COMMENT TO
"WORK-RELATED TAX EXPENDITURES IN THE EU: IMPLICATIONS FOR TAX REVENUE" BY SALVADOR BARRIOS, SERENA FATICA, DIEGO MARTÍNEZ LÓPEZ AND GILLES MOURRE

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Main takeaways

By combining the EUROMOD simulations with labor supply elasticities the paper traces the behavioral impact of tax expenditure reforms and argues that the welfare gain of maintaining these measures are not negligible.

At least one-fourth of the extra tax revenues collected through a reduction in make-work pay tax incentives is washed away after factoring in labor supply responses, especially through lower participation by individuals most at risk of exclusion.

In some instances, the revenue gain erosion might become substantial. Even for policies strongly targeted at the bottom of the earnings distribution, the reform might even bring about a net revenue loss, depending upon the calibration strategy of the labor supply elasticities and reflecting the heterogeneity across types of workers.

Policy implication: Removing tax expenditure in upper income quintile can minimize the labor supply distortions and maximize fiscal revenues.

Comments

The main results are derived from benchmarking France and UK against Hungary and Slovakia. These two groups of countries represent different income levels and tax to GDP ratios neglecting the smaller tax bases of the latter group. Results would likely to be overestimating the impact on Hungary and Slovakia due to the higher share of informal economies.[1] In this respect, the paper can benefit from benchmarking to a more comparable sample for robustness i.e. other emerging economies could be used as benchmarks for Hungary and Slovakia.

One of the shortcomings of these models is the difficulty in aggregation (Tyson, 2014) with overlapping tax expenditures. This may lead to multiple equilibria in identifying the macroeconomic feedbacks with the use of varying models to trace microeconomic dynamics, *i.e.*, Various tax expenditure policies may lead to various tax outcomes.

Could the paper extend the current strategy of policy change to optimal policies? With tax expenditures governments presence grow, which can be distortionary. However, such approach ignores positive spillovers (e.g., incentive to work) and introduces another layer of cost for the benefit of transparency (ITEP, 2011). Rather than simulating policy changes, welfare improving policies should be preferred to minimize the tax burden. Such a strategy will be able to deliver a superior welfare outcome and can highlight the tradeoff between austerity and growth.

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1 The size of the informal economy is estimated to be around 20-25 per cent in Hungary and Slovakia, and 12-15 per cent in the UK and France (Schneider, 2001)

It would be useful to clarify the benchmark tax rate in the model. A uniform tax rate could be associated with efficient tax expenditures and would identify the space for maneuver and balance growth when redistributive tax policy is in question.

The paper can benefit from providing the details of how EUROMOD integrates the labor supply model for an average reader.

REFERENCES

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