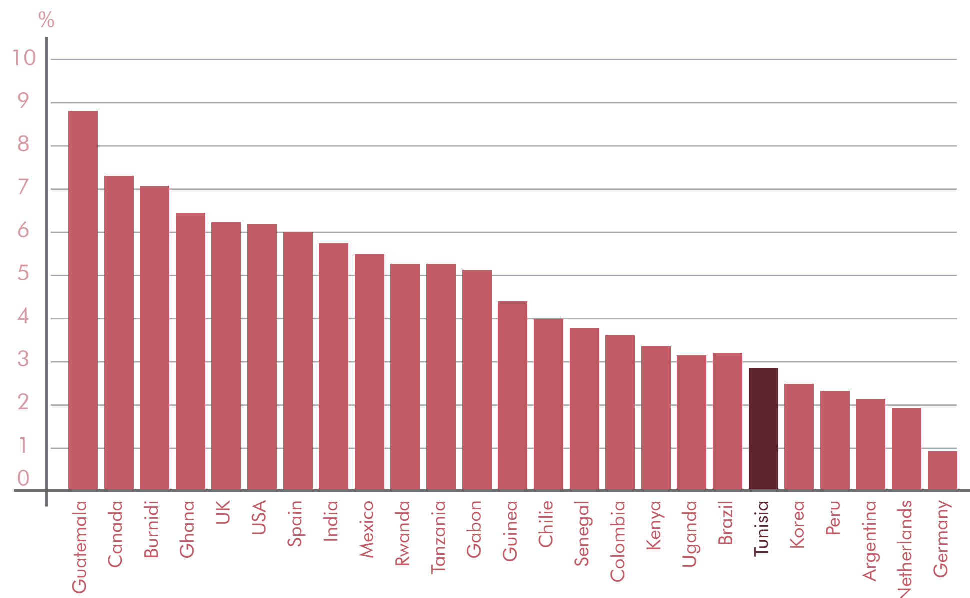

Figure 3 : Cost of tax expenditure per country (World Bank)

The cost of tax incentives represents a considerable chunk of revenue that is being lost every year. As can be seen by figure 4, this cost averages around 1.6% of Tunisia's GDP, with a peak 2.85% in 2008. To put that into perspective, that year, the Tunisian government spent 1.57% of its GDP on higher education, putting fiscal expenditure to be nearly twice as expensive as tertiary education. It also puts it at 3 times more than the budget of the Ministry of Agriculture and 19.5 times higher than the budget of the Health Ministry of that same year.

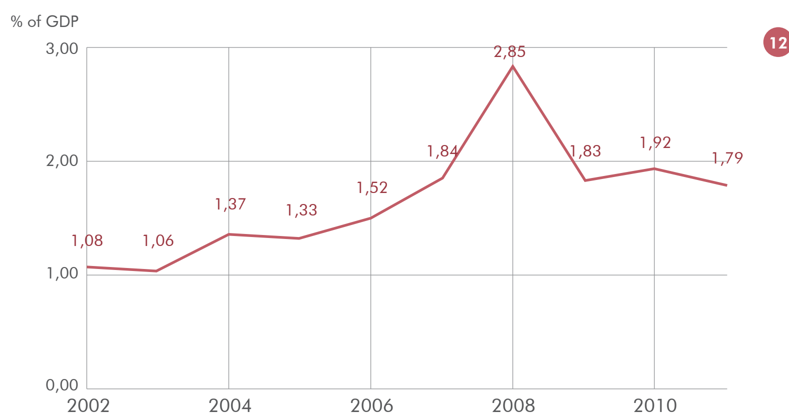

Figure 4 : The cost of tax expenditure as % of GDP (Author)

[12] Calculations based on Amine Bouzaïene. "Les avantages fiscaux une perte de revenu pour un bénéfice incertain", and World Bank Database

Other estimates put the average of the cost of tax expenditure even higher, at 2.14% of the GDP between 1997 and 2007.[13]
In terms of national budget, tax expenditures represent on average 5.9% of the annual budget. The cost is very elevated, especially considering that, for example, the budget of the Health Ministry for 2019 is 5% of the state budget -excluding grants (Figure5).

Figure 5 : Tax expenditure as % of the public budget excluding grants (Author)

In terms of state revenue, studies found that, tax expenditures represented on average about 70% of all fiscal revenue coming from corporate tax.[14] This is a significant amount of revenue that the state could have collected and used to better balance its accounts better and reduce the budget deficit. Instead, it has opted not to collect it and to allow companies to have it in order to accomplish other objectives.

The export business is by far the biggest winner in terms of tax incentives with 83% of tax expenditure (Figure 6). Among exporting businesses, the offshore is the largest beneficiary of Tunisian tax incentives.[15] Regional development benefits from only 2.7% of tax expenditure, whereas agriculture benefits from 1.3%.

[13] Kamel Ghazouani (2011), Evaluation of Investment Incentives, Tunisian Center for Economic Studies.
[14] AMINE BOUZAÏENE. "Les avantages fiscaux une perte de revenu pour un bénéfice incertain" Observatoire Tunisien de l'Economie, 2019
[15] OECD, Analysis of the Tunisian Tax Incentives Regime, March 2013, OECD, Paris, France, Page 13

TYPE OF INCENTIVE	DEDUCTIONS (annual average 2008-2011 in TND million)	%	CUMULATIVE %
Totally exporter (Corporate tax deduction)	826.8	67.0%	67.0%
Export (Deduction from the activity)	97.4	7.9%	74.9%
Partial exporter (Corporate tax deduction)	87.2	7.1%	82.0%
Public incentives (Firm's capital deduction)	25.9	2.1%	84.1%
Priority regional development (first 10 years) (Corporate tax deduction)	24.5	2.0%	86.1%
Revenues and profits in places funds priming	21.4	1.7%	87.8%
Priority Regional development (first 10 years) (Subscription)	17.0	1.4%	89.2%
Regional development (Zone 1) (Firm's capital deduction)	16.5	1.3%	90.5%
Development of agriculture or fishing (Corporate tax deduction)	15.8	1.3%	91.8%
Reinvest SICAR, or placement of capital risk funds (75 percent free)	11.8	1.0%	92.7%
Investment support (Firm's capital deduction)	11.7	1.0%	93.7%
Economic 'free zones' (Corporate tax deduction)	11.1	0.9%	94.6%

[16]

Figure 6 : Beneficiaries of tax expenditure (World Bank)

LESS REVENUE FOR THE STATE

By their very nature, tax incentives lead to less public revenue. By imposing lesser rates for companies and businesses (or totally exonerating them), the state deprives itself from revenue that it could have gotten otherwise. This is why tax incentives are categorized as indirect expenditures.

This loss of revenue negatively affects the state's capacity to achieve the objectives it set for itself (such as better healthcare, education, etc) by reducing the resources at its disposal. It also posed other problems in terms of equity and fiscal justice that will be addressed later on.

COSTING MORE THAN IS INITIALLY EXPECTED

Tax incentives, unlike direct expenditures such as financial incentives, are not capped and can run a limitless cost. Therefore, it is essential, when designing them, to provide their estimated cost for the sake of transparency towards tax-payers.

The problem with estimating incentives cost arises from their complexity. First, it is important to identify all the tax incentives that the system offers. Then, it is necessary to look for the baseline of taxation that should have been implemented in the absence of tax incentives. Next comes the identification of the potential beneficiaries so that the government could estimate how much revenue it stands to lose.

In doing so, the state will have to base its calculations, not only on current patterns, but also to take into account any changes in behaviors and the decision-making processes that might result from the tax incentive. This is a very difficult task especially when the tax administration that is under-staffed, overworked, and lacks the appropriate resources to undertake an endeavor. Such a difficult and cumbersome task is also experienced in countries with more developed tax administration as actual tax expenditures are often underestimated.[17] Thus, an annual review becomes a must.

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[16] World Bank. 2014. The unfinished revolution : bringing opportunity, good jobs and greater wealth to all Tunisians (English). Washington, DC : World Bank Group. Page 144

[17] Kalyva, Athena, Caterina Astarita, Lovise Bauger, Serena Fatica, Gilles Mourre, and Florian Wöhlbier. "Tax expenditures in direct taxation in EU Member States." European Economy, Occasional Papers 207 (2014). Page 38-39

For instance, in the United States, Arizona state passed a tax credit for vehicles running on alternative fuels in the year 2000 and estimated that the policy would cost between USD 3 and 10 million a year. However, in the first year alone, the tax incentive cost the state USD 680 million, 70 times more than the estimated cost.[18] It shows how tax expenditure, unlike direct expenditure, can be uncontrollable and go severely over budget.

In Tunisia, the elevated cost causes the spending per benefit to also be very elevated, making the investment more costly than the problem itself. Upon examining one of the major reasons for offering tax incentives, job creation, the results of tax incentives are found to be very limited, leading to a high cost per job created. In 2012, the World Bank estimated that the cost of incentives per job created is 6362 Tunisian Dinars annually in the companies benefitting from tax incentives.[19]

This cost increases even further when we take into account that companies benefitting from tax incentives would have invested regardless of the existence of these advantages. Looking only at the jobs created by investments that were motivated primarily by tax incentives (marginal investment), that cost per job increases to 12 000 Tunisian Dinars annually.[20]

But, with such a high cost to the state and tax payers, it is important to examine the efficiency of these incentives and whether they reach the objectives they set out to achieve.

[18] Levitis, Jason, Nicholas Johnson, and Jeremy Koulish. Promoting state budget accountability through tax expenditure reporting. Washington, DC: Center on Budget and Policy Priorities, 2009.PAGE 6
[19] World Bank. 2014. The unfinished revolution : bringing opportunity, good jobs and greater wealth to all Tunisians (English). Washington, DC : World Bank Group, Page 153
[20] Ibid.

In this context, efficiency refers to the cost-benefit analysis of this tax policy. As the cost analysis demonstrates, incentives are expensive and weigh heavily on the state budget. Their benefits are questionable and heavily depend on the type of the incentive, the sector it aims to target, as well as the national economic context. This puts their efficiency and design into question. Analyzing them can help us solve many problems within this system which will, in turn, save the government substantial amounts of spending.

The example of France can, perhaps, explain the importance of a cost-benefit analysis. In 2011, the French Financial Inspection Office looked at 538 tax incentives with a total estimated cost of nearly 104 Billion Euros. It concluded that half of them are inefficient[21], meaning that their cost outweighs their public benefits. This is a significant amount of revenue that France is depriving itself from. What of Tunisia?

The next section looks at the efficiency of tax expenditures in Tunisia and how they might affect public spending, and whether or not they can be considered a good investment.

MORE FRAUD

Tax incentives complicate an already complex tax system. The increase in complexity leads to more loopholes and opportunities for tax evasion and fraud, which stands to cost the state even more revenue.

Fraud resulting from tax incentives is difficult to identify, and becomes even harder to prevent when taken into account the lack of human and material resources that the tax administration suffers from and that prevents it from effectively and efficiently detecting, investigating, and prosecuting tax fraud.

Incentives can be used to evade taxes through round-tripping investments. This type of fraud is usually linked to incentives aimed at encouraging Foreign Direct Investment (FDI). Round-tripping is a process by which local investors send their money overseas, and then reintroduce it to the local market, through shell companies or other means, as FDI. This is mainly done to take advantage of tax incentives which are offered exclusively for foreign investment.[22]

Another possible abuse to the tax incentives system is through advantages targeting regional development. Thus, companies buy or build an office in a disadvantaged area that offers such incentives and register them as being based off that office. That office works more as “ghost headquarters” and the real headquarters works out of some privileged area.

An example can be found in India where the government offers area-based exceptions to companies working out of under-privileged areas in the hope of encouraging local investment in regions such as Jammu and Kashmir. Investigations found that some companies had set up front offices in these areas, thus allowing them to benefit from incentives. Meanwhile, their real activities happened elsewhere. “Revenue losses in just two cases were equal to 4 percent of the spending on this incentive.”[23]

Incentives can also be taken advantage of through transfer pricing. This happens when two companies belonging to the same entity are exchanging goods or services. Even if they are owned by the same entity, the two companies must register the transition between them as goods or services bought and sold, and thus must issue a price for them. However, since they are owned by the same person or group, they will not use the market price, but rather whatever price works best for the interest of the owner entity.

[21] Marie Visot, « Les niches fiscales et sociales inefficaces pointée du doigt », Le Figaro, 29 aout 2011

[22] Stausholm, Saila N. 2017. “Rise of Ineffective Incentives: New Empirical Evidence on Tax Holidays in Developing Countries.” SocArXiv. December 14.

[23] James, Sebastian. “Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications.” FIAS, The World Bank Group, 2009. Page 30

For example, let us assume that there is a transfer between a company that does not benefit from a tax exemption (Company A) and a company that does benefit from them (Company B for benefits). The two companies are owned by the same entity. If company B is selling a service to company A, it may charge company A a price far superior to the prevailing market price. This way, company A will be transferring much of its profit to company B through this transaction. Company A will present a decreased bottom line in its annual financial report (and might even come out with a deficit rather than a profit) and will pay less in taxes. Meanwhile, company B will report higher profits. However, thanks to the incentives, these profits will be tax-exempt. The owner of these companies will be able to evade paying corporate income tax on both businesses.

Going back to India, it was found that usually "when companies had two units, one of which benefited from tax incentives while the other did not, the profits of the unit that did not benefit were often much lower than the profits of the unit that did"[24], proving the strong likelihood of the existence of tax evasion through incentives manipulation.

Another type of fraud can occur in incentives with an expiration date. Companies may close down the business and reopen under a different name and continue to do so whenever incentives are about to run out, so that they might benefit from them indefinitely. Anecdotal evidence seems to point that this is a rather popular type of fraud in Tunisia which is why the law on reviewing tax incentives specifically asks for a business continuity analysis of the beneficiaries.

AFFECTING THE PRIORITIZING OF PUBLIC FUNDS

Tax expenditures are automatically renewed each year and do not have a cap on their costs. The automatic renewal of spending associated with tax incentives puts their cost directly above any other expenditure, giving them a higher priority over any spending. Additionally, with the cost not being capped, tax expenditures spending can easily exceed the cost spent on vital sectors. The hidden prioritization conflicts with the declared objectives of the Tunisian governments.

BECOMING OUTDATED

Tax expenditures are usually targeted towards specific sectors such as agriculture, the fossil fuel industry, renewable energy, etc. The choice of the affected sector depends heavily on the economic context of a country at the time when the tax incentive is being passed. However, that context changes over time, and might make the tax incentive no longer necessary. For instance, the targeted sector might not seem so vital for the overall health of the economy or might not be providing as many jobs as it once did. Yet, because tax incentives are not periodically reviewed, that industry will still be benefiting from public funds.

In the United States for example, the state of Georgia passed an incentive exempting the videotape rental industry from sales tax in 1989 (back when that industry was flourishing). Because this incentive was not questioned since, it now costs the state more than 4 million dollars annually despite the industry no longer being detrimental to the state's economy.[25] This poses the question of how many industries in Tunisia still benefit from outdated incentives?

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[24] Ibid.
[25] Levitis, Jason, Nicholas Johnson, and Jeremy Koulish. Promoting state budget accountability through tax expenditure reporting. Washington, DC: Center on Budget and Policy Priorities, 2009.PAGE 8

OVERLAPPING OR CONFLICTING WITH OTHER TAX INCENTIVES AND WITH DIRECT EXPENDITURE

Many sectors such as agriculture, tourism, and companies operating out of disadvantages regions benefit more from public funds through both tax incentives, but also financial aid. The renewable energy sector, for example, benefits from both tax incentives in the form of exemptions for new companies entering the market, as well as financial aid related to investment expenses, such as material investments in new technologies, research and development investments, etc..[26]

Taxpayers find themselves supporting these companies through both direct and indirect expenditure, making it extremely difficult to evaluate the efficiency of these public policies. It is crucial to study whether any growth in these sectors can be attributed to fiscal incentives which are easier to administer or to financial incentives because they are easier to track and cap, or perhaps the solution lies in some kind of combination.

Aside from overlapping, tax incentives can also conflict with each other or with other incentives. They can be given to opposing industries thus negating any advantage given to one industry over the other, and presenting conflicting objectives. Perhaps the best example would be the incentives that the Tunisian legislator offers to the oil industry[27]. The advantages not only conflict with those given to the renewable energy industries[28] but also with the government's declared goals of a healthier less polluted environment.

ENCOURAGING WEAK INVESTMENTS

Incentives for investment, specifically in equipment might create distortion in assets within companies. Meaning that companies might over-invests in assets targeted by incentives such as production machinery, but might under-invests in other vital assets such as building and maintenance. This creates unhealthy investments in companies. In Thailand, for instance, studies have found that "firms that benefited from incentives had weaker financial ratios than those that did not."[29]

Incentives related to equipment are also exclusionist to small companies that do not yet have the capital to invest in new equipment. The benefits from these measures are disproportionally affected to medium to large companies.

Though, it should be noted that incentives related to equipment might be better than other kinds of incentives, especially in developing countries like Tunisia, as it not only ties the incentives to actual concrete local investment but it also introduces workers to a diverse set of equipment that allows them to learn new skills, and thus provide positive externalities.[30]

ENCOURAGING INVESTMENT WITH FEW BENEFITS

As can be seen by Figure 7, most incentive benefits are accorded to the mining and energy sectors (collectively 27.73%), followed by the textile sector (6.08%), then banking with 5.28%. An analysis into these sectors' responsiveness to tax incentives shows that the sectors are rather indifferent to this policy tools.

[26] Cabinet Zahaf & Associés, Résumé des avantages, primes et incitations octroyés dans le cadre de la nouvelle réglementation d'investissement en Tunisie, 2018, Crowe Horwath, PAGE 9
[27] Abdelkarim Ketata, La fiscalité des entreprises pétrolières en Tunise, 2010
[28] Cabinet Zahaf & Associés, Résumé des avantages, primes et incitations octroyés dans le cadre de la nouvelle réglementation d'investissement en Tunisie, 2018, Crowe Horwath, PAGE 4
[29] James, Sebastian. "Tax and non-tax incentives and investments: evidence and policy implications." FIAS, The World Bank Group (2009). PAGE 6
[30] Ibid.

The mining and energy sectors, for instance, are rather capital heavy sectors linked more to available local resources than tax incentives. Investors will invest where the raw material is located regardless of possible incentives[31]. As for the textile industry, it offers little in terms of technology or knowledge transfer and requires mostly low-skilled labor and usually offers low wages.[32] These types of investments are not the ones that Tunisia should aim to attract and not the ones which will offer us substantial positive externalities.

PRIMARY ACTIVITY CODE	ACTIVITY LABEL	DEDUCTIONS (annual average 2008-2011 in TND million)	%	CUMULATIVE % [33]
5101	Miniral extraction and natural fertulizers	259.7	21.04 %	21.04 %
5902	Production and distribution of electricity and gaz	82.6	6.69 %	27.73 %
5404	Textile production	75.0	6.08 %	33.82 %
4501	Banking	65.1	5.28 %	39.09 %
3910	International Trade	59.0	4.78 %	43.87 %
5811	Other eclectronic material production	58.6	4.75 %	48.62 %
6105	Research company	53.3	4.32 %	52.94 %
5401	Clothing inductry	47.4	3.84 %	56.78 %
6401	IT services	29.9	2.42 %	59.20 %
6312	Consultant	28.4	2.30 %	61.50 %
5703	Metal construction	20.5	1.66 %	63.16 %
5203	Climent, lime, and plaster production	15.5	1.23 %	64.39 %
6403	Call Center	14.5	11.8 %	65.56 %

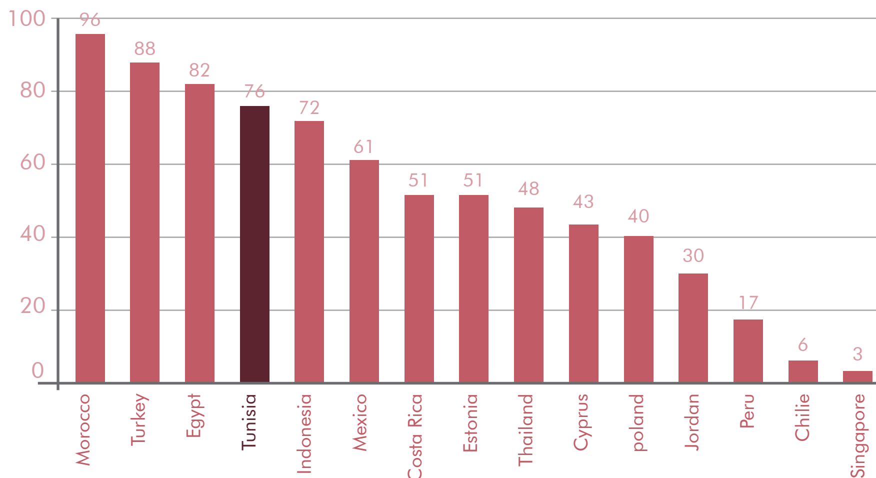
Figure 7 : Sector breakdown of tax expenditure (World Bank)

FAILURE TO ATTRACT INVESTMENT

The priorities of investors in developing countries are not the same as those in developed countries, seeing as the investment climate in these two regions differs greatly. In developing countries, studies have shown that tax incentives do not make up for the other factors that constitute a poor investment climate[34]. Investors prioritize other factors such as the low cost of labor, adequate infrastructure, transparent and non-corrupt administration, etc.[35]. In terms of taxes, before looking for tax incentives, investors request a tax code that is easy to find and navigate, and ted to dislike ones that are scattered across multiple codes, laws, and decrees as is the case in Tunisia.[36]

Knowing this, it comes as no surprise that in the 2011 United Nations Conference on Trade and Development (CNUCED) FDI attraction index, Tunisia ranked 76th out of 181 countries. (Figure 8)

[31] Chafik Ben Rouine, Bilan des incitations aux investissements en Tunisie, Observatoire Tunisien de l'Economie, May 2014, Page 3
[32] World Bank. 2014. The unfinished revolution : bringing opportunity, good jobs and greater wealth to all Tunisians (English). Washington, DC : World Bank Group Page 148
[33] Chafik Ben Rouine, Bilan des incitations aux investissements en Tunisie, Observatoire Tunisien de l'Economie, May 2014, Page 3
[34] Mustapha Ndajiwo. "Are Tax Incentives in Nigeria Attracting Investment or Giving Away Revenue?" Council on Economic Policies, August 16, 2018.
[35] Ibid.
[36] On its web page regarding tax incentives, the Finance Ministry makes reference to 30 different laws, 7 decrees, and one order



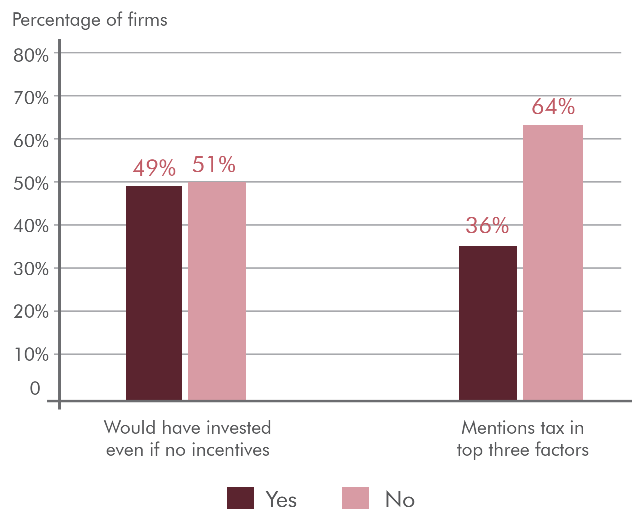
[37]

Source:
UNCTAD (2012)

Note: The Inward FDI Attraction Index ranking (out of 181 countries) is based on the average of a country's percentile rankings in FDI inflows and in FDI inflows as a share of GDP.

Figure 8 : Ranking based on the FDI Attraction Index (World Bank)

This leads to the overwhelming majority of investments in Tunisia being redundant (Figure 9), meaning that it would have happened with or without tax incentives, consequently making the revenue lost through them without cause or purpose. Especially with regards to FDI (which is the primary argument raised in Tunisia), studies have shown that "the effect of tax holidays on FDI is negligible and decreasing, and importantly, that it does not translate into neither real capital accumulation nor economic growth"[38]In fact, the World Bank estimated the redundancy rate of investments in Tunisia to be around 79%[39].



[40]

Figure 9 : The importance of tax expenditure to companies (World bank)

[37] World Bank. 2014. The unfinished revolution : bringing opportunity, good jobs and greater wealth to all Tunisians (English). Washington, DC : World Bank Group Page 135

[38] Stausholm, Saila N. 2017. "Rise of Ineffective Incentives: New Empirical Evidence on Tax Holidays in Developing Countries." SocArXiv. December 14. Page 1

[39] World Bank. 2014. The unfinished revolution : bringing opportunity, good jobs and greater wealth to all Tunisians (English). Washington, DC : World Bank Group Page 151.

[40] Ibid 142

FDI INCENTIVES ARE DETRIMENTAL TO DEVELOPMENT

Other studies show that not only are tax incentives useless in terms of attracting investment, but also that when they do work, the type of investment that they attract is detrimental to the sustainable development of the country's economy[41].

FDIs are encouraged by most international finance institutions because of the many advantages it would theoretically offer to developing countries such as Tunisia. Benefits include transfer of knowledge, transfer of technology, the accumulation of capital, etc.[42] However, even these benefits are highly controversial. Some studies found no direct correlation between FDI and economic growth[43]. Additionally, the drawbacks of foreign direct investments can severely damage the local economy. Tax incentives aimed at attracting FDI negatively affects the local market and creates distortions and unfairly favors foreign investment over local ones [44].

The uneven playing field between local and foreign investment leads the Tunisian investors to be less inclined to invest their money in sectors targeted by FDI because they simply cannot compete with companies that have such a large tax write-off. This reluctance to invest severely impacts the local business climate and inhibits the growth of local markets. It also encourages local investors to commit fiscal fraud and round-trip their investment, so that they may benefit from tax incentives given to FDI.

Another concern regarding FDI comes from its environmental impact. In Tunisia, foreign direct investment is found to not be "clean", meaning that it was bad for the environment. In fact, a study found a strong causality between FDI in Tunisia and CO2 emissions[45], further proving the conflict between the tax fiscal incentives giving to environmentally-friendly technology such as renewable energy and other incentives

Opponents of incentives also point out that the kind of FDIs attracted by incentives in Tunisia are of low-quality. These types of foreign direct investments are usually of low value added to the economy[46] and do not offer many positive externalities. In fact, "projects that are aimed at specific skills, resources or market characteristics are less responsive to tax policies than efficiency-seeking FDI projects, which are usually of the more footloose, export-oriented kind with fewer potential spillover effects"[47] This means that FDI that are primarily motivated by incentives are not going to provide much benefits in terms of knowledge transfer or introducing new, cutting-edge technology to Tunisian workers and markets.

Another concern regarding FDI that rely on incentives stems from their unreliability and high mobility. We suppose that two countries (A and B) have similar investment climates. If country A decides to offer FDI incentives in the form of a 10% reduction on corporate income tax, the company will go to country A. If after two years, country B, in an effort to compete with country A and attract FDIs, decides to give it a tax exoneration, the company will simply close up shop in country A and set up its operation in country B. The workers of the company in country A will suddenly find themselves without jobs and the country would have wasted tax revenue to support an investment that is no longer there.

[41] Ibid.
[42] Nonnemberg, Marcelo Braga, and Mario Jorge Cardoso de Mendonça. "The determinants of foreign direct investment in developing countries." In Anais do XXXII Encontro Nacional de Economia, 2004. Page 7
[43] Belloumi, Mounir. "The relationship between trade, FDI and economic growth in Tunisia: An application of the autoregressive distributed lag model." Economic systems 38, no. 2 (2014): 269-287.
[44] World Bank. 2014. The unfinished revolution : bringing opportunity, good jobs and greater wealth to all Tunisians (English). Washington, DC : World Bank Group
[45] Abdelaziz Hakimi, Helmi Hamdi,Trade liberalization, FDI inflows, environmental quality and economic growth: A comparative analysis between Tunisia and Morocco, Renewable and Sustainable Energy Reviews, Volume 58, 2016, Pages 1445-1456,
[46] World Bank. 2014. The unfinished revolution : bringing opportunity, good jobs and greater wealth to all Tunisians (English). Washington, DC : World Bank Group
[47] Stausholm, Saila N. 2017. "Rise of Ineffective Incentives: New Empirical Evidence on Tax Holidays in Developing Countries." SocArXiv. December 14. Page3

As can be seen by Figure 10 the main reason that investors choose to invest in Tunisia are low wag. These factors are easily duplicated by other countries (such as other Maghreb countries). Nationally, this kind of investment is found to be highly mobile, unreliable, and precarious.[48] Internationally, it triggers a race to the bottom between countries as they lower their tax rates and offer countless incentives in an effort to be competitive.[49]

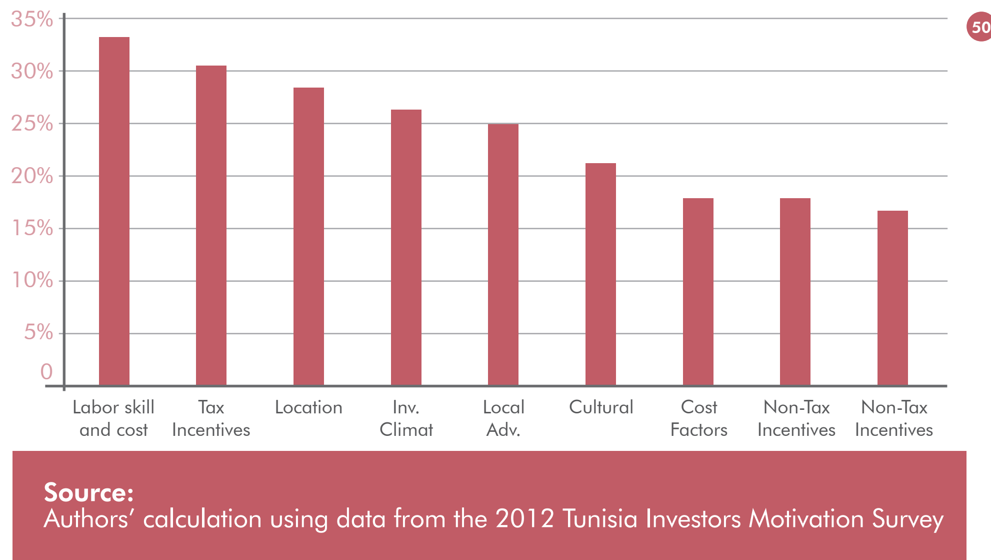


Figure 10 : The importance of the different factors for investors in Tunisia (World Bank)

With this type of FDIs, Tunisia sets itself up to lose significant amount of tax revenues on investments whose effect on growth is uncertain, whose positive externalities are small and insignificant, and whose impact on the environment is decidedly bad.

Instead, to fight this race to the bottom between country that leads to the impoverishment of public services, it is recommended that Tunisian diplomacy opts for advocating for fiscal harmonization with its neighbors and partners to ensure adequate resources for the state, and to oppose tax competition that ultimately harms the public services and further engrains social inequalities in our community, in clear opposition to the tenants of fiscal and social justice and equity.

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[48] World Bank. 2014. The unfinished revolution : bringing opportunity, good jobs and greater wealth to all Tunisians (English). Washington, DC : World Bank Group

[49] Ozay Mehmet & Akbar Tavakoli (2003) DOES FOREIGN DIRECT INVESTMENT CAUSE A RACE TO THE BOTTOM?, Journal of the Asia Pacific Economy, 8:2, 133-156

[50] World Bank. 2014. The unfinished revolution : bringing opportunity, good jobs and greater wealth to all Tunisians (English). Washington, DC : World Bank Group Page 142

Fiscal justice refers to how tax collection and redistribution is used to reduce inequalities and poverty within a collective, and redistribute wealth in a way that evens out access to opportunities for citizens. This concept seems to be severely violated by tax incentives, especially by the unjust and inefficient allocation of resources offered through tax expenditures[51].

This section discusses how tax expenditure further entrenches injustice and inequalities in the fabric of a society that is already inherently unequal.

TYPE OF INCENTIVE	SHARE OF NATIONAL INCOME PRE-TAX (2017)
Bottom 50 percent	17.9%
Upper middle 40 percent	41.3%
Top 10 percent	40.7%

Figure 11- Income Distribution in Tunisia (World Inequality Database)

As can be seen through Figure 11, the Tunisian society is unequal with the top 10 percent having more than twice the income of the bottom half of the population. The top 1% alone has accumulated 10.7% of income before tax.

The drastic inequality is somewhat alleviated through the fiscal system and the redistribution of wealth, be it through tax collection where people with higher incomes are taxed at a higher rate, or through the redistribution system with public goods and services that are available to the population (particularly the poor) free of cost or at very low prices.

UNFAIR DISTRIBUTION OF FISCAL EFFORT

Some tax incentives are harmful to this wealth redistribution system. For one, many of the well-to-do people and companies are exempt from giving back to the system and paying their fair share of taxes. All is done to achieve objectives that they are not even accountable for. To make up for the lack of resources, the state might increase tax rates or widen tax scopes in other sectors. In Tunisia, this usually happens through enlarging the scope and increasing the rate of indirect taxes such as the value added tax and the other consummation taxes. Because of their proportional nature, these taxes often fall heavier on poor households than in wealthy ones.[52]

[51] Inter-American Center of Tax Administrations. Handbook of Best Practices on Tax Expenditure Measurements: - An Iberoamerican Experience. Panamá: Inter-American Center of Tax Administrations, 2011. Page 5
[52] Amine Bouzaiene, LE PROJET DE LOI DE FINANCES 2019: SOUS LES PROJECTEURS DE L'ÉQUITÉ FISCALE, Al Bawsala, April 2019, Page 19

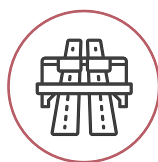
LACK OF FUNDING FOR STRATEGIC SECTORS

The revenues that would have been collected in the absence of tax incentives could have been allocated to support vital sectors such as health, education, infrastructure, etc.

the annual cost of tax expenditure in 2013, Tunisia could have financed

10 regional hospitals

or



500 KM of highways

or

11 000 schools

X6
the transport subsidies of 2019

or

X1.3
the energy subsidies

There is also the issue of traceability of spending in regards to tax expenditures, especially compared to the aforementioned strategic sectors. Allocation for health, education, and other vital sectors and public services would also have been done through direct spending. The latter is significantly easier to monitor and evaluate than indirect spending such as tax incentives, and makes it easier to hold people accountable for the allocation of recourses.

Thus, if invested elsewhere, the tax expenditures could have substantially improved education, health, and infrastructure. Investment in these sectors, unlike tax incentives, has been proven to have a positive cost-benefit outcome and many positive externalities on society as a whole, and vulnerable populations in general, especially in developing countries [53].

Consequently, it is important, before passing incentives, to study them carefully and to see if their objectives cannot be achieved through direct spending which is easier to track and evaluate, and if their cost would not be better invested in strategic sectors.

[53] CEP council on economic policies. "Fiscal Transparency: The Case of Tax Expenditures in Developing Countries." Council on Economic Policies, April 11, 2019.

BARRIERS TO ACCESS THESE INCENTIVES

Before the law is passed

While the law states that tax incentives will be given to those who qualify for it without discrimination, the reality does not reflect that. Instead, incentives are given to a privileged few, in sectors that might not need it. These barriers to access incentives are the result of factors that start before the law containing the incentives is even passed.

Unlike direct expenditure that are reviewed and renewed yearly, incentives are found in laws that need only be passed once. Once they are voted on, they rarely ever get revoked. To make it simple, tax incentives are easy to pass and hard to cancel. This makes them prime candidates for capture by lobbying groups representing the interests of companies in specific sectors.[54]

These groups put pressure on decision-makers to pass these incentives which takes away from the democratic process and the principle of the representation of citizen interests rather than the narrow interests of lobbyists and the privileged few. They may also actively work towards defending and keeping these incentives and preventing their rollback.

Injustices are created in terms of access to and degree of influence on decision-makers and on the public policy elaboration process. Lobbying also generally leads to an absence of a study of the effects of these policies in terms of their potential cost and repercussions on the economy, the labor market, and public services.

It is recommended that the government keeps track of any lobbying activities. Additionally, to preserve transparency, it is recommended that any parties willing to present their opinion to decision makers do so through the public hearings that committees and legislators hold for that purpose, same as with other stakeholders.

After the law is passed

The inequality of access to incentives persists after the law is passed, mainly due to an information asymmetry.[55] Some individuals and big companies are better informed on them than small companies owing to the fact that they are able to invest more resources in departments such as finance, accounting, and fiscal optimization. Unlike the average investor who may or may not hear of these incentives, big companies and wealthy individuals have entire teams of experts dedicated to fretting out these incentives and tax breaks.

This is worsened with the way tax incentives appear in Tunisian legislation, as they are dispersed among laws, decrees, circulars, orders, etc.[56] For instance, a mention of an incentive might appear in a law. However, its details such as percentages or conditions are found in a governmental decree. The scattering of incentives and their details makes accessing them even harder for people without the means to hire experts to fret them out.

This especially hurts small businesses that might be eligible for incentives but remain in the dark about them, or are aware of them superficially but unable to get access to them because of the complexity of the system and the scattering of the legal texts. While its bigger competitor, thanks to more resources dedicated to fiscal optimization, benefit from them fully. An example would be the CICE (Crédit d'Impôt Compétitivité Emploi)

[54] International Budget Partnership, Guide to Transparency in Public Finances Looking Beyond the Core Budget: 2.Tax Expenditure: Page 6
[55] Extrait de la fiche concours « Les niches fiscales » publiée en juin 2008 et actualisée en février 2010 sur le site www.formation-publique.fr de la DILA et le projet de loi de finances pour 2011.
[56] AMINE BOUZAÏENE. "Les avantages fiscaux une perte de revenu pour un bénéfice incertain" Observatoire Tunisien de l'Economie, 2019

tax incentive in France which aims to encourage investment and job creation. It is by far, the most expensive tax incentive in France, costing 9,01 billion euros[57]. In 2016, nearly half of these expenses (49%) go to large corporations whereas small business only benefit from 19% of the cost of the incentive.

To combat this access issue, the Tunisian legislation should do away with decrees and only pass incentives through laws. It is also recommended that all incentives be collected and kept in one code of fiscal incentives and that this code be updated as needed when an incentive is added, cancelled, or modified.

Authorities should also invest in communicating on these incentives to the public. Not only so that beneficiaries are aware of it, but also so that the wider public is aware of their cost and possible benefits. This will ensure a wider acceptance of the incentives and more transparency in the policy-making process.

THE RICH BENEFIT MORE THAN THE POOR

Tax expenditures inherently exclude low-income people. Poor people do not pay (income) taxes since their income usually does not meet the threshold for paying taxes, and they are rarely found to be company owners.[58]This makes them generally not benefit directly from tax incentives[59] [60]. So, the main and direct beneficiaries are, more often than not, wealthy individuals and big companies.

An argument can be made that poor people indirectly benefit from tax incentives as they attract investment, encourage business expansion, and create job opportunities for this social class. But, as will be discussed later, these statements so far lack the evidence to back them up.

To address this issue, it is recommended that the government thoroughly studies who the direct and indirect beneficiaries are, and how the benefits of these incentives are distributed between the different economic classes, to ensure that policies are put in place to protect the most vulnerable instead of being fiscal gifts for the most wealthy and powerful.

REGIONALLY INEQUITABLE

As can be seen by Figure 12, most investment incentives have gone to costal privileged areas. This comes as no surprise when the beneficiaries of the incentives are identified. As discussed previously, 83% of fiscal spending goes to encouraging exports. And, due to the fact that most export businesses are set up in coastal areas because of their proximity to ports and better infrastructure, that is where most beneficiaries will be located.

[57] Projet Loi de Finance 2020, France

[58] Swift, Zhicheng Li. Managing The Effects Of Tax Expenditures On National Budgets. Policy Research Working Papers. The World Bank, 2006, PAGE 2

[59] Marr, Chuck, and Brian Highsmith. "Recent Proposals Underscore Bipartisan Support for Reform," PAGE 1

[60] Redonda, Agustin, Santiago Diaz de Sarralde, Mark Hallerberg, Lise Johnson, Ariel Melamud, Ricardo Rozemberg, Jakob Schwab, and Christian von Haldenwang. "Tax Expenditure and the Treatment of Tax Incentives for Investment." Economics: The Open-Access, Open-Assessment E-Journal, 2019. Page 50

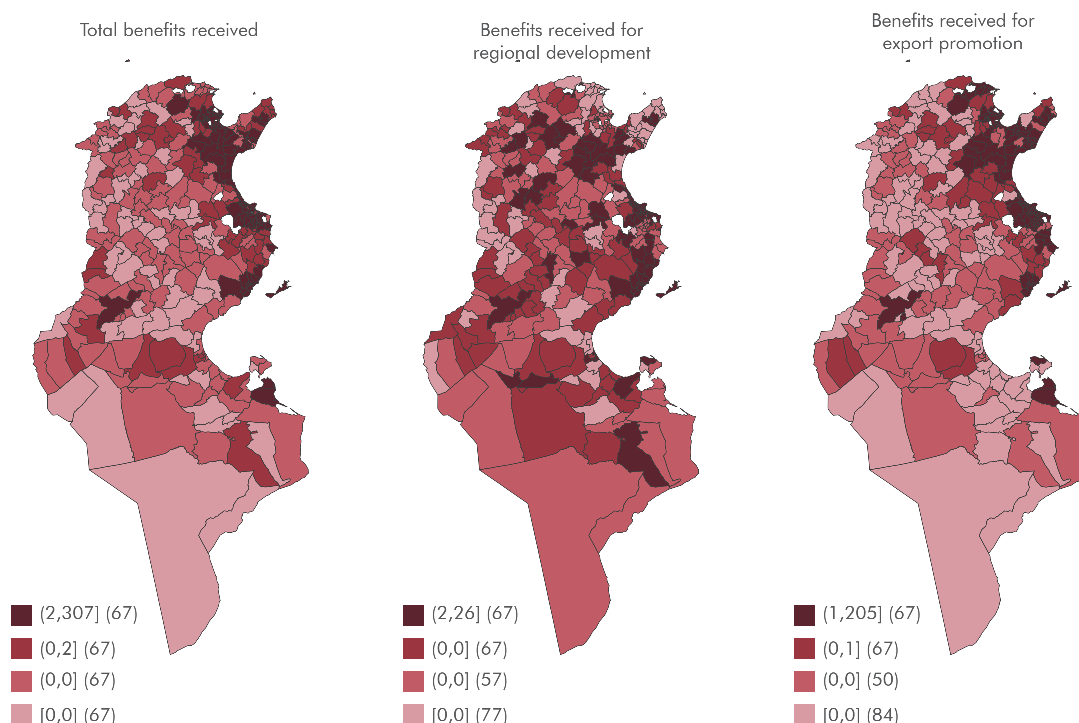


Figure 12 : Geographical distribution of tax ex incentives in Tunisia 2008 2008 (World Bank) [61]

However, it should also be noted that even if more incentives are afforded to under privileged areas, it will still not be enough to solve the problem of under-investment in these regions. As previously mentioned, incentives do not make up for a poor investment climate or bad infrastructure. The funds will be better allocated in building infrastructure and creating a clearer structure for the administration.

CONTRIBUTE TO KEEPING COUNTRY DEPENDENT ON AID THROUGH LOWER RESOURCES

Tax expenditure not only widens inequalities internally within a country but also perpetuates inequalities between countries, particularly developing countries.

The lack of resources brought upon by tax expenditures leads to a bigger deficit, which in turn leads to more debt. More debt leads to more resources being allocated in service of that debt in the future (resources that would have been better invested in health or education). Debt service grows further and further till the state is eventually pushed to borrow money just to pay off its debt. Ultimately, the state finds itself in a viscous circle of taking out debts to pay off other debts and its debt service becoming unmanageable. In extreme cases, these debts become irredeemable as the state declares bankruptcy, such was the case in Greece.

[61] It should be noted that the graphic represents all advantages given to companies both fiscal and financial. However, it should also be noted that 93% of these advantages are fiscal.

As proven by its history, Tunisia is trapped in this vicious circle of debt. Tunisia has started taking out loans from this international financial institution in 1964. Up until of 1986, the country's loans from the IMF were fairly small with an average of 8 076 000 SDR [62]. All these loans were paid back within a year or less. However, in 1984 in response to an economic crisis, Tunisia took out a substantially bigger loan (103 650 000 SDR) to be repaid on a longer period of two years. Since then, Tunisia has been under one IMF program after another, with increasing loans to be repaid at longer periods.[63] The latest of which is the one taken out in 2016 of 2 045 625 000SDRs to be paid out in 2020.[64] (Figure 13)

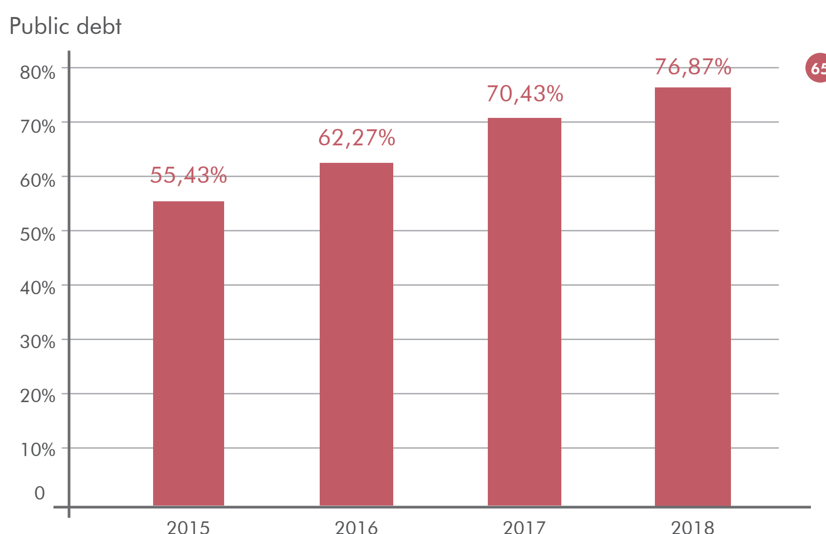


Figure 13 : Public debt (Al Bawsala)

These successive loans and their increasing amounts are proof of the failure of Tunisian policies and the programs it had followed under international financial institutions to balance its budget and lessen its dependency on international institutions such as the IMF.

Because the loans taken from the IMF are linked to various conditions, this dependency not only affects the budget balance but also affects all public policy and the sovereignty of the state. In order to get all the installments of the loan, Tunisia is strongly encouraged to follow the public policy recommendations and the guidelines published by the IMF in its annual reports. If not, the IMF may choose to halt payment of loan installments until Tunisia passes the policies suggested by the IM, policies that have continued to fail as evidenced by the increasing debt service. The conditionality of the loans was criticized by many as undue meddling in the internal affairs of the country.

These conditions fail to recommend and incite investment in infrastructure and other strategic sectors such as education and health[66], leading to a decrease in the quality of these vital services. Consequently, this fosters more popular discontent and instability, eventually leading to economic crises and even more

As evidenced above, tax expenditures effects different socio-economic classes differently, this is why they need constant vigilance and control. This responsibility falls on the decision-makers such as the legislators and the executive who must be accountable for the policies they pass and maintain.

62 SDR, Special Drawing Right, a unit of account of the IMF

63 "History of Lending Arrangements: Tunisia." International Monetary Fund. Accessed June 19, 2020. https://www.imf.org/external/np/fin/tad/extarr2.aspx?memberkey1=970&date1Key=2020-05-31.

64 "History of Lending Arrangements: Tunisia." International Monetary Fund. Accessed May 12, 2019.

65 Marsad Budget, https://budget.marsad.tn/ar/#section-3

66 Oxfam, La justice fiscale en Tunisie, un vaccin contre l'austérité, June 2020, Page 2

As discussed previously, tax expenditures are costly and their benefits are questionable. So, why do law-makers still employ them? The problem here is one of accountability.

Accountability, here, refers to being responsible for the decisions taken, and answering to one's actions and their repercussions. However, tax expenditures make this incredibly hard to do. Law makers not only escape accountability for them, but they are often not even aware of the possible costs and repercussions of these incentives before passing them. This mainly comes back to the fact these kinds of measures are easy to pass and hardly ever get reassessed.

LACK OF INFORMATION

Accountability requires knowing the results of the public policy that have been passed. Yet, up until very recently, the government had no obligation to review tax incentives and law-makers had no way of knowing their cost.
By the passing of the legislations discussed in the introduction, Tunisia now benefits from a legal framework that requires the government to submit a report on tax expenditures annexed to the annual finance law. It is important to note that this legislation has not been respected for the 2020 finance law, as the finance ministry failed to provide the report to legislators and the public, further obstructing accountability in relations to this fiscal policy.

LACK OF DEFINED VISION, OBJECTIVES AND TARGETS

Another factor that serves as an obstacle for accountability is that these tax expenditures are not linked to any specific objectives. Legislation related to tax expenditures usually offer some general purpose that these policies are supposed to accomplish such as creating job opportunities and encouraging investment.

However, how many job opportunities need to be created to say that this policy was a success? How much investment linked to tax incentives needs to be done to justify the cost of these expenditures? All of this is not known because there are no quantitative targets set to test the impact of these policies and to see if their predicted cost-benefit analysis is actually positive, which is contradictory to how other (direct) expenditures are treated.[67] This lack of tracking can lead to the excessive costs discussed in the efficiency section and encourages companies to benefit from large amount of potential tax revenue without actually providing the benefits intended by the tax incentive.

It should be noted that this lack of concrete objectives is not only related to tax expenditure, but is also related to a general lack of vision on how to guide the Tunisian economy. Instead of creating a common vision on how to govern public finances, decisionmakers remain stuck in pumping out stopgap measures and have relegated the bigger strategic decisions to other actors such as international financial institutions.

EVADING ADDRESSING THE ROOT CAUSES OF ECONOMIC ISSUES

Passing tax incentive measures also allows law makers to avoid addressing the real causes of under-investment, namely infrastructure, unreliable administration, and scattered legislation, etc. Solving these issues would require an overhaul of the investment code and tax administration. Instead, law-makers

[67] Direct expenditures are linked to Key Performance Indicators (KPIs). These are indicators that measure the performance of public spending. A baseline measurement is made of the indicator and targets for the coming fiscal years are set. At the end of the fiscal year, the KPIs are measured and compared to target values to see if objectives are met.

may prefer to count on tax incentive measures that are easy to pass and appear somewhat harmless. A good example of this are the incentives passed to encourage investments in interior regions and which appear to have failed to promote good lasting impact as can be seen by the continued protests done by the inhabitants of these regions.

To address these issues, the ministry of finance should publish its annual report on tax expenditures and make it available to both legislators and the public. Legislators should be careful about passing fiscal incentives and should make sure that they are being utilized because they are the optimal solution to the problem not because they are the easiest one. They should also ensure that they are tied to actual measurable outcomes on which they will be annually reviewed and evaluated and not simply pass them then never look at them and their impact.

LACK OF COMPANY ACCOUNTABILITY

Companies also have a role to play in the governance of these policies Firms that benefit from incentives should provide a target of what they would accomplish with these incentives so that the government can monitor and track the possible consequences (both positive and negative) of the incentives that it provides.

If the incentive had been created to provide jobs, for instance, the benefitting company should provide a number of the jobs it hopes to create by the revenue saved thanks to these incentives. If by a certain period the numbers that the company promised were not achieved, the company should reimburse the state for the loss of revenue. This will guarantee a better spending of public funds and will incite the companies to invest the excess revenue where it is most needed.

The monitoring of companies benefiting from fiscal incentives should be done by both the legislative and the judicial branch. The legislative, as discussed above, should monitor the efficiency of these expenditures. The judicial, specifically “Cours des comptes” should ensure that companies who benefit from public funds are respecting their obligations both in terms of conditions linked to the fiscal incentives but also with regards to other laws such as those related to employment (paying fair wages, paying social coverage to their employees).
The accounts of the monitoring process and the added layer of control should also be made public so that stakeholders are made aware of the effects of this policy. This is why the transparency aspect is particularly important.

The transparency of tax expenditure is a fundamental part of fiscal transparency as a whole[68]. It is an important axis of public participation in policy-making in general, and the budget elaboration process more specifically. However, countries tend to do worse on tax transparency than they do on most other aspects of fiscal transparency as illustrated by Figure 14:

	SCORE IN TAX EXPENDITURE TRANSPARENCY	SCORE IN OVERALL BUDGET TRANSPARENCY [69]
World	23	42
Western Europe & North America	77	73
Eastern Europe & Central Asia	16	55
Middle East & North Africa	10	20
Sub-Saharan Africa	7	25
Latin American and the Caribbean	37	50
South Asia	33	46
East Asia and the Pacific	25	47

Figure 14 : International Budget Partnership

Tunisia is no exception to this rule. While the country scored 39 out of 100 on the budget transparency index in 2017[70], its score on tax expenditure transparency is 0 out of a 100[71]. To remedy this opacity, the paper will discuss why transparency is an important characteristic for tax expenditure reporting and what that reporting should entail.

Why provide it?

FOR THE POLICY MAKER

The tax expenditure report should be annexed to the state budget to provide the law maker with a periodic review on the impact of this type of public policies. It also related to the annual review that policy makers should do for all public expenditure, be they direct or not. The reports should contain the necessary information; in order for the policy maker to make an informed decision on whether to keep the tax expenditure, to change it, or to cancel it and replace it with direct expenditure.

[68] Paolo de Renzio , Counted But Not Accountable: Tax Expenditure Transparency In Latin America, June 2019, International Budget Partnership, Accessed 23 December, 2019
[69] Ibid.
[70] International Budget Partnership, Open Budget Survey 2017: Tunisia, https://www.internationalbudget.org/wp-content/uploads/tunisia-open-budget-survey-2017-summary-english.pdf Accessed 23 December, 2019. Page 1
[71] International Budget Partnership, Tunisia Open Budget Survey 2017 Questionnaire, January 2018, https://www.internationalbudget.org/wp-content/uploads/tunisia-open-budget-survey-2017-responses.pdf Accessed 23 December 2019. Page 51

FOR CITIZENS

Elaborating and publishing tax expenditure allows citizen participation in drafting public policy and engaging with policy makers in informed discussions about where their taxes are being spent. This is especially relevant to Tunisia, and its low citizen engagement rate, as proven by its public participation score of 2 out of 100 according to the International Budget Partnership[72]. This might explain the reluctance that Tunisians feel towards paying taxes.

Increased transparency, accountability, and fiscal justice will not only give rise to more citizen political engagement, but the perception of fairness and transparency will also lead to more adhering and acceptance of the fiscal effort, leading to more people and corporations paying their fair share of taxes, effectively reducing tax fraud.

Canada, for instance, annually publishes a detailed report on tax expenditure, makes it public, and accompanies it with a downloadable spreadsheet of the data.[73]Tunisia will do well in following its footsteps and engage its citizens more in the political process.

FOR OTHER STAKE HOLDERS

Tax expenditure reporting also allows stakeholders outside the government to monitor and evaluate the efficacy of these types of policies. The report allows them to conduct in-depth studies about the subject (optimization methods, comparative studies…), and helps them to advocate for changes to improve current policies.

However, in order for them to conduct their work, several key components should be available in the tax expenditure report. The following section discusses some of the more controversial ones, before summarizing all the requirements of a tax expenditure report in check-list form.

What should be in the tax expenditure report?

The law on reviewing tax incentives makes a point to mention some components. Specifically, it requires government to provide information on the method used in the calculations, the loss of state revenue analyzed by economic sector, governorate, and delegation, the number of jobs created, the revenue from exports coming from companies benefitting from tax incentives, as well as the state of business continuity within these companies.

It is important to understand why a simple cost benefit analysis is not enough, which is why the paper will analyze some of the more controversial components that figures or should figure in a tax expenditure report

STATING THE METHOD OF CALCULATION

In its article 18, the law on reviewing tax incentives had made citing the method of calculation a requirement for the annual report, and for good reason. Not all methods are created equal. The method is often a key indicator of the reliability of the numbers given in the report, which is why Tunisian law states that it should be explicitly mentioned in the report. There are three main methods for measuring tax expenditure: aggregated simulations, indirect calculation, and micro-simulation.

[72] International Budget Partnership, Open Budget Survey 2017: Tunisia, https://www.internationalbudget.org/wp-content/uploads/tunisia-open-budget-survey-2017-summary-english.pdf Accessed 23 December, 2019. Page 1

[73] Paolo de Renzio , Counted But Not Accountable: Tax Expenditure Transparency In Latin America, June 2019, International Budget Partnership, Accessed 23 December, 2019

Without going into too much detail, the first, aggregated simulations are most appropriate when the tax payers provide the administration during the tax filing process with information on which tax expenditure they benefit from. This is not the case in the Tunisian tax collection processes.

Indirect calculations are based on census data. It tries to estimate what the tax revenues would have been if the state was to apply the baseline percentage on the targeted entities. While this is the simplest method to implement, it is not the most reliable in terms of result.

Micro-simulations are considered the most powerful tool.[74] As they take into account the tax information of a representative sample of individuals (be they people or corporations) and analyze how they might benefit from tax expenditure.

REFERRING TO THE LEGAL TEXT

One thing that will significantly help citizens and policy-makers better understand the tax expenditure report is linking each tax expenditure to its legal text, saving them the effort of navigating the dozens of texts where tax incentives are dispersed. Mexico, for instance, not only mentions the legal text from which the tax incentive originates but also offers a web link to the text.

HISTORICAL PERSPECTIVE AND FUTURE ESTIMATES

The report must provide a full picture of the expenditures by including a historical perspective on them as well as their projected trajectories. For this, the report must provide tax expenditure costs and benefits over the years as well as estimates for the future. This gives the public and policy makers a more comprehensive picture of the tax incentives, leading to better decision-making.

The multi-year perspective is already common practice in many countries including Bolivia, Brazil, and Colombia.[75] Future estimates are provided by reports in several countries such as Argentina, Chile, and the Dominican Republic.

OBJECTIVES AND KEY PERFORMANCE INDICATORS

Government reports should explain the objectives related to each tax incentive and their Key Performance Indicators (KPIs), much like it does for direct expenditure.

The objectives will decide the KPIs based on which to evaluate the tax incentives. Baseline measures and targets should be put in place at the creation of a tax incentive. Its evaluation should be based on the evolution of these indicators.

BREAKDOWN OF INCENTIVES BY SECTOR AND GEOGRAPHICAL LOCATION

As Tunisia focuses more and more on decentralization and inclusive development, it should also ensure that tax incentive policies and its benefits are equitably distributed among its governorates. And so, the report should breakdown the tax incentives and their benefits by geographical.

[74] Inter-American Center of Tax Administrations. Handbook of Best Practices on Tax Expenditure Measurements: - An Iberoamerican Experience, 2011, Page 11

[75] Paolo de Renzio , Counted But Not Accountable: Tax Expenditure Transparency In Latin America, June 2019, International Budget Partnership

It is worth reminding that one important type of tax expenditures should be reevaluated, namely incentives regional development, as proof of their efficacy is somewhat lacking (See: Fiscal Justice, Accountability)

The report should also breakdown tax incentives by sector to make sure that incentives are being used in sectors which are susceptible to these advantages, and not sectors that are indifferent to them.

IDENTITIES OF BENEFICIARIES

It is recommended that the government publish not only the number of the beneficiaries, broken-down by nature (SME/ Enterprise) and sector, but it should also identify them by name. This is perhaps one of the more contentious aspects of tax expenditure. Some argue that this disclosure undermines the concepts of tax secrecy and the right to privacy[76]. However, this is not about tax information but rather about declaring who is benefitting from public funds, as incentives are, as explained above, indirect public aid for the beneficiaries. And so, funders, in this case taxpayers, have a right to know who is benefitting from their tax money. Sharing the identities of beneficiaries is practiced internationally by states such as France, Dominican Republic, Guatemala, and Canada.

TRANSPARENCY CHECKLIST

Aside from the components mentioned above, a transparent tax expenditure report should have many other characteristics. The paper narrowed them down into a checklist with 43 items that can be used to evaluate the transparency of a good tax expenditure report.

Most of the indicators are based on the work of the Center on Budget and Policy Priorities[77] as well as that of the U.S. Government Accountability Office[78].

[76] Ibid.
[77] Levitis, Jason, Nicholas Johnson, and Jeremy Koulish. Promoting state budget accountability through tax expenditure reporting. Washington, DC: Center on Budget and Policy Priorities, 2009.
[78] U.S. Government Accountability Office, Tax Expenditures: Background and Evaluation Criteria and Questions, GAO-13-167SP, November 29, 2012

STAKEHOLDERS

Mentions agencies implicated in evaluating the tax expenditure?

ACCESSIBLE

Published in time

Annexed to the budget

Available online

SCOPE

All taxes are accounted for

Includes implicit taxes

Includes local taxes

Includes planning, recordkeeping, reporting, and other compliance costs associated with the tax expenditure

DETAIL

The benchmark of the tax (what the tax would be without the incentive)

The type of tax incentive

The data is current

Calculation method mentioned

Allows for comparisons (past years and estimates for future years)

Explains the tax expenditure

Gives an example of the tax expenditure

States the purpose of the tax expenditure

Gives relevant legal citation and year of enactment

Gives performance indicators (KPIs)

States duration of the expenditure (if it is temporary or permanent)

States the sector of the tax expenditure

States if tax expenditure is geographically bound

States if tax expenditure is cost-based or profit-based

Mentions the number of beneficiaries

States the identities of the beneficiaries

States Reliability of the estimate

Duration of the expenditure

ANALYSIS

Taxes classified using the same categories as direct spending (by goal/program?)

Evaluate the performance of each tax according to its KPIs

Redundancy rate in FDI and investment in general

Analyze the distribution of benefits by income level and size of business

Cost-benefit analysis

Does the tax incentive duplicate another one?

Would direct spending in this case be preferable to tax incentives?

Would eliminating or creating tax expenditure affect revenue loss estimates for other tax expenditures?

Would eliminating or creating the tax expenditure affect other taxes?

Would eliminating or creating the tax expenditure change taxpayer behavior in ways that affect revenue?

Would eliminating or creating the tax expenditure affect the amount the government spends on other programs?

Can the aggregate amount that the taxpayers claim for the tax expenditure be capped?

Can taxpayers’ eligibility for the tax expenditure be restricted?

For eligible taxpayers, can the value of the tax expenditure be reduced?

Is the reliability of the estimate mentioned?

Breakdown of tax expenditure by sector

Breakdown of tax expenditure by region

CONCLUSION

The recent Tunisian legislation relevant to reviewing tax expenditures is a step in the right direction towards adding more transparency and accountability to this policy tool. However, this effort does not appear to be enough.

Tax expenditures in Tunisia weigh extremely heavy on public finances and serve a tremendous loss of revenue for the state. This cost does not seem to be justified as they fail to accomplish their announced objectives.

Though the Finance Ministry failed to publish its first annual report on them, according to literature and a general analysis, tax incentives seem to lack efficiency. The lack of resources they cause the state affects the performance of the government and the objectives and strategies it peruses through direct expenditure. It also exhibits coordination failures as it overlaps and conflicts with other tax incentives and direct expenditures and has a tendency to become outdated. Additionally, it could potentially further encourage fraud, weak investments, and investments with low added-value.

Tax expenditures also pose an accountability problem as they are rarely revisited. While having a report on them annexed to the budget is a positive step forward. Legislators need to start effectively using the report in public policy making to cancel the incentives that have proved to be ineffective and to only pass incentives after studying them and linking them to specific objectives and tangible, measurable targets.

Tax incentives also seem to violate concepts such as fiscal justice. They deprive strategic sectors of much-needed funding, and seem to be geared towards benefiting the rich and the multinationals more than any other class. They are set up with barriers that keep vulnerable groups from accessing them and benefiting from them, including the poor and the economically-disadvantaged areas.

Finally, tax expenditures lack in transparency measures that may allow stakeholders, especially tax-payers, to evaluate them. This includes the withholding of the annual report on them for the year 2019. The legislation also needs to be reviewed to include provisions requiring the Finance Ministry to include details in their report, such as requirements to publish a list of beneficiaries and analyzing their geographical and economic distributions.

This leads us to conclude that the road to achieving good governance of tax expenditures is still long. Many efforts still need to be made in terms of effectively using this tool to achieve equitable, inclusive, and just economic progress. Legislators are called upon to further investigate and overhaul the arsenal of tax incentives offered to investors and to re-evaluate them through the lens of not only a purely macroeconomic cost-benefit analysis, but also through the lens of social justice and the values called for by the 2011 Tunisian Revolution.

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