

Tax Expenditures Policy in Algeria Between Effectiveness and Cost

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Abstract

This research aims to explore the effectiveness of tax expenditures in Algeria during the period 2000-2020 , in light of the cost incurred by the state through its voluntary relinquishment of a part of its tax revenue. This policy seeks to stimulate economic activities, particularly by encouraging domestic investment in priority economic programs and attracting foreign investment, in addition to achieving social, cultural, and environmental objectives. To achieve this objective, a descriptive-analytical approach was used by analyzing data on the size of tax expenditures in Algeria as percentage of tax revenue and the gross domestic product. The research concluded that the tax expenditures policy in Algeria are effective in encouraging investment, while it is sometimes used as a fraudulent tool for tax evasion.

Key words: tax expenditure, tax policy, effectiveness, cost, Algeria

Jel Codes Classification :E62, H20

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سياسة النفقات الضريبية في الجزائر بين الفعالية والتكلفة

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ملخص

يهدف هذا البحث إلى استكشاف مدى فعالية سياسة النفقات الضريبية في الجزائر خلال الفترة 2000-2020 في ظل التكلفة التي تتحملها الدولة من خلال تنازلها الطوعي عن جزء من إيراداتها الضريبية في شكل إعفاءات وتخفيضات من الوعاء الضريبي وتخفيضات في المعدلات، وذلك من أجل تحفيز الأنشطة الاقتصادية وبصفة خاصة تشجيع الاستثمار المحلي في البرامج الاقتصادية ذات الأولوية واستقطاب الاستثمار الأجنبي المباشر، بالإضافة إلى تحقيق أهداف اجتماعية وثقافية وبيئية. ومن أجل تحقيق هذا الهدف تم استخدام المنهج الوصفي التحليلي من خلال تحليل البيانات المتوفرة حول حجم النفقات الضريبية في الجزائر ومقارنتها بحجم الحصيلة الضريبية و الناتج المحلي الخام. وقد توصل البحث إلى فعالية سياسة النفقات الضريبية في الجزائر في تشجيع الاستثمار مع استخدامها أحيانا كأداة احتيالية بغرض التهرب الضريبي.

الكلمات المفتاحية: نفقات ضريبية، سياسة ضريبية، فعالية، تكلفة، جزائر

التصنيف Jel: H20, E62

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Introduction:

Through public budgets, countries seek to allocate annual financial appropriations for spending in various fields in order to achieve primarily economic and social goals, in addition to political, environmental, and cultural objectives. This direct government spending is subject to various oversight processes by the legislative and executive authorities and various regulatory bodies within the state. Conversely, these objectives can be achieved in other ways through the tax system, with the same degree of effectiveness, fewer administrative and regulatory procedures, and greater flexibility compared to direct spending. Governments voluntarily relinquish a portion of their tax revenues to achieve their various objectives through exemptions, reductions in the tax base, rate reductions, and tax credits. These policies have come to be known in tax literature as tax expenditures. The American economist Surrey is credited with first suggesting this idea while on leave from Harvard University. As an assistant director at the U.S. Treasury, he proposed the necessity of assessing the size of tax expenditures and including them in the general budget.

While relying on tax expenditures as a tool of tax policy helps governments achieve their objectives through the tax system, it presents numerous difficulties and challenges, including those related to oversight, transparency, cost, difficulty in estimation and impact measurement, and those related to effectiveness, fairness, and the complexity of the tax system. In the face of these challenges, many countries and governments have sought to include tax expenditures in the general budget or in a special booklet that allows for comparison with direct government spending and subjects them to oversight by government bodies and agencies for the purpose of disclosure and transparency.

Since the tax reform in the early 1990s, Algeria has adopted a policy of tax expenditures as a tool of tax policy to achieve its economic, social and environmental goals. However, the absence of these expenditures in the general budget or official documents has raised many doubts about the transparency of this policy compared to direct government spending, which is subject to many prior and subsequent control procedures and measures. Algeria has incurred a high cost due to the reduction in its revenue resulting from the adoption of a tax expenditures policy, but its impact remains difficult to measure. Based on the above, the following problem arises: How effective is the tax expenditures policy in Algeria given its high cost?

The Importance of the Study

The importance of the study lies in the fact that the tax expenditures policy are considered one of the tools of tax policy in particular and public finance in general. Governments can achieve their economic, social and cultural goals, whether by using direct spending or through the tax system via the tax expenditures policy. Given that it does not appear in the general budget as is the case with direct spending and it is not monitored by the legislative authority, it raises the problem of transparency and effectiveness in achieving the goals, especially since Algeria loses large revenues in order to use this policy, which requires measuring the effectiveness associated with it.

I-Tax Expenditures; Origin, Rationale and Challenges:

I-1- The Conceptual Origin of Tax Expenditures:

The concept of tax expenditures emerged in the early 1960s, almost simultaneously in both the United States and Germany. Before this period, there was no comprehensive classification of tax incentives or a standardized methodology for analyzing and measuring their economic impact. The concept is attributed to Stanley S. Surrey, a Harvard Law professor, who observed that many provisions of the tax code

have the same economic impact as government spending programs, but are not subject to the same level of oversight and auditing because they fall under the umbrella of tax legislation. As Assistant Secretary of the Treasury for Tax Policy, Surrey began cataloging tax preferences and establishing a systematic framework for measuring them, with the goal of enabling Congress to review tax expenditures and government spending programs more comprehensively and improve fiscal policymaking. (World Bank Group, 2024, p. 01)

The initial results of these efforts attracted widespread attention when Treasury Secretary Joseph Barr revealed to the Joint Economic Committee that 21 individuals in the United States had earned over \$1 million in 1967 without paying any federal income tax, due to their exploitation of tax preference provisions. As a result, a separate section on tax expenditures was included for the first time in the 1968 U.S. budget. Subsequently, the Budget and Probation Control Act of 1974 mandated that the U.S. Government publish an annual report on tax expenditures, along with financial estimates, accompanying all bills submitted to Congress. (World Bank Group, 2024, p. 01)

Surrey defined the concept of "tax expenditure" as follows: The concept of tax expenditure assumes that income tax consists of two main parts:

The first part includes the structural provisions necessary for the application of ordinary income tax, such as defining the concept of net income, establishing accounting rules, identifying taxable persons or entities, setting tax rates and exemption levels, and outlining the rules for applying the tax to international transactions. (Ministère des Finances Canada, 1995, p. 07)

The second part consists of the tax preferences or concessions included in various tax systems, often known as tax incentives or subsidies. These provisions are exceptions to the general rules of the tax system and are intended to encourage a particular sector or category of taxpayers.

These preferences take many forms, such as permanent income exemptions, deductions, tax deferrals, tax credits, or the application of reduced tax rates. Regardless of their form, they represent indirect government spending implemented through the tax system rather than relying on traditional support mechanisms such as direct subsidies or loans.

Interest in measuring tax expenditures began in Germany with the publication of the first report on tax subsidies and preferences in 1967, which is considered the true starting point for this concept there. During the 1970s, the International Finance Association (IFA) and the International Institute of Public Finance (IIPF) contributed to expanding the use of this concept internationally. In 1978, Austria published the first official report on tax expenditures, followed by Canada and the United Kingdom in 1979, and then Spain and France the following year. By the end of the 1980s, measuring tax expenditures had become common practice in most OECD countries. By 1983, Australia, Austria, Canada, France, and Spain had begun to identify and report on tax expenditures, and by 1996, most OECD member countries were also producing regular reports on this topic. (World Bank Group, 2024, p. 01)

I-2- Rationale and Challenges:

Similar to public spending programs, tax expenditures can be used to achieve allocation or redistribution objectives. Allocative expenditures aim to incentivize individuals or corporations to engage in activities with desirable economic or social benefits. Prominent examples include tax exemptions for research and innovation (R&I) in companies, or those designed to encourage investment-whether generally or in specific sectors- as well as housing purchases or savings for the elderly. Tax

expenditures based on redistribution include exemptions for low income families or families with children, as well as reductions in value-added tax (VAT) rates on essential goods that constitute a larger share of the spending of poor families. There are also tax expenditures that combine the objectives of economic efficiency and social fairness, such as expenditures to cover the professional costs of the self-employed. These aims, on the one hand, to achieve tax fairness compared to salaried workers (social dimension), and on the other hand, to encourage entrepreneurship (economic dimension). (Alessandro, et al., 2024, p. 05)

Conversely, tax expenditures can increase the complexity and transparency of the tax system, have negative distributional effects, and cause significant losses in public revenue. While their impact may be comparable to that of public spending programs, they often lack transparency, resulting in revenue reductions that are difficult to accurately estimate, unlike direct spending, which is clearly reflected in the budget. Furthermore, multiple tax expenditures increase the complexity of the tax system and the costs of administration and compliance. Depending on their design, targeting, and interaction with other policies, these expenditures can produce unintended and negative distributional effects, and in some cases, have cross-border fiscal effects. They are also sometimes used as a tool for harmful tax competition. (Alessandro, et al., 2024, p. 06)

II- The Concept of Tax Expenditure:

II-1- Definition of Tax Expenditures:

Tax expenditures are defined as the shortfall in public revenue resulting from the application of preferential tax provisions, such as exemptions, exceptions, allowances, deductions, credits, deferrals, or reductions in tax rates, and other measures that reduce the tax burden on certain categories of taxpayers compared to general tax rules. These provisions are policy tools that are essentially similar to government spending programs, hence the term tax expenditures (TE_s). (Antonilla, 2011, p. 07)

Tax expenditures are a common method of financing public policies, as they can achieve the same goals as direct spending, from supporting social welfare to achieving environmental and industrial objectives. Their main advantages lie in their operational flexibility, the speed with which beneficiaries can benefit, and the absence of direct government intervention in selecting funded projects. Studies indicate that this mechanism may be more effective than direct subsidies in stimulating desired economic behavior to achieve public policy goals.

In contrast, direct spending programs are characterized by greater administrative complexity, due to their reliance on discretionary mechanisms that require precise information for selecting projects and beneficiaries, as well as the associated bureaucracy, which reduces the transparency of disbursement schedules and methods. Therefore, it can be argued that tax expenditures are more cost-effective, as they require less administrative expenditure compared to traditional government spending. (Antonilla, 2011, p. 07)

Governments resort to tax expenditures (TEs), which are deviations from the reference tax system, to provide financial support or targeted benefits to individuals, businesses, and other entities, including non-governmental organizations. These expenditures have a fiscal impact similar to direct public spending, as they reduce the resources available to fund other government priorities. Although tax expenditures often conflict with the principles of sound tax policy, they are a widespread tool and frequently amount to considerable sums. It is estimated that these expenditures reduce tax revenues by approximately 4 percent of GDP in countries that report them, while this figure exceeds 10 percent in some countries that grant preferential tax treatment to specific sectors or categories. (International Monetary Fund, 2022, p. 01)

In general, tax expenditures are privileges granted outside the framework of the tax reference system or standard. This standard typically includes the tax rate structure, the accounting rules applied, the deduction of mandatory payments, provisions that facilitate tax administration, and international financial obligations. Tax expenditures take many forms, such as exemptions, allowances, credits, preferential rates, tax deferrals, and others. The purpose of tax expenditures reporting is to measure the revenue generated from these deviations from the tax standard. However, the definition of a tax standard varies from country to country, making cross-border comparisons difficult. For example, one country might consider a particular exemption a tax expenditure, while another considers it part of the regular tax system. Furthermore, some items may fall in an intermediate category, making it difficult to determine whether they constitute tax expenditures or fall under the tax standard itself. (Zhecheng Li, Hana Polackova, & Christian, 2004, p. 03)

Tax expenditures are defined as a set of legal or regulatory provisions or tax practices that reduce or defer revenue for a relatively small segment of taxpayers compared to standard taxation. For the government, they represent a loss of public revenue, while for taxpayers, they represent a reduction in tax liabilities. In many OECD countries, tax expenditures are known by terms such as exemptions, subsidies, or tax relief. (OECD, 2010, p. 12)

Tax expenditures represent a shortfall in public revenue resulting from tax provisions designed to encourage taxpayers to adopt certain behaviors or to support them in specific situations. The term "tax expenditures" are typically used to refer to these provisions themselves, not just the resulting financial loss. These measures can be viewed as a form of public spending implemented through the tax system, as they fall under the same functional categories as the U.S. budget. (Service, 2020, p. 02)

Tax expenditures are tax policy tools designed to reduce the tax burden on specific taxpayer groups or encourage particular activities. These tools include exemptions, allowances, deductions, reduced rates, and tax deferrals. The term "tax expenditures" are used to indicate that these measures, although on the revenue side of the budget, achieve similar objectives and effects to those of direct spending programs such as subsidies and government benefits. In some countries, they are known by other names such as tax exemptions, aid, or subsidies. (Alessandro, et al., 2024, p. 04)

Tax expenditures can only be accurately defined or measured by comparison with a reference tax system under which these expenditures are granted as tax relief. However, there is no single method for defining this reference system. It may be defined using a "normative" approach based on the concept of the optimal or most efficient tax system, or-as is often the case- a "descriptive" approach based on the general rules and principles set forth in current tax legislation to determine what constitutes an exception. According to a recent OECD report, the EU member states have adopted this latter approach. Generally, the reference tax system is supposed to include the rate structure, accounting conventions, the deduction of mandatory payments, provisions that facilitate tax administration, and provisions related to international financial obligations. (Alessandro, et al., 2024, p. 04)

The World Bank defines tax expenditures as revenue losses resulting from special tax provisions, such as exemptions, deductions, credits, and preferential rates, used to support economic activity, promote social policies, and address market imbalances. The term "tax expenditures" may seem paradoxical, as "tax" implies collection and "expenditure" implies spending. However, these expenditures are essentially a form of indirect government spending channeled through the tax system, directed toward specific activities or groups. (World Bank Group, 2024, p. 01)

According to the OECD definition, which is also adopted by the World Bank, tax expenditures are essentially privileges that fall outside the framework of the basic tax system or standard. This standard includes elements such as the structure of tax rates, the accounting rules adopted, the deduction of mandatory payments, provisions aimed at facilitating tax administration, and international financial obligations. In other words, tax expenditures refer to revenue losses resulting from preferential provisions within the tax system, specifically designed to achieve particular economic or social objectives. (Vjekoslav, 2006, p. 115)

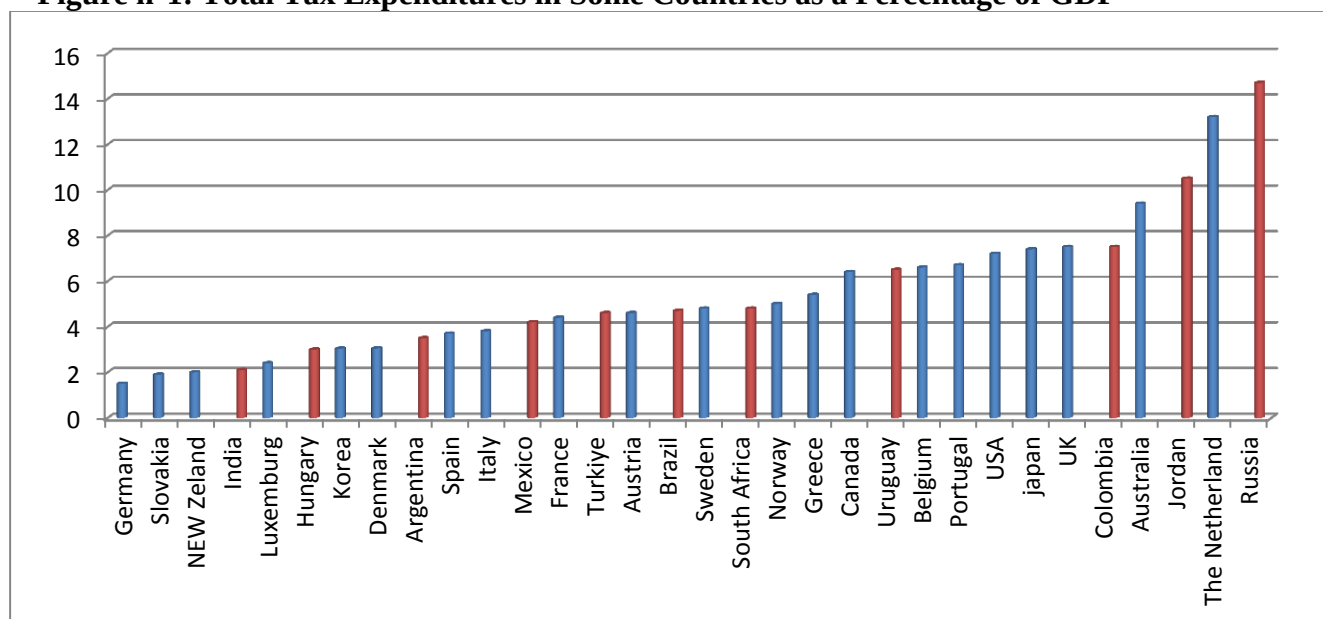
II-2- The Tax Reference System :

Studying tax expenditures requires a thorough understanding of the legal aspects of the tax system. This is the task of the legislative team responsible for establishing the benchmark tax standard (BTS) for each tax in every fiscal year. This team prepares a matrix that includes measures that deviate from this standard, identifying those that are classified as tax expenditures based on two main criteria: the degree of deviation from the reference tax and the size of the final loss in public revenue. This matrix serves as a primary reference for the assessment team in the process of estimating tax expenditures. (Yannick, Emelie, Bertrand, & Celine, 2018, p. 13)

The tax reference system forms the basis for determining the nature and size of tax expenditures. This system should be based on the fundamental principles of sound tax policy, such as fairness, efficiency, and simplicity. To ensure that all forms of public spending are subject to the same level of evaluation and transparency, the definition of the reference system should be as comprehensive as possible, avoiding any exceptions to the general rule. Three main approaches to defining the tax reference system can be distinguished: (International Monetary Fund, 2022, p. 02)

- The conceptual approach: This approach involves formulating a reference tax system based on the theoretical foundations of tax policy.
- The benchmark tax law approach: This approach is characterized by its practical nature and focuses on analyzing existing tax provisions.
- The benchmark expenditure equivalent approach: This approach defines the benchmark system based on the provisions that can be achieved with the same level of effectiveness through public spending.

These approaches can be combined in practice, as it is common to incorporate some elements of the reference tax law even when the conceptual approach serves as the primary guiding principle. Regardless of the approach taken, the reference tax system should be clear and transparent, and limited to the essential characteristics of basic taxes. It should reflect the normal tax treatment applied to taxpayers or similar activities, excluding provisions that grant special privileges to specific economic groups, activities, or geographic areas. Furthermore, the system should be consistent across different types of taxation and structured in such a way that the resulting list of tax elements provides policymakers with the necessary information regarding possible reform options. (International Monetary Fund, 2022, p. 02)

Figure n°1: Total Tax Expenditures in Some Countries as a Percentage of GDP

Source: prepared by researcher based IMF Data,2022, p02.

II-3- Types of Tax Expenditures:

Tax expenditure takes many forms, including income tax exemptions, reduced tax rates, tax credits, deductions, and tax deferrals. All of these forms share the characteristic of reducing the tax burden on taxpayers, thereby lowering government revenue. These expenditures can be classified according to several criteria, such as their objectives, the groups benefiting from them, or their economic impact on public revenue. Depending on the type of economic benefit or exemption they provide, tax expenditures are typically divided into specific categories that reflect their nature and economic function. (Sammartino & Toder, 2020, p. 03)

A- According to Economic Function

Tax expenditures can take many forms, including: (OECD, 2010, p. 12)

- Allowances: These are amounts deducted from the tax base to arrive at the taxable amount;
- Exemptions: Amounts excluded from the taxable amount;
- Rate reductions: Applying a lower tax rate to a specific category of taxpayers or to specific transactions;
- Tax deferral: Postponing the payment of tax obligations to a later date;
- Tax credits: Amounts that are deducted directly from the tax due.

B- By Tax Type

Tax expenditures can also be classified according to the different types of taxes, as their design, target groups, and objectives vary depending on the nature of the tax. Among the most prominent taxes that apply tax expenditures are: personal income tax, corporate tax, value-added tax (VAT), customs duties, and excise taxes. (Sammartino & Toder, 2020, p. 03)

C. According to Public Policy Objectives

Tax expenditures are also classified according to the objectives that tax policy seeks to achieve, which may be social, economic, environmental, political, or cultural: (Rosanne & Robert D, 2008, p. 38)

- Social: such as deductions granted to people with disabilities, pension savings, or donations to charitable organizations of a social or religious nature.

- Economic: such as exemptions or deductions designed to encourage investment and reduce the effective tax burden on investors.

- Environmental: such as exemptions or accelerated consumption for investments directed towards environmentally friendly technologies.

- Political: such as exemptions granted to the public sector or donations to political parties.

- Cultural: such as exemptions on income generated from cultural activities, or from value-added tax on artistic and musical performances.

D. According to the Beneficiary

Tax expenditures can also be categorized based on the identity of the beneficiaries, whether individuals, families, businesses, or non-profit organizations. This categorization helps enhance transparency in the allocation of public resources and enables a deeper discussion about the impact of these expenditures on social fairness. Beneficiaries can also be categorized according to additional criteria such as income level, business size, economic sector, or geographic location. (Sammartino & Toder, 2020, p. 03)

II-4- The Positive and Negative Aspects of Tax Expenditures:

When tax expenditures are used as a tool to achieve specific social and economic goals, or as an alternative to direct financial assistance provided by the state (such as grants, loans, or guarantees), it is essential to carefully evaluate its positive and negative impacts. Among the most prominent advantages of tax expenditures are the following: (Zhecheng Li, Hana Polackova, & Christian, 2004, p. 04)

- Encouraging private sector participation in the implementation of economic and social programs in which the government plays a central role.

- Promoting individual and institutional decision-making freedom, rather than centralized government decision-making.

- Reducing the need for close and continuous government oversight of this type of spending.

Most of the disadvantages associated with tax expenditures relate to their potential ineffectiveness, efficiency, and fairness, and these can be summarized as follows: (Zhecheng Li, Hana Polackova, & Christian, 2004, p. 05)

- Reduced effectiveness: Some tax expenditures may not be sufficient to influence underlying economic factors, or their effects may be negated by other domestic or foreign tax arrangements.

- Reduced efficiency: Many tax expenditures programs are designed in response to pressure from special interest groups rather than to meet genuine economic needs. This leads to distortions in resource allocation by favoring certain sectors or projects over others, thereby weakening overall investment.

- Lack of equity: Tax expenditures policies often result in an unfair distribution of the tax burden, both vertically (between social classes) and horizontally (among taxpayers in similar circumstances). In particular, non-taxpayers-typically the poorest segments of society- are excluded from benefiting from the non-refundable measures adopted by most governments.

Additional negative effects include:

- Erosion of the tax base, limiting the ability to reduce tax rates.

- Increased openness and uncontrolled nature of government spending, complicating the estimation of expected revenues.

- A more complex and costly tax system, creating greater opportunities for illicit profiteering.

- Distorting the true size of the government, since relying on tax expenditures instead of direct spending makes the apparent size of government activity smaller than reality.

III- Estimating and Evaluating Tax Expenditures:

III-1- Estimation Methods:

Tax expenditures are typically estimated using the "lost revenue" method, which calculates the amount of tax that could have been collected if the tax exemption had been eliminated, assuming economic behavior remained unchanged. According to Anderson (2008), there are alternative methods for measuring tax expenditures, the most prominent of which are: (OECD, 2010, pp. 13-14)

- Initial revenue loss (or gain): This represents the decrease (or increase) in tax revenue resulting from the application (or elimination) of tax expenditures, assuming constant tax behavior and revenues from other taxes.

- Final revenue loss (or gain): This reflects the change in tax revenue after accounting for the effects of tax behavior resulting from the application (or elimination) of tax expenditures, as well as their impact on revenues from other taxes.

- Expenditures parity: This is an estimate of the amount of direct expenditure required before taxation to achieve the same effect on taxpayers' income as tax expenditures, assuming that these direct expenditures are treated the same way.

The "loss of revenue" method (also known as the "initial loss of revenue" method) is commonly used to estimate the financial impact of tax expenditures. It calculates the tax that would have been paid if the exemption had been eliminated, assuming economic behavior remained constant. While considering behavioral effects-known as the "final loss of revenue" method- can lead to a more accurate estimate, its practical application remains complex. Furthermore, these effects are often not included in government budgets because the dynamic impact of expenditures on revenue is not typically accounted for. (Alessandro, et al., 2024, p. 05)

The impact of tax expenditures can also extend to deferring tax revenue collection, as in the application of depreciation rules that deviate from traditional accounting principles. Some countries adopt the present value method to calculate the financial impact of such expenditures over the entire depreciation period. More broadly, this approach is used to estimate deferred taxes, which are essentially like an interest-free government loan. (Zhecheng Li, Hana Polackova, & Christian, 2004, pp. 7,8)

III-2- Criteria for Evaluating Tax Expenditures:

Ideally, the evaluation of tax expenditures should be based on a theory of change that explains the causal relationships between these expenditures and their intended outcomes, while also considering their interrelationship with other public policy measures. Frameworks for evaluating tax expenditures, both nationally and internationally, are typically developed according to a set of evaluation criteria that may include the following: (Agustin, Christian, & Sofia, 2023, pp. 11,12)

- Relevance and Rationale: A clear and detailed presentation of the stated policy objective of the tax expenditures and the rationale behind it should be provided. What public problem or issue does this measure aim to address? Is it economically and socially justified?

- Fiscal Cost: What is the estimated amount of tax revenue lost as a result of this expenditure? If a precise figure cannot be determined, an estimated range based on different scenarios can be used. It is also advisable to clarify the uncertainties associated with the estimate, such as behavioral elasticity, which is difficult or impossible to predict in advance.

- **Efficiency:**

Efficiency is a key element to consider when comparing different public policy instruments. In this context, it is essential to assess whether the analysis considers alternative public policy instruments, such as direct spending or regulatory interventions. Furthermore, it is crucial to ensure that the administrative and compliance costs arising from the use of these alternative instruments are accurately accounted for.

- **Impact and Evidence:** This aspect concerns identifying the expected or actual changes resulting from the implementation of the policy instrument. Available evidence demonstrating its effectiveness or limitations should also be reviewed. Where possible, it is advisable to refer to the results of previous evaluations of similar measures implemented in similar sectors or countries. Furthermore, a detailed description of the affected groups should be included, such as different economic sectors, types of businesses (startups or small and medium-sized enterprises), and different income brackets.

- **Side Effects or Externalities:** This section addresses the identification of potential or actual side effects or externalities resulting from the use of the public policy instrument, such as unintended impacts on specific groups or on the overall economic and social environment.

- **Indirect cognitive or economic effects:** Does the measure have indirect cognitive or economic effects, such as stimulating innovation or creating jobs in other sectors or regions?

- **Sustainability:** What are the expected or observed effects on environmental, economic, and social sustainability, including long-term environmental impacts?

- **Distributional impact:** Who are the primary beneficiaries of the resulting benefits? Are they individuals based on income levels, or specific categories of businesses?

- **Monitoring and Evaluation:**

- **Governance:** Which institutional body is responsible for the evaluation? Is it the Ministry of Finance or the National Audit Office? What is the role of other entities such as the legislative authority, the tax authority, and relevant sectoral ministries?

- **Timeline:** When is the impact assessment conducted, and how are its results integrated into the decision-making process? Are there specific deadlines for submitting the results to the legislative authority or executive bodies?

- **Methods and Data Availability:** What methodologies are adopted for the evaluation? Is the necessary data available? Are there effective protocols for data exchange between institutions?

- **Policy Coherence:** Policy coherence is a crucial aspect. The use of technology tools must be consistent with the budgetary framework, aligned with national development strategies, medium-term financial frameworks, and the country's international commitments.

IV- Tax Expenditures Versus Direct Spending:

IV-1- Taxes or Direct Expenditures?

Most local and state government programs and activities rely on direct spending. Taxes and fees are collected to fund the operation of public schools and universities, the provision of police and fire services, the construction and maintenance of streets and highways, and the coverage of healthcare costs within public programs. This traditional approach represents the primary method of government management and operation, as the tax system simply generates the necessary financial resources to run government operations, as explained in the basic civics curriculum. (Joel, 2018, p. 03)

However, the tax system can be used directly to provide public services or government grants. This use is commonly referred to as "tax expenditures" rather than direct spending. For example, Minnesota relies heavily on tax expenditures, with its annual budget for tax expenditures estimated in the billions of dollars. This expenditure is typically used to achieve specific policy goals, such as encouraging individuals to save for retirement, purchase homes, and invest within the state, or to provide limited benefits to a broad segment of the population, such as reimbursing childcare costs or supporting the income of low-income workers. In some cases, the legislature has used both direct and tax expenditures to achieve the same policy goals. (Joel, 2018, p. 03)

IV-2- The Impact of Tax Expenditures on the Performance of the Tax System

Adding tax expenditures inevitably complicates the tax system, making it less understandable and more difficult to comply with and manage. Given the multitude of tax expenditures with purposes not directly related to revenue collection, tax officials may be less receptive to the objectives of these expenditures than those of the agencies tasked with administering them. Furthermore, institutional factors may shift the focus of tax officials from revenue collection to simply "administering" provisions, as is the case with direct spending programs, thus impacting how these programs are managed. The increased number and complexity of tax expenditures force taxpayers to dedicate more time to completing their tax returns, especially when multiple tax expenditures compete for the same purpose, such as higher education costs or retirement savings, requiring careful decision-making regarding the optimal option for each individual. Moreover, the perception that some deductions or exemptions enable others to evade taxes may undermine public trust in the tax system and reduce its transparency and understanding. Therefore, these negative effects must be weighed against the potential benefits of using the tax system to support various programs. Taxpayers often only discover their ineligibility for new programs after reviewing their tax returns and learning the details. (Joel, 2018, p. 08)

IV-3- Tax Expenditures VS Direct Spending

- Unlike direct spending, tax expenditures do not appear in the budget and remain invisible until their impact on revenue is estimated and reported. For example, if the government decides to fund the construction of a bridge at a cost of \$10 million through Company Y, it has two options: either pay \$10 million directly to the company (direct spending) or refrain from collecting the same amount in taxes from the company (tax expenditures). Although the two options may appear to be equal in cost, there is a clear difference in appearance. Direct spending would be recorded in the budget as the cost of building the bridge, while tax expenditures would make the bridge appear "free," since the financial report does not show that the government is funding the bridge by forfeiting \$10 million in tax revenue.
- Although governments use both tax expenditures and direct spending as tools for implementing public policy, there is a clear difference between them in terms of administrative oversight and control of public funds. While direct spending is characterized by direct government oversight of the amount and disbursement of funds, tax expenditures typically rely on the decisions of taxpayers themselves, making them less transparent in their implementation. Tax incentives often operate independently and unilaterally, with limited intervention from authorities to determine the validity of tax claims. At best, only a small fraction of tax returns are audited, generally reducing the chances of detecting false claims. Consequently, the government's ability to control and supervise tax expenditures is significantly less than with direct spending. (World Bank Group, 2024, p. 02)

- Because tax expenditures are enshrined in complex legal provisions and do not require periodic appropriations to ensure their continuity, they are often subject to less rigorous legislative oversight. This makes them more politically appealing, as they only reveal potential revenue losses, making them less transparent than direct spending. Furthermore, their allocation can be selectively targeted through legislation, giving politicians a way to appear as proponents of fiscal discipline with lower political costs in some cases. Once adopted, tax expenditures become a permanent part of the tax structure and are not subject to periodic legislative reviews to ensure their appropriateness or effectiveness. They are also included in the overall revenue projections in future budgets.
- The widespread of tax expenditures, resulting from weak legislative oversight, can lead to the accumulation of significant financial costs over time, posing a threat to fiscal sustainability. The high level of lost revenue due to these expenditures can negatively impact the budget's distributive, economic, and regulatory functions, and may undermine the tax system's fundamental role of revenue collection.
- However, despite these challenges, tax expenditures have some advantages over direct spending. They can support individuals and businesses or influence their behavior more quickly and with a greater degree of certainty. Their self-funding nature also reduces the compliance costs or stigma associated with some government programs, as accessing them typically does not require applications or prior approvals. (World Bank Group, 2024, p. 03)

V- The Reality of Tax Expenditures in Algeria:

V-1- The Most Important Forms of Tax Expenditure Granted Under Investment Law 22-18

The Algerian legislator has granted several tax exemptions according to the type and location of the investment, through exemptions from customs duties, value-added tax, professional activity tax (It was repealed by FL 2024), or corporate profits tax.

• Tax Exemptions Within the Sectoral System

Investments in the implementation phase, as stipulated in Article 27 of Law 22-18, benefit from the following exemptions:

- Exemption from customs duties on imported goods directly used in the implementation of the investment;
- Exemption from value-added tax on imported or locally produced goods and services directly used in the implementation of the investment;
- Exemption from property transfer fees and real estate registration fees on all real estate acquisitions related to the investment;
- Exemption from registration fees for company incorporation contracts.

During the operational phase, this type of investment is exempt from professional activity tax and corporate income tax for a period ranging from three to five years.

• Tax Exemptions Within the Framework of the Regional System

In addition to the exemptions mentioned in Article 27 of Law 22-18, these investments benefit from tax exemptions from the professional activity tax and the corporate profits tax for a period ranging from 5 to 7 years.

• Tax Exemptions Within the Framework of the Structured Investment System

In addition to the exemptions mentioned in Article 27 of Law 22-18, these investments benefit from tax exemptions from the professional activity tax and the corporate profits tax for a period ranging from 5 to 7 years.

V-2- Evaluating the Evolution of Tax Expenditures in Algeria During the Period 2000-2020:

Algeria has made numerous attempts to stimulate domestic investment, attract foreign investment, and support certain social groups, cultural activities, and environmental programs by adopting a policy of tax exemptions as an incentive to encourage these activities. The table below shows the cost of tax expenditures in Algeria during the period 2000-2020.

Table n°1: Evolution of Tax Expenditures in Algeria as Percentage of Tax Revenue and GDP

Unit: Million Dinars

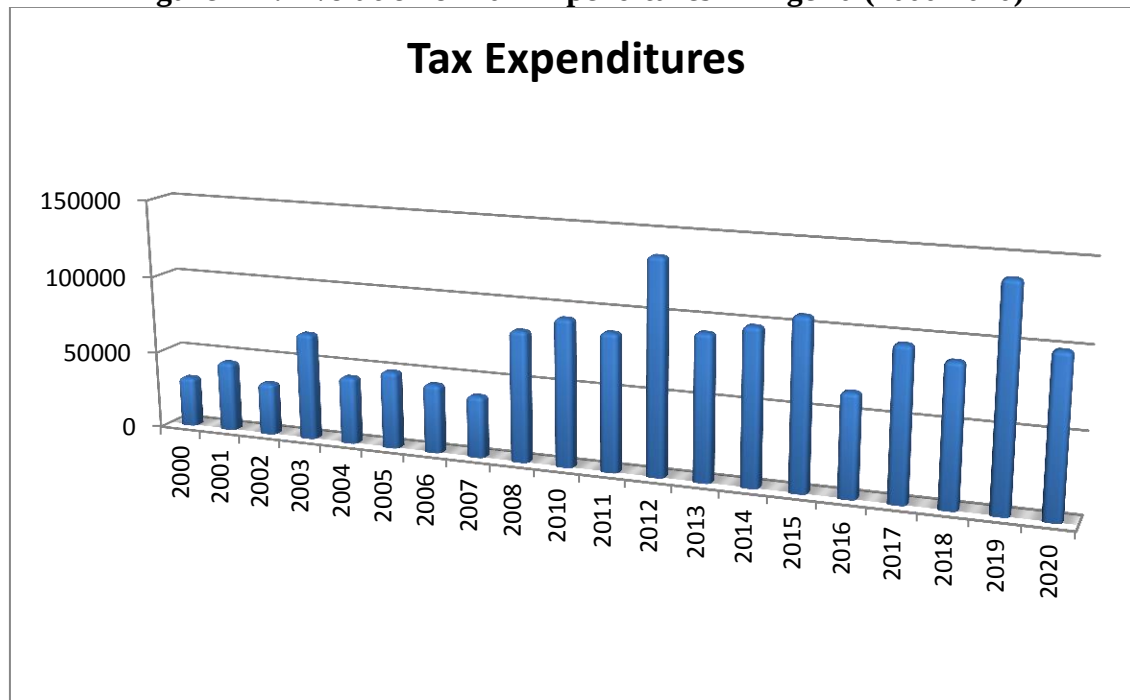
Years	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
TE	32457	45180	33878	69246	43434	49717	44173	39565	83689	ND	93671
TE%TR	9,28	11,35	8,84	13,3	7,5	7,74	7	6,23	10,5	---	7,22
TE%GDP	1,56	2,03	1,1	2,04	1,15	1,18	0,95	0,75	0,76	---	0,78
Years	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	
TE	87429	136084	92331	98832	107551	64711	95700	88460	138000	99800	
TE%TR	5,72	6,86	4,55	4,73	4,57	2,61	3,64	3,26	4,85	3,80	
TE%GDP	0,60	0,86	0,55	0,57	0,64	0,37	0,51	0,43	0,67	0,54	

Source: prepared by researcher based on: Ministry of Finance, General Directorate of Taxes, Planning Department and Bank of Algeria Reports

Table 1 above clearly shows the increasing size of tax expenditures in Algeria from year to year, with a significant rise in some years. The year 2008 witnessed the beginning of the increase in the size of tax expenditures due to the financial crisis that occurred at that time, as the effectiveness of tax expenditures and demand for it increases during times of crisis. In that year, it reached 83,689 million dinars, and continued to rise to reach its highest value in 2012 at 136,084 million dinars. It then declined in 2013 to reach 92,331 million dinars and stabilized near this level in the remaining years. The reason for this decline is due to the drop in oil prices, which is the state's main resource, which prompted the financial authorities to review the size of tax expenditures granted. However, the size of tax expenditures rose again to reach its highest value in 2019 at the level of 138,000 million dinars, despite a slight decline in 2020. This was due to the economic crisis that the world witnessed as a result of the Corona pandemic in 2019.

In general, Algeria has given great importance to this policy to promote the economic sector in the areas of local and foreign investment and its use for social and environmental purposes. This is evident in the large sums the state loses annually through the tax system. Regarding the structure of tax expenditures in Algeria, value-added tax (VAT) is the dominant component, followed to a lesser extent by income tax, whether within the general framework through finance laws or through special regulations via various agencies established to support investment, youth, and entrepreneurial initiatives. The evolution of tax expenditures in Algeria during the period 2000-2020 can be illustrated in Figure 2 below.

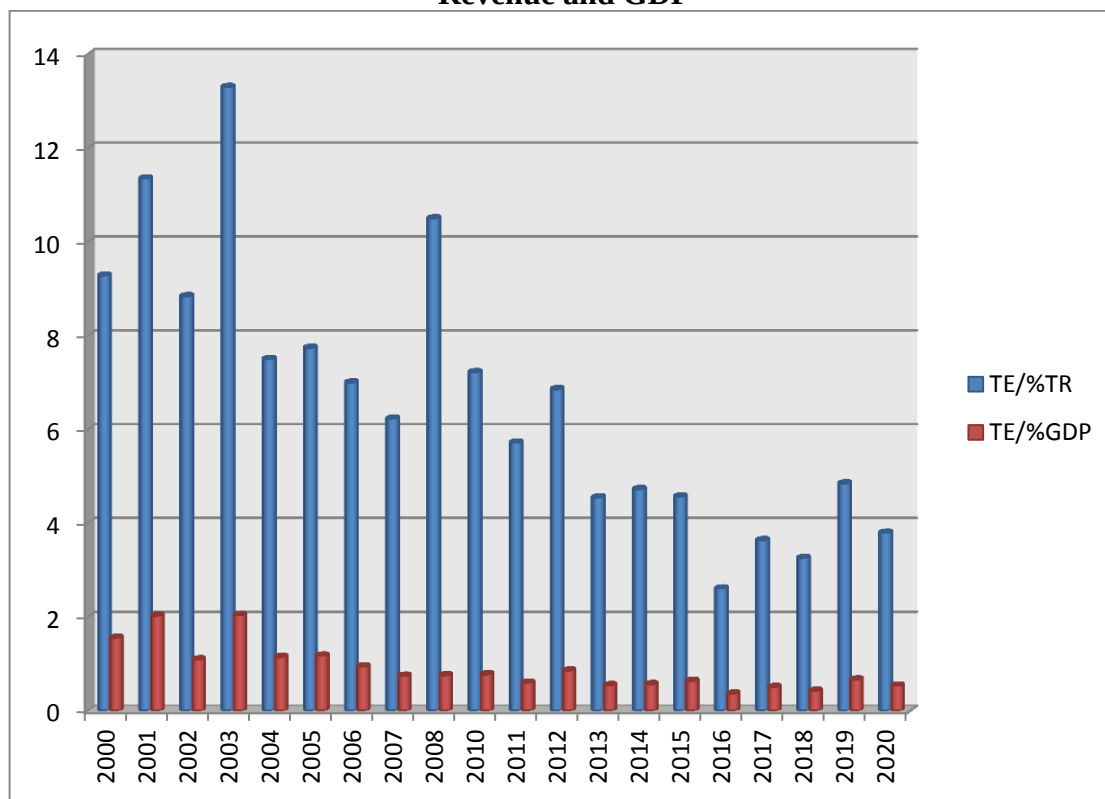
Figure n°2: Evolution of Tax Expenditures in Algeria (2000-2020)



Source: Prepared by the researcher based on the data in Table 01

Figure 03 below shows the size of the loss incurred by the government as a result of adopting the tax expenditures policy as a percentage of the size of the tax revenue and the gross domestic product (GDP) during the period 2000-2020.

Figure n°3: Evolution of Tax Expenditures in Algeria as Percentage of Tax Revenue and GDP



Source: prepared by researcher based on table 01 above

It is observed from the figure that the government is losing a large tax revenue as a result of its adoption of the tax expenditures policy, as the size of tax expenditures as a percentage of tax revenues in 2003 amounted to 13.3%. This percentage then began to decrease despite the increase in the size of tax expenditures due to the increase in the size of tax revenues resulting from Algeria's adoption of the strategy of replacing oil revenue with ordinary taxation within the framework of the move towards economic diversification, as well as due to the improvement of collection mechanisms and the imposition of strict measures to reduce tax evasion. The highest percentages of loss in revenues were in 2008 at 10.5%, in 2012 at 6.86%, and in 2019 at 4.85%.

Conversely, tax expenditures as a percentage of GDP were low due to the continuous increase in the size of the gross domestic product from year to year, reaching its highest percentage in 2003 at 2.04%, before beginning to decline despite the continued increase in the size of tax expenditures.

VI- Econometric Study

VI-1- The Effect of Tax Expenditures(TE) on Foreign Direct Investment (FDI)

A- Estimating the Model

Excluding other variables that affect foreign direct investment(political and security stability, infrastructure, ICT development, legislative and legal stability...) and assuming that tax expenditures are the most prominent factor affecting the attraction of foreign direct investment, and by providing data on the development of the size of foreign direct investment in Algeria during the period 2000-2020 by means of the World Bank database and comparing it to the size of tax expenditures for the same period, and by modifying the data using the logarithm and using the ordinary least squares (OLS) model, we obtained the following table.

Table n°2: Results of Estimating the OLS Model

Variable	Coefficient	t-Statistic	Prob
Ln TE	1.42	5.35	0.000
C	-4.12	-2.30	0.03
R ² = 0.6 F-statistic= 28.6 Prob(F)= 0.000			

Source: Established by researcher using Eviews outputs

It can be observed from Table No. 02 above that the change in the size of tax expenditures have a positive and significant impact on foreign direct investment flows, when the coefficient of determination between the dependent variable (foreign direct investment) and the independent variable (tax expenditures) was approximately 0.6, and this correlation is significant(Prob=0.000).

$$\text{Ln(FDI)} = -4.12 + 1.42 \text{ Ln(TE)}$$

The coefficient 1.42 means that an increase in tax expenditures(TE) by 1% lead to an increase in foreign direct investment(FDI) by 1.42%, all other factors being constant.

B- Statistical Hypotheses Testing

H₀: There is no statistically significant effect of tax expenditures on foreign direct investment.

$$H_0: \beta = 0$$

H₁: There is statistically significant effect of tax expenditures on foreign direct investment.

$$H_1: \beta \neq 0$$

The value of t-statistic of Ln TE= 5.35 and Prob= 0.000, Prob<5%. So we reject H₀ and accept H₁, which state there is statistically significant effect of tax expenditures on foreign direct investment.

C- Model Quality

Standard results indicate a statistically significant positive effect of tax expenditures on foreign direct investment at a significance level of 5%, and the model as a whole is statistically significant according to the F-test.

VI-2- The Effect of Tax Expenditures on Domestic Investment

A- Estimating the Model

Using the ordinary least squares method, the relationship between the dependent variable (domestic investment) and the independent variable (tax expenditures) can be measured. This is done by excluding some independent variables that can affect the size of domestic investment (the size of government spending, bank financing, roads, transportation, railways...). By relying on the size of domestic investment during the period 2000-2020 obtained from the World Bank database and comparing it with the size of tax expenditures for the same period after adjusting it by logarithm, we obtained the following estimated model:

Table n°3: Results of Estimating the OLS Model

Variable	Coefficient	t-Statistic	Prob
Ln TE	1.5	5.41	0.000
C	-1.565	-1.18	0.000
R ² = 0.672 F-statistic= 36.92 Prob(F)= 0.000			

Source: Established by researcher using Eviews outputs

The model's ordinary least squares (OLS) estimation clearly shows a direct relationship between tax expenditures as the independent variable and the size of domestic investment as the dependent variable, assuming other factors that could affect on investment remain constant. The coefficient of determination(R²) for this relationship was estimated at 67.2%, meaning that 67.2% of the changes in the size of domestic investment are due to the effect of tax expenditures. This relationship is significant at the 0.05 level, where the model's significance was estimated at (Prob=0.000).

$$\text{Ln(DI)} = -1.565 + 1.5 \text{ Ln(TE)}$$

The coefficient 1.5 means that an increase in tax expenditures(TE) by 1% lead to an increase in domestic investment(FDI) by 1.5%, all other factors being constant.

B- Statistical Hypotheses Testing

H₀: There is no statistically significant effect of tax expenditures on domestic investment.

H₀: $\beta = 0$

H₁: There is statistically significant effect of tax expenditures on domestic investment.

H₁: $\beta \neq 0$

The value of t-statistic of Ln TE= 5.41 and Prob=0.000 , Prob<5%. So we reject H₀ and accept H₁, which state there is statistically significant effect of tax expenditures on domestic investment.

C- Model Quality

Standard results indicate a statistically significant positive effect of tax expenditures on domestic investment at a significance level of 5%, and the model as a whole is statistically significant according to the F-test

Conclusion

The use of tax expenditures in Algeria for economic stimulus faces numerous obstacles and challenges, most notably tax evasion and the informal sector. The multiplicity and diversity of tax expenditures forms complicate the tax system and make it difficult for the tax administration to monitor. This creates an opportunity for some investors to exploit tax expenditures for speculative purposes. This is particularly true in the Algerian economy, which is experiencing a continuous increase in the size of tax expenditures, coupled with substantial tax losses due to tax evasion. Despite the problems and shortcomings that characterize tax expenditures in Algeria and their ineffectiveness, the relevant authorities can improve their effectiveness by adopting sound performance standards in formulating and managing tax expenditures and directing them towards national priority and productive projects. Furthermore, achieving a degree of coordination between tax expenditures and other factors that stimulate economic activity is crucial, as the effectiveness of tax expenditures depends on coordination rather than quantity and value. Based on the above, some conclusions can be displayed:

- Using tax expenditures as a tool of fiscal policy allows governments to broaden their range of public finance options, as tax expenditures have become a tool for intervention.
- Despite the success of the tax expenditures policy in Algeria in attracting foreign direct investment($R^2=0.6$) and encouraging domestic investment($R^2=0.672$), there are some pseudo-investors who exploit this preferential measure for the purpose of circumventing and evading taxes, which requires the establishment of strict legislative texts to benefit from tax expenditures.
- The lack of rationalization in tax expenditures policy and the reliance on automatic activation mechanisms that lack accuracy and measurement standards.

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