

# REVENUE MOBILIZATION AND DEVELOPMENT

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## Overview of Lessons, Issues and Opportunities

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# Presentation Outline

1. Introduction
2. Lesson on Tax Reforms
3. Income Tax Measures
4. VAT Measures
5. Excise Tax Measures
6. Other Sources taxes

# Introduction

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- # First, I want to thank the IMF Mgt, particularly FAD for inviting me to be a discussant in a subject I consider most important for any policymaker in a developing country.
- # This workshop builds on a similar one organized jointly on SSA by IMF and GoK in Nairobi, Kenya, and I consider it appropriate, timely and most welcome;
- # These workshops come amid renewed growth momentum in developing countries, but with downside risks
- # As already demonstrated in the opening remarks, we are gathered here in IMF HQ to deliberate on policy and revenue reform options available to developing countries to raise additional resources for:
  - ✓ Financing priority development, necessary to expand economic growth, create employment;
  - ✓ Building human capital and assuring food security; and
  - ✓ Reducing poverty on a sustainable basis.

# Introduction Cont..

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- # The paper by Michael Keen on “Trends, Challenges and Opportunities – Policy Focus” provides us with a lesson platform on which to launch a fresh round of tax reforms for developing countries
- # It is comprehensive and deep in its coverage of critical lessons, challenges and what opportunities exist in terms of tax policy and design issues for developing countries;
- # These observations, notwithstanding, allow me chair to pose to the distinguished participants two questions as a guide to my discussion;
  - What is the role of tax policy in this revenue mobilization – development nexus? and
  - Why are we concerned with revenue mobilization in developing countries?

# Introduction Cont..

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- # We know from theory and various studies that taxation impacts growth and development;
- # Experience have also shown that there exist a link between economic performance (the tax base) and revenue mobilization effort in developing countries (DCs).
- # Consequently, to sustain revenue mobilization, effort must also be expended toward assuring broad-based economic growth and development
- # Achieving this objective, however, require that we implement appropriate economic policies and structural reforms that support growth and promote private sector expansion

# Introduction Cont..

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- # Therefore, policymakers need to reflect on the recent economic developments, the challenges DCs must address and what role tax policy will play in terms of:
  - ✓ Encouraging economic efficiency, promoting productivity and growth
  - ✓ Raising additional resources to finance priority development
  - ✓ Redistribution and promoting governance and accountability
- # Indeed, to maintaining high growth and achieving development goals ultimately requires additional resources to finance among others:
  - ✓ Accelerating rehabilitation and expansion of key infrastructure such as road, rail system, waterways, ports, affordable and reliable energy
  - ✓ Basic social services, sanitation, food security and environmental conservation
  - ✓ Expanding access to basic education and healthcare services
  - ✓ Promoting competitive business environment

# Lessons on Tax Reforms

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- # After the recent crisis of 2008 – 2009, we recognized that revenue mobilization is crucial for creating fiscal space to among others things:
  - ✓ Finance important priority development; and
  - ✓ Allow for quick adjustment to adverse exogenous shocks when they arise
- # But creating such fiscal space from revenue effort may not possible in a number of developing countries, which continue to face challenges, such as:
  - ✓ Structures of economies, which makes it difficult to enhance revenue efforts;
  - ✓ Increasing complexity of the tax code due to many amendments
  - ✓ Narrow tax bases arising from large informal sector and tax evasion
  - ✓ Inappropriate tax policy designs with many exemptions and incentive regimes; and
  - ✓ Institutional constraints such weaknesses in tax administration (the subject of the next session)

# Measures to Raise Income Taxes Revenue

- # While agreeing with the lessons drawn in Michael's presentation, as a policymaker in a developing countries, I see potential to raising additional revenues under the income tax regime we administer:
  - ✓ Given that fewer people in developing countries are on employment payroll and large informal sector, the PIT regime should limit relief and other deduction as they are not equitable
  - ✓ The implementation of PIT reforms need to strengthen existing PIT withholding mechanism
  - ✓ The need for appropriate tax and expenditure policies that grow the revenue base by expanding the private sector and formalizing the under-ground economy
  - ✓ On the Corporation Taxes – there is need to review the entire exemptions and incentive regimes in order to enhance effective tax rate (for Kenya, the effective tax rate is estimated at about 16%)
  - ✓ Developing countries within Regional Integration should coordinate and harmonize the tax structures, especially on human and capital under Common Market
  - ✓ At the international level, there is need for coordination on transfer pricing and re-look at various DTAs by developing countries to ensure their taxes are not transferred to developed countries

# Measures to Raise VAT Revenue

- # Although a number of developing countries adopted and continue to administer VAT, there are emerging challenges that continue to impose constraints on its potential as productive; Improving VAT yield will require decisive actions to address the following challenges:
  - ✓ Complexity arising from various amendments, often driven by interest groups
  - ✓ Narrow VAT base arising from design and compliance enforcement challenges
  - ✓ Expanded list of exemptions and zero-rating purported to safeguard the poor against regressivity (some studies now question the regressivity of VAT)
  - ✓ Refund backlog and governance related challenges it poses to the tax system and compliance in general;
  - ✓ Existence of multiple rates in some countries, inappropriate level of threshold; and
  - ✓ Any design challenges, including withholding mechanism if any

# Measures to Raise Excise Revenue

- # Excise taxes in developing countries are imposed on a few products such as petroleum, alcoholic beverages, soft drinks and mobile airtime in some countries, cigarettes/tobacco, motor vehicles, among others
- # The three major sources of excise revenue are the petroleum, alcohol and cigarettes
- # For alcohol and cigarettes, tax policy should focus on:
  - ✓ Promoting investment (consistent with economic agenda),
  - ✓ ensure productivity of the tax system through inflation indexation for specific regimes; and
  - ✓ safeguard against cross-border challenges through coordination and harmonization, especially those economies under regional trade
- # For oil-importing economies, given the impact of high oil prices on the economy, there is a dilemma amongst policymakers, especially in regard to whether to adopt an ad valorem or specific regime, and if specific whether to index for inflation
- # This workshop should help us to draw lessons on feasible options to tax petroleum products that safeguards the revenue base and assure productivity

# Measures for Trade Taxes

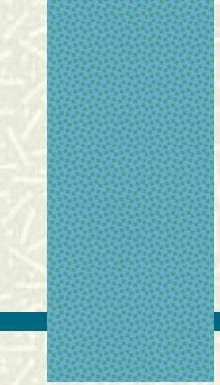
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- # Trade taxes as correctly observed by Michael, are not good for growth, especially imported inputs
- # Raising additional revenue in most developing countries is further constrained by the regional economic arrangements hence focus should be on strengthening customs administration (the subject of next discussions)
- # Further customs reforms should consider:
  - ✓ Facilitating trade, while ensuring proper valuation and enforcement of standards
  - ✓ Breaking the chains of risk profiling, scanning and verification;
  - ✓ Implementing a single window cargo clearance system bring all cargo related port community players

# Other Measures to Raise Revenue

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- # To growth and expand revenue yield, policymakers in developing countries must explore innovative and new sources of additional revenues such as:
  - ✓ Design and implement a simplified tax regime for the small taxpayers and those in the informal sector
  - ✓ Appropriate tax design to expand urban property tax revenues and capital gains taxes
  - ✓ Imposition of land tax to raise revenue, discourage speculation and enhance productivity of the economy
  - ✓ Investment in environmental conservation and raising of carbon credit financing as a source of revenue



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**THANK YOU**