



PUBLIC FINANCE

Migration, Taxation and Inequality

INDIA, DECEMBER 2011
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Migration, Taxation and Inequality

International migration is intimately intertwined with issues of taxation and income distribution, both in the home and host country



Migration and Taxation Issues

Home country:

- a fiscal loss in terms of previous cost of education and foregone tax revenues
- remittances (over \$300 billion annually) can create a multiplier effects, when well spent, and contribute to increasing domestic demand and growth:
 - Additional indirect tax collections
 - Should that income be taxed?
- how to encourage diaspora investments

Host country:

- perception that immigrants – often the poorest and undocumented ones– are taking more from the government budget in the form of social welfare and healthcare benefits than what they contribute in the form of tax revenues



Outline

- Introduction: migration and taxation issues
- How to deal with the fiscal losses and economic effects of emigration, particularly high-skilled
- How to prevent migration of high-paid workers motivated by high income taxes
- What are the multiplier effects of cross-border remittances and should they be taxed
- How to design appropriate tax incentives to encourage diaspora investments in the country of origin
- How to bring immigrants into the recipient country tax system and make them net contributors



Fiscal losses due to emigration of high-skilled labor

- High-skilled emigration from India to the US reached almost half of US temporary work (H1B) visas issued in 2001 (Kapur and McHale, 2001).
- Such emigration resulted in a net annual fiscal loss of 0.5% of gross national income (GNI) or 2.5% of overall government revenues in 2005 (Desai et al., 2009, after controlling for the counterfactual earnings of the high-skilled migrants, the loss of direct and indirect taxes, and the use of government benefits).



Growth and Inequality Impact of high-skilled labor emigration

- Africa: severe impact on the health sector in regions with supply shortages: the emigration of doctors and nurses may reduce the ability to provide essential public services at home (AfDB and World Bank 2011)
- Negative effects on growth and human development indicators: more inequality



Dealing with Fiscal Losses of Emigration

- Citizenship-based tax – the so-called “Bhagwati tax” – which would involve raising tax revenues from citizens abroad in order to partly compensate the fiscal losses in the country of origin
- Although some countries such as the Philippines have tried such citizenship-based taxes, the experience with implementation of such taxes is not encouraging (Pomp 1989, World Bank 2006).



Dealing with Fiscal Losses of Emigration

- The US has signed reciprocal tax-treaties with migrant-sending countries: allow the US to tax income of foreign residents or citizens at a reduced rate, or exempt certain items of the income they receive from sources within the United States from U.S. taxes, in return for similar tax treatment of US citizens in these foreign countries (US IRS 2011)
- The US also has a citizenship-based tax on world-wide income and requires citizens to file taxes irrespective of location



Cross-border migration of high-skilled labor in response to income taxes

- Marginal income tax rates are only one of several factors in migration and location decisions of the highly-skilled
- However, extremely marginal high tax rates can cause the highest-income earners to emigrate in search of low-tax havens, reducing the resources available for redistribution and social welfare programs



Cross-border migration of high-skilled labor

- Tax competition to attract and retain high-skilled individuals could lead to a “race to the bottom”, reducing tax revenues, leaving limited resources available for providing essential social services
- There is need for a balance between taxes on high skilled individuals and redistributive policies
- Policies to improve the investment climate and business environment and stable macroeconomic policies may be more effective in retaining the high skilled



Contribution of remittances to tax revenues via multiplier effects

- Flows account for about 2 percent of GDP in middle-income countries and 6 percent of GDP in low-income countries, and reach over 10 percent of GDP in several other countries
- These transfers are spent mostly on consumption (AfDB and World Bank 2011) and contribute to taxes through sales or consumption taxes



Contribution of remittances to tax revenues via multiplier effects

- For example, each dollar sent by Mexican migrants to the United States was estimated to boost Mexican GDP by \$2.90 (Adelman and Taylor 1992, World Bank 2006)
- Remittances also may have multiplier effects due to increasing returns, typically as the expansion of one sector increases the optimal size of other sectors (World Bank 2006)



Should remittances be taxed?

- Most remittance-receiving countries today do not impose taxes on incoming remittances
- Some implicit tax on remittances: a general financial services tax or on remittances in kind (for example, food, clothing, electronic items, or vehicles): the Philippines and India impose a small stamp or service tax on remittances
- When Vietnam removed its 5 percent tax on remittances in 1997, it found that the flow of remittances through formal channels increased (World Bank 2006)
- In Tajikistan the removal of the state tax on cross-border bank transactions in 2003 reportedly helped raise remittances from \$78 million in 2002 to \$256 million in 2003 (Olimova and Bosc 2003)



Encouraging diaspora investments in the home country

- Many countries offer favorable tax treatment to attract diaspora investments, and more recently for diaspora bonds
- Israel and India, have successfully raised over \$40 billion from such bonds (Ketkar and Ratha 2009)
- Ethiopia, Kenya and India have exempted the interest earnings of these bonds from income taxes



Encouraging diaspora investments in the home country

- Even when investments in these bonds are in foreign currency terms, after maturity some portion is likely to remain in the country.
- Such schemes were a major factor behind the doubling of remittance flows to India between 2002 and 2003 (Chisti)



Encouraging diaspora investments in the home country

- Matching grants for contributions from diaspora groups or Home Town Associations (HTAs) to attract funding for specific community projects: Mexico's 3-for-1 program, under which the local, state, and federal governments all contribute \$1 for every \$1 of remittances sent to a community for a designated development project: two-thirds of which benefited labor-intensive agricultural economies in four high emigration states (IOM 2005)
- The Salvadoran government partners with HTAs in rural development projects in El Salvador.



Encouraging diaspora investments in the home country

- Matching funds coming from fiscally constrained governments may be diverted from other—perhaps higher priority—development projects/regions (World Bank 2006)
- Need to balance priorities for growth and equality: which social groups and regions will benefit?



Contribution of migrants to taxes vs. benefits from social services

- Increase in international labor mobility (World Bank 2006) and especially with hardening of attitudes towards immigrants in destination countries after the recent global crisis
- Several studies, including a recent United Nations Human Development Report, find that fears about migrants placing an unwelcome burden on local services, or costing the taxpayer money, are generally exaggerated (UN 2009)



Contribution of migrants to taxes vs. benefits from social services

- Immigration typically leads to increase in welfare in the destination country, as it increases the supply of labor, which usually leads to more employment, production and thus GDP (Ortega and Peri 2009)
- Fiscal impact depends on how extensive the social safety nets and welfare services are, to what extent migrants are allowed to access them, and their contributions as taxpayers (Ratha, Mohapatra and Scheja 2011)



Migration, Taxation and Inequality

- Most countries acts as both home and host countries
- Taxation issues related to migration must be analyzed from a global perspective as they go across borders
- Tax and spending issues related to migration must be taken into account when analyzing the income distribution effects of taxation

THANK YOU FOR YOUR ATTENTION

