

Ph.D. Thesis: Consumption-based tax reform and economic development: A case study of Thailand

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One of the main aims of developing countries is to achieve economic development. Since financial aids from abroad have become scarce¹, developing countries are now urged to rely on its own resources to finance their development programmes rather than to wait for external interventions. Taxation is considered to be an important tool to generate additional financial resources for economic development. However, due to the influence of the Keynesian theory in development economics, tax policy in developing countries has been neglected. Beside its revenue function, efficiency or equity issues of the tax system are hardly discussed or investigated. Thus, **an improvement of tax systems throughout the developing world can offer one of the greatest unexploited instruments of economic progress.**

The first part of the thesis deals with an introduction to fiscal policy in developing countries. The problems in taxation of developing countries will be examined, with an explicit critical analysis of the Thai tax system as a case study for developing countries. The Thai tax system contains several positive features such as relative low marginal income tax rates and flat rated corporate tax with tax credit for dividend income. However, several economic distortions prevail as the other types of capital incomes are still subject to income tax at different marginal tax rates. Moreover, the Thai tax system is quite complex with its long list of allowances, exceptions, special regulations and treatment programmes for investment. Such special treatments eliminate transparency of the system while narrowing its base. A more transparent and straightforward tax system would improve the allocation of production factors, when individuals and corporate planning are distorted at a lesser degree. Thus, reform of the Thai tax system which enhances its efficiency will be beneficial.

The main focus of the thesis is on a possibility of an implementation of consumption-based taxes in developing countries. The concept of consumption-based income and corporate tax has gained more interest in the last few years. Efficiency effects are obtained through their economic neutrality, transparency and administrative feasibility. The prevalence of economic advantages of the consumption-based taxes is seen to positively influence the process of capital formation which is a crucial factor for development process of developing countries. A consumption-based tax system has been successfully implemented in the Republic Croatia since 1993.

In the second part, several types of consumption-based taxes will be discussed focussing not only on their economic effects but also administrative and political aspects based on those typical economic constraints of developing countries. Also, experiences and lessons of tax reforms in developing countries will be examined.

The analytical part of the research will be drawn to welfare effects of a consumption-based income and corporate tax reform in a general equilibrium frame work. Implementing a fundamental tax reform cause tax-induced changes in factor price and also behavioural changes of individuals in their consumption, saving and investment decisions. In order to capture these effects, a fully dynamic model class with overlapping generations of Fehr (1998) will be considered. The model is based on the traditional Auerbach/Kotlikoff general equilibrium model with some additional extensions in the household sector for capturing both intragenerational and intergenerational

¹ In the last decade, financial aids from industrial countries to developing countries reduced sharply. The net of inflation value of development aids granted in 2001 was 20% less than in 1990. See the press release of the World Bank International Conference Finance for Development Finance held in Monterrey, March 2002, at www.worldbank.org

redistribution among individuals. The simulation model on the Thai data will provide a numerical decomposition of welfare effects into individual redistribution and efficiency components in order to investigate tax-induced redistributive effects which are crucial for developing countries. As a small open economy, Thailand is highly exposed to international capital inflows. Therefore, international effects of consumption-based tax reform will also be studied. Putting this together with the simulation results, the thesis should provide an outlook of possibility of a consumption-based tax reform to improve welfare of the Thai economy as a case study for developing countries.