REVENUE MOBILIZATION IN SUB-SAHARAN AFRICA

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Overview

- Context
- Objectives, trends and strategies
- Issues and lessons
- Institutions and transparency
- Conclusions
Context

- The fiscal situations of most developing countries were left relatively unscathed by the recent financial/economic crisis ...

- ...but there nonetheless remains urgent need for more revenue —for low income countries, 4 points of GDP to meet MDGs

- The IMF has long been a lead provider of technical assistance with respect to this issue —stock-taking Board Paper in February 2011 (on the web)

- And there is now even stronger interest from donors —G20 request to international organizations; TA Trust Funds established at IMF
OBJECTIVES, STRATEGIES, TRENDS
Objectives

Revenue not the only concern—quality matters

Efficiency and growth

Evidence limited for lower income countries

— For advanced economies, hierarchy:
  
  *Real estate (best)* – *VAT/excises* – *CIT (worst)*

— Some signs efficiency gains from VAT
— And that trade liberalization fosters growth
**Distributional effects**

— Need to consider impact of all taxes (and spending)
— Who really bears tax burden not always as it seems
  E.g. capital income taxes may fall not on (mobile) capital but on (immobile) labor
-- A critical issue

**State building**

Taxation is a central element of government power and sovereignty
-- bargaining between state and citizens, a crucial part of wider state building
— emphasized in recent policy documents
Strategies

There are many *common challenges* in taxation in developing countries (issues are also found in advanced economies—but loom larger here):

— Large hard-to-tax sectors
— Weak administrations, low taxpayer morale, governance problems
— Heavy reliance on sophisticated MNEs
— Shallow use of financial institutions
— Challenges from trade reform (much now unstoppable), including regional integration, and tax competition
But lower income countries also *differ* greatly, in
— Natural resource wealth
— Geography: e.g. small islands vs. large landlocked
— History: not just post-conflict, but legal tradition
— Constitutions: constraint from allocation of powers

**Strategies of reform must reflect both**
— Some aspects of good practice are very general
  E.g. managing largest taxpayers
— But differing capacities and priorities call for different emphasis and sequencing
Worldwide trends in tax revenue—LICs less affected by crisis
Resource wealth

• Clearly affects total revenue for low and lower-middle income countries...

• ...as well as (in reverse) tax revenues
Tax Revenue Trends in SSA by Income Level, 1980–2005
(Simple averages)
Assessing the scope to raise more

• Many factors affect revenue mobilization
  — in addition to resource wealth, foreign grants seem to discourage

• Econometrics can only be suggestive—but it suggests:
  — ’Effort’ (= ratio of actual to potential revenue) not especially low in lower income countries
  — But LICs with the lowest effort could plausibly raise 3-4% GDP more
  ... as several lower income countries have
ISSUES AND LESSONS
Administrative reform

• Progress essential for improved revenue mobilization
  ("Tax administration is tax policy"—yes (and vice versa))
  —aimed at effective self-assessment, essential not least for PIT and to improve governance

• Organizational changes have been constructive
  —Integrated, function-based structures
  —Taxpayer segmentation, starting with large taxpayers
  —Revenue authorities: have not lived up to (overly-high) expectations, but signs of progress
• Much to do:
  — Compliance costs high
  — Revenue administrations hampered by under-resourcing, misallocation
  — Tax-customs coordination poor
  — Compliance strategies (audit, dealing with hard-to-tax,...) under-developed
  — Corruption: progress can be made

• For all this to succeed, strong political commitment needed
  — and reforms need entrenching to avoid reversal
Value Added Tax

• Now the norm
• Often 25% all revenue
• Evidence that relatively efficient
Spread of the VAT in SSA, 1980-2009
To capitalize on potential strengths of VAT (substantial revenue, reasonably fair and easy to comply with and administer) standard advice is for:

- Single rate
- Broad base—with only some exemptions (for hard to tax sectors, e.g., most financial services universally exempt; and consumption of a few basic commodities by the poorest, generally recommended in LICs)
- Reasonably high threshold
What about equity?

• Most studies find VAT no less progressive than taxes it replaces—and may underestimate fairness (purchases from small retailers, and by non-compliant firms)

• Preferences benefit most the better-off
  —the poor may spend relatively more on (e.g.) food, but rich spend absolutely more (Mexico)

• Even limited ability to target spending may be enough for poor to benefit from uniform rates: e.g. Ethiopia
VAT challenges:

• Understanding and managing non-compliance

• Improving refund procedures and audit

• Now limited room to raise rates in many lower income countries...but expanding the base can help greatly...
  —perhaps 2% of GDP in some low-income countries
Trade taxes

• Rates, revenue in decline
• Easy to collect, but bad for growth
• Challenges
  – Recovering lost revenue has been problematic in some LICs
  – Administrative challenges from formation of customs unions (how implement the VAT without internal frontiers?)
Tax Revenue and Trade Revenue SSA 1980 -2009

(Low and Lower Middle Income)
Personal income tax

• Revenue stagnant in LICs
  – Almost all is wage withholding by large firms and government

• ‘Global’ PIT (tax on sum of income from all sources) has failed
  ─ move to explicit schedular systems with more coherent taxation of capital income?

• More action on high-income individuals needed for fairness
  – Limit exemptions they can exploit
  – Establish specialist units
  – Strengthen international cooperation
Tax Revenue and PIT Revenue SSA 1980 -2009

(Low and Lower Middle Income)
Corporate Income Tax

- Statutory rates have fallen worldwide since 1980—SSA included—though revenues have largely held up on average worldwide.
  - But the CIT raises a much larger proportion of tax revenue in LICs than in industrial countries, so this trend is a greater cause for concern.
  - Revenue from CIT more volatile in SSA, on average, than in higher income regions...
Developments in Corporate Tax Rates and Revenues
SSA 1980 -2009
(Low and Lower Middle Income)
• ....but again, much of this is due to resource wealth
• When resource rich countries are removed, there is little positive impact from expanding tax bases on CIT revenues in SSA...
Cit Rates and Non-Resource CIT Revenues in SSA, 1980–2005
(Simple averages)
Challenges:

• Incentives
  — Threaten revenue, including from profit-shifting
  — Have become more pervasive in SSA: in 1980, 40 percent of countries had tax holidays, now 80 percent; none had free trade zones, now 50 percent

• International considerations growing stronger
  — Loss of tax bases through source taxation, treaties
    --- Transfer pricing issues

• Case for regional/wider cooperation, including on policy, becoming stronger?
Excises

Attractive for revenue and addressing externalities

Challenges:

• Significant potential in cigarettes, fuel
  ...but is more coordination to address cross-border issues needed to realize it?

• Mobile phones—role for excises if licences not auctioned
Small businesses

• Limited revenue potential...
  —and remember may already in effect pay VAT on inputs
  ...but importance of taxing them (effectively!) goes beyond that
  —competitive distortions, tax morale, state building

• Simplified regime, aligned to VAT threshold
  — For micro, patente; for intermediate: cash-flow/turnover

• Administrative focus on their special characteristics
Property taxes

Revenue potential modest in absolute terms, but:
—Could be transformative for local governments
—A relatively easy source of some progressivity?

Challenges
—Mainly administrative: developing cadasters and valuation methods
INSTITUTIONS AND TRANSPARENCY
The informed discussion needed for sustained progress calls for:

• Simple, transparent, easily accessible tax rules

• Tax expenditure analysis
  —Costing preferences helps to decide if offsetting benefits
  —Much good practice in Latin America, now starting in Africa

• Capable tax policy units
CONCLUSIONS
• Countries are different—and progress can be hard

• But we know a lot, thanks to successful reformers, about what works (and what doesn’t)

• One lesson is that the issue is not just capacity—political will is critical