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Amend CREATE Towards Distributive Justice and Efficiency

We the undersigned are professional economists, who are committed to advancing inclusive Philippine economic growth and development in the short and long run. We belong to different public and private academic institutions but share a commitment to promote evidence-based public policymaking. The positions we take here are our own and do not reflect those of the institutions where we belong.

We believe in a continuing tax-reform program both for the Personal Income Tax (PIT) and the Corporate Income Tax (CIT). However, we oppose the Corporate Recovery and Tax Incentives for Enterprises Act (CREATE) in its current form. CREATE is a tax policy-reform bill, administration-certified, that the Department of Finance (DOF) and the National Economic Development and Authority (NEDA) have endorsed to Congress for enactment.

CREATE seeks an acceleration of the reduction in the corporate income tax rate (CITR) from 30% to 25% by July 31, 2020, instead of the gradual reduction over 10 years under the previous Corporate Income Tax and Incentives Rationalization Act (CITIRA) bill.

The CITR reduction immediately results in foregone tax collection from corporations that are able to turn a profit, notwithstanding COVID-19 and the global slowdown. At a time when the economy and the tax base are shrinking, government urgently needs additional resources to cover its Covid-19 commitments, it is imprudent to shed off tax revenue. And now to recover the losses, CREATE seeks an imposition of a value-added tax (VAT) on digital services, sweetened beverages and junk food.

Moreover, CREATE proposes a flexible special incentive system to be implemented by a central authority attached to DOF, the Fiscal Incentives Review Board (FIRB). Specific incentives are to be approved by the Philippine President upon recommendation by FIRB. Such powers need to be developed in the context of trust-building, partnership with the private sector and reform, and strengthening of regulatory institutions.

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We oppose CREATE in its current form and its accompanying supporting provisions on the following grounds:

- CREATE is both inequitable and inefficient: in contrast to the position of its proponents, who tout CREATE as a fiscal stimulus amid the economic decline brought about by the COVID-19 pandemic, it is in fact a mere tax relief for incorporated businesses, equivalent to a subsidy, leaving out microenterprises and unincorporated small and medium enterprises (MSMEs). CREATE definitely falls short in terms of distributive justice.

    - CREATE is an immediate negative shock to tax collection and the national budget at a time when the budget deficit has breached targets considered manageable; the deficit-to-GDP ratio has exceeded the original target of 3.2% at this point and is projected to reach 8.1% by the Bureau of Treasury (BTr) in 2020.
    - The reduction in the CITR is most likely to be ineffective given the shock to aggregate demand triggered by the pandemic and is not likely to deliver extra income growth and investment from large corporations. Large corporations are already being assisted by the credit, interest rate, and regulatory relief that the Bangko Sentral ng Pilipinas (BSP) has extended to the big banks whose clients are big corporations with loans. The BSP program is better than the across-the-board CITR cut since banks are better informed about the corporations that are distressed by the pandemic and the BSP targets those that are legitimately in need of relief and poses no immediate shock to the budget of the government.

- CREATE is short on distributive justice in another way. The indirect taxes to accompany CREATE are more burdensome to low-income than to high-income families. The earlier package called "Tax Reforms for Acceleration and Inclusion" (TRAIN) has already added new excise taxes. And recently, Executive Order 113 raised tariff rates or border taxes on imported petroleum products, while concerned sectors like drivers of public transport were on furlough. This is taxation without representation. As more of the low-income groups slide below poverty levels, the benefits from CREATE will only trickle down if firms actually reinvest in jobs-intensive recovery. During this crucial period when economic stimulus should be both pro-poor and decisive, this is both inefficient and inequitable. As currently designed, CREATE will take from the teeming poor to give to the few rich!

- Enterprises in export zones under the Philippine Export Zone Authority will suffer from CREATE since their privilege to pay the gross income tax of 5% will expire after 4 to 9 years. In addition, CREATE proposes a flexible special incentive scheme that replaces rules by discretion. PEZA enterprises and foreign investors do not welcome this change from rules to discretion, which is fraught with risk and uncertainty. And we simply cannot afford to add more uncertainty during this fragile recovery period from the COVID-19 pandemic.
    - The proposed flexible incentive system adds the extra transaction cost of the new bureaucratic layer and the lobbying cost it entails in the corridors of power. These are deadweight losses, which need not be incurred during this period of economic fragility, if CREATE were shelved.
    - CREATE sends a message of uncertainty to existing locators in PEZA, aggravating their already tenuous financial situation due to COVID-19 and generating a real risk of reducing the country's export capacity and growth prospects in the years to come.

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In line with our commitment to inclusive long-run economic growth and development, we propose the following:

- We recommend unbundling the important segments of CREATE and deliberating each segment in separate bills: one for corporate tax reforms and another for special fiscal and investment incentives and another for PEZA.

- Contingent on accepting the CITR reduction, we recommend preserving the gradualist approach to reducing the CITR to mitigate the negative shocks to government tax collection and to the deficit-to-GDP ratio that, while inevitable in the COVID-19 times, pose long-run problems, such as inflation, prolonged recession, joblessness, and severe balance-of-payments difficulties.

- We recommend maintaining revenue-neutrality of CIT to avoid additional indirect tax burden on low-income families and the poor, which can be achieved by tying any CITR cut to ceilings on allowable corporate expenses. A separate bill on special fiscal incentives is essential and there should be public hearings on existing laws on fiscal incentives laws to assess each and consolidate them into a single law.

- Meanwhile, the status quo for PEZA must be maintained, pending the enactment of a consolidated incentive act.

- In the interest of distributive justice, we support stimulus proposals to allocate additional funds commensurate to the needs of MSMEs and additional cash transfers to the truly disadvantaged members of society and workers laid off by the pandemic with food aid, temporary unemployment insurance and other benefits. These are priorities of "Bayanihan to Heal as One Act" that deserve to be continued. And we oppose the reduction in allocation to education and infrastructure spending proposed by DBM to reduce CITR on the rich.

- We propose that instead of more indirect taxes, financing for the equity-minded public programs should come from a gradualist reduction in the CIT but not from cuts on education and public works spending. This can be undertaken by the Department of Budget and Management (DBM).

- We underscore the importance of having a long-term development plan geared towards stable, sustainable, and equitable growth that will accompany the business survival and economic recovery plan from the COVID-19 pandemic. In this context, NEDA as head of the Inter-Agency Task Force for the Economy Moving Forward as One (IATF-EMF1) will monitor Program Action Plans (PAPs) for outcomes and recommend which of them deserve to be permanent.

- To help promote a more inclusive recovery from the COVID-19 pandemic, the priority should be on direct measures to strengthen the country's health and social protection systems as part of a "build-back-better" plan. A strong healthcare system and social protection system underpinning the recovery and providing a credible assurance of coverage for all citizens should they need it, will also be critical in backstopping the psychology of recovery. Simply put, without these systems, recovery will likely be timid and uncertain, if many consumers and investors continue to fear a relapse due to a lack of trust in crisis response capabilities, notably the health sector.

- Finally, the long-term plan can define the strategy that hinges on growing out of the public debt that the pandemic has jacked up to new heights.

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