The high cost of generous tax benefits

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BRAZILIANS HAVE NO IDEA of how costly the federal government's tax breaks are terms of lost revenues and state-owned banks' subsidized credit to the private. These tax benefits and credit subsidies, which are mostly not apparent in the federal government budget, have grown so rapidly that tax experts are calling vigorously for more transparency and accountability on tax breaks and subsidized credit costs.

"This is not about whether or not tax benefit policy is correct, but about the fact that estimates of policy costs should be transparent. They should be discussed and evaluated. Only then we will be able to revise the policy in a more orderly fashion," say Brazilian Institute of Economics (IBRE) researchers José Roberto Afonso and Érica Diniz, who have published a study on tax breaks and subsidized credit using official data since 2011. That is when the federal government began measuring the cost of subsidized credit on the basis of differences between the interest the government pays on its borrowing and the interest rate at which state-owned banks lend to the private sector.

Unchecked growth

The study found that the generosity of total tax benefits went from R$196 billion in 2011 (4.7% of GDP) to an estimated R$323 billion in 2014 (6.2%). Its authors also underscore the magnitude of the gap between growth in GDP and growth in tax benefits: "Between 2012 and 2013, tax benefits grew by almost 20% while GDP rose only 2.3%," Diniz says. Expectations are for a similar result in 2014: tax benefit growth of 11% and GDP growth of 2%.

Tax benefits amount to more than the budgets of some ministries. In 2013, the health budget was R$99 million and the education budget R$81 billion. Tax benefits cost a staggering R$273 billion.

"Tax benefits are … amounts that the government fails to collect or grants as financial subsidies. But the government is not monitoring them carefully and systematically," Diniz comments.

Typical of what has been driving up tax benefits and credit subsidies in recent years is the broadening of exemptions from payroll taxes and the National Development Bank's subsidized loans to the private sector. In 2013 together they amounted to R$20 billion. Payroll tax exemptions alone have shot up from R$400,000 in 2008 to R$5 billion in 2013 and are expected to rise to R$23 billion in 2014. "When the government adopts a policy of tax exemptions, it is not committing to anything at present but it is committing future tax revenues," Diniz says.

Tax benefits are not transparent. Of total benefits in 2014, the budget makes less than 10% explicit; the other 90% are implicit. "Only financial benefits are in the budget; tax and

credit benefits are not shown," Diniz observes. What is the outlook for tax benefits and subsidies? "It will be very difficult to change tax benefits in the short run because the estimated volume is too large and they are associated with tax exemptions and subsidized loans already granted for a long time," Afonso says. "What we hope is that the government at least assesses the results of its tax benefit policy and be more judicious in granting tax benefits."

The generosity of total tax benefits went from R$196 billion in 2011 (4.7% of GDP) to an estimated R$323.17 billion in 2014 (6.2%).

Total tax and financial benefits and credit subsidies have surged since 2011.

(Billions of reais, constant prices as of December 2013)

	2011	2012	2013	2014 Est.
Total	**219**	**229**	**274**	**305**
Taxes not collected	169	183	204	236
Financial benefits	37	33	60	54
Subsidized credit	13	13	10	15



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