Chapter 18

The Distributional Effects of Tax Policy: Tax Expenditures in Turkey

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ABSTRACT

This chapter first discusses the Turkish tax policy performance for the period of 2004-2013 in terms of equitable distribution of tax burdens. Then, it examines tax expenditures, which are believed to be one of the main sources of inequity in tax burden distribution, in terms of equity and fiscal transparency grounds. The chapter also estimates tax expenditure figures based on very limited data in Turkey. One of the main findings of the chapter is that because fiscal transparency and non-discrimination principles of taxation are violated in Turkey, there are considerable amount of hidden tax reliefs that are not counted as tax expenditures in the Turkish tax system.

When the rate of return on capital exceeds the rate of growth of output and income, as it did in the nineteenth century and seems quite likely to do again in the twenty-first, capitalism automatically generates arbitrary and unsustainable inequalities that radically undermine the meritocratic values on which democratic societies are based. (Piketty, 2014, p. 1)

INTRODUCTION

Since the late 1970s, there has been a general deterioration of income distribution in most countries around the world1 (see Chu, Davoodi, & Gupta, 2000; Stiglitz, 2012; Piketty, 2014; Tanzi, 2016, Chapter 1 in this handbook). Even though the most recent data are not yet all available, as Martinez-Vazquez, Vulovic and Dodson (2012) suggest, “all indications are that inequality has increased as a consequence of the 2009 global crisis and the following recession” (p. 95). As a result, inequality became a heated topic after the global crisis2 and the interest in income distribution, its changes and the underlying factors have

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increased. Widening income disparities that increasingly become visible have also heightened the interest in the role of fiscal policy as a redistributive instrument in the short run and in the long run, as well as in the progressivity (or the lack thereof) of tax and transfer policies (Chu, Davoodi, & Gupta, 2000).

Although the principal function of tax policy is to ensure the collection of sufficient tax revenues to financing public expenditures, it is indeed much more than that. “It is also a major instrument of government policy used to influence the distribution of income as well as discouraging some activities through additional taxation and encouraging others through tax concessions. Such tax concessions are known as ‘tax expenditures’” (James, 2016, Chapter 3 in this handbook). Tax expenditures are a common channel for financing government policies outside the budgetary framework. Contingent liabilities are another common channel for such “hidden” spending that tends to arise from a government’s explicit and implicit promises of financial support (Swift, Brixi, & Valenduc, 2004, p. 2). Tax expenditures are an important and possibly growing spending item in public budgets (Avram, 2014).

If used properly, tax expenditures can play an important role in implementing government policy priorities. For example, a number of well-regarded programs for the poor take the form of tax expenditures. Redistribution plays a central role in the tax and benefit system, and the trade-off between redistribution and efficiency is at the center of many debates about tax policy. Chu, Davoodi and (2000) claim that “[t]he major aim of tax policy as a redistributive instrument should be to raise the revenues needed to finance efficient pro-poor and other essential government expenditures and to avoid generating horizontal inequities.”

Although operating on the tax side, tax expenditures resemble direct spending programs. They both have similar budgetary effects and provide selective benefits that alter the allocation of resources. Like spending programs, they may often be justified because of public policy benefits but should be regularly monitored and evaluated. Tax expenditures, however, do not regularly receive the same level of scrutiny as direct spending programs. Unless, tax expenditures are exposed to adequate scrutiny, they may invite fiscal opportunism. When scrutiny is lacking, as Ansu and Laursen (2004) suggest, “it is difficult, if not impossible, to evaluate the cost, efficiency, and equity impact of tax expenditures and the extent to which resources could be rationalized or better allocated to strengthen government finances and to support progress toward broader economic and social objectives” (p. xi). Therefore, it is important to discuss tax expenditures and ways of dealing with them. An analysis of tax expenditure can contribute to the tax policy debate and shed light on trade-offs with direct spending programs.

By lowering the final tax liability for some groups of taxpayers, tax expenditures effectively narrow the tax base. Due to extensive reliance on tax expenditures, developing countries face not only revenue losses higher than they had anticipated, but also the erosion of their tax bases. Interest in tax expenditures has recently resurfaced in the context of growing public deficits and a reluctance to increase tax rates for fear of hurting national competitiveness and discouraging economic activity (Avram, 2014). Reducing tax expenditures is a potentially powerful way to reduce budget deficits. However, tax expenditures may also provide important benefits. This tradeoff makes it important to identify the costs and benefits of major tax expenditures to determine which expenditures are most valuable (Chetty et al., 2013).

With regards to income distribution and the role of fiscal and other economic policies, a number of questions arise: Is income distribution in Turkey becoming more unequal? What is the redistributive role of tax, transfer and other expenditure policies? Who bears the final burden of a tax? The limited availability of high-quality data for Turkey prevents a rigorous analysis of the questions above. Income distribution data for Turkey are expanding, but are still not adequate. Internationally comparable data on before-tax and after-tax household incomes are virtually nonexistent. The available data do not allow
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