A Balanced Tax Policy to Sustain Thailand's Economic Development

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Thailand is one of the greatest developmental success stories in recent history. In 2011, the World Bank acknowledged Thailand's rapid economic rise as it upgraded the country from a middle-income economy classification to an upper-middle income economy. A senior World Bank Economist stated then:

"The upgrade is in recognition of Thailand's economic achievements in the past decade in which GNI per capita has almost doubled, while poverty has been significantly reduced. The country has been prudent in macroeconomic management with a strong fiscal stance and low public debts and inflation. Thailand has a friendly business environment and has been successful in attracting foreign direct investments and achieving greater diversification in manufacturing production, both in terms of higher value-added production and expansion into new emerging export markets."

In simpler terms, the upgrade recognized that Thailand's impressive economic performance in the first decade of this century was characterized not only by an increase in the size of the country's economic production but also by a distribution of this growth in a way that led to a reduced incidence of poverty. This is significant because as recent global events and academic research have amply demonstrated, non-inclusive economic growth is unsustainable – economically, politically and socially. Indeed, the elevation of a sizable chunk of a population out of poverty and to the middle-class is both (i) a validation of the effectiveness of a country's economic policies and (ii) an indication of the sustainability of economic growth.

Tax policy is a vital element in a country's overall economic policy. Governments must, of course, raise revenue for the expansion and upkeep of physical infrastructure, the financing of the bureaucracy and the implementation of social and poverty alleviation programs. Note however that tax policy involves more than just tweaking tax rates to raise sufficient revenue to support public programs. Just as important is the manner by which such revenue is raised.

DIRECT TAXES, INDIRECT TAXES AND PROGRESSIVITY

Taxation's indirect distributive effect is widely recognized (Figure 1). For example, a majority of income taxes are collected from a small subset of corporations or a relatively small portion the overall population, yet they are directed to fund public programs and infrastructure that can be used by or which redound to the benefit of all members of society.

What is less recognized is that the imposition of different types of taxes also has immediate distributive effects. Depending on the type and manner of collection of these taxes, the effect could either support an equitable sharing of the burden (progressive taxation) or impose heavier burdens on economically disadvantaged taxpayers than on more well-off sections of society (regressive taxation).

Direct taxes such as personal and corporate income taxes typically require higher-income persons or entities to pay a larger fraction of their income to the state. The Thai personal income tax system is an example of this – the effective tax rate increases as the level of income increases (Figure 2).

Indirect taxes such as consumption taxes impose the same level of taxes on all affected taxpayers. With the value added tax ("VAT"), for example, a middle-class family and an upper-class family buying the same basket of goods would pay the same amount of VAT. However the VAT paid by the middle-class family would constitute a higher fraction of its total income compared to its better off neighbor.

To make the VAT system more equitable, states (especially developing economies) exempt basic commodities from VAT. This policy is grounded on the assumption that lower-income taxpayers spend most of their financial resources on these VAT-exempt goods and are therefore insulated

Figure 1: Global Trends: Low and middle income states rely more heavily on Indirect Taxes than Direct Taxes. In Structures, Economic Growth and Development; Kyle McNabb and Philippe LeMay-Boucher (2014)

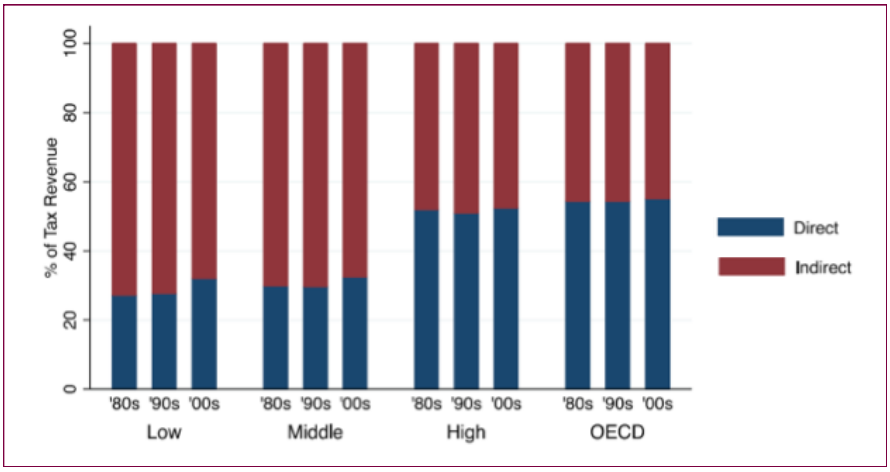

Figure 2: Breakdown of Thailand Tax Collections

Unit : Million Baht

ประเภทภาษี Tax Type	ปีงบประมาณ 2554 FY 2011	ปีงบประมาณ 2555 FY 2012	ปีงบประมาณ 2556 / FY 2013 เก็บได้ Tax Collection	สัดส่วนร้อยละ Percentage
1. ภาษีเงินได้บุคคลธรรมดา Personal Income Tax	236,482.70	266,203.23	299,066.99	16.95
2. ภาษีเงินได้นิติบุคคล Corporate Income Tax	574,152.10	544,590.66	592,345.96	33.57
3. ภาษีเงินได้ปิโตรเลียม Petroleum Income Tax	81,444.35	94,096.75	113,291.28	6.42
4. ภาษีมูลค่าเพิ่ม Value Added Tax	577,724.68	659,803.62	698,033.01	39.56
5. ภาษีธุรกิจเฉพาะ Specific Business Tax	35,714.13	41,056.55	48,773.20	2.76
6. อากรแสตมป์ Stamp Duty	10,313.34	11,180.07	12,740.53	0.72
7. รายได้อื่น ๆ Other Income	278.70	362.39	290.27	0.02
รวม Total	1,516,110.00	1,617,293.28	1,764,541.24	100.00

from much of the burden imposed by the VAT system. Thailand's VAT rules apply this policy through the exemption of the sale of certain agricultural products, certain animals or animal by-products, fertilizers, fish meals & animal feeds and educational services. Note however that such exemptions, while reducing the burden of low-income earners, do not promote progressive taxation, since high-income taxpayers also enjoy the VAT exemptions.

For purposes of progressivity and equitable sharing of tax burdens, direct taxes are therefore more effective tools than indirect taxes. As stated in a recent IMF Working Paper (Distributional Consequences of Fiscal Consolidation and the Role of Fiscal Policy: What Do the Data Say; Jaejoon Woo, Elva Bova, Tidiane Kinda, and Y. Sophia Zhang [2013]):

"On the implications of fiscal policies for income inequality, studies find that countries' differences and historical trends in income inequality can be partly explained by the level and progressivity of tax and spending policies. Yet specific fiscal policy measures can have either equalizing or disequalizing effects on income distribution. In general, direct taxes (e.g., personal income tax, and to a lesser extent of corporate income tax) and social expenditure are found to improve income distribution, while indirect taxes (including consumption taxes and custom duties) tend to increase inequality."

DIRECT TAXES, INDIRECT TAXES AND ECONOMIC GROWTH

While direct taxes on income are preferred over consumption taxes for the promotion of equitable taxation, the reverse applies if the goal is to promote the expansion of investment and overall economic growth. Some studies by academics and multilateral institutions have pointed out that high personal and corporate income tax rates have greater negative economic effects on an economy than high consumption taxes. Lower tax income tax rates are associated with the expansion of GDP (which bodes well for the drop in Thailand's corporate income tax rate to 20%).

A very recent paper from the International Center for Tax and Development (Tax Structures, Economic Growth and Development; Kyle McNabb and Philippe LeMay-Boucher (2014)) suggests for example that increases in income tax rates have a negative impact on GDP growth while finding no demonstrable effect on the introduction or increases in consumption taxes.

Indirect taxes such as consumption taxes are also preferred by governments because they are relatively easier to manage and administer than direct taxes. For example, the invoice trail generated by VAT-input and VAT-output reporting allows tax authorities to track the liabilities of merchants along the value chain. Under the VAT system, businesses are effectively deputized by the state not only to collect the tax, but also to keep records and track the economic activity of their suppliers and their customers. This compares favorably to the policing of income tax where transactions are prone to re-characterization or mischaracterization. International transactions also impact the corporate income tax liabilities of multinational companies and domestic tax authorities have less control and oversight on cross-border transfers of income.

THINGS TO THINK ABOUT

The above general discussion on the distributive effects of taxation can be analyzed in light of recent developments in Thailand's tax regime. The VAT, for example, will spring back to the regular 10% rate in late 2015 unless the reduced rate of 7% is again extended. The reexamination of excise tax rules may lead to the extension of these taxes to products (mostly beverages) currently considered as exempt and also to an increase of the excise tax base of all excisable goods (from ex-factory price to a state-recommended retail price). It is currently not clear whether such increases in indirect taxes will significantly affect the progressivity of Thailand's tax system. The theory is that it should lead to a less progressive tax system, but at this point it is difficult to determine the magnitude of the shift. It should also be borne in mind that a less progressive tax system may be balanced by a more distributive social spending program.

Thailand's tax system has aided the rapid growth of Thailand's economy and the distribution of the benefits of such growth to the country's population. The coming years bring with it challenges as regional and global trade trends bring down state revenue from international trade, and as Thailand competes with the rest of ASEAN for foreign investments in a more integrated regional economy. Thailand's policy makers must continue to balance the country's tax mix and the policy choices between higher growth and progressive taxation. ■

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