

Fiscal Affairs Department

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

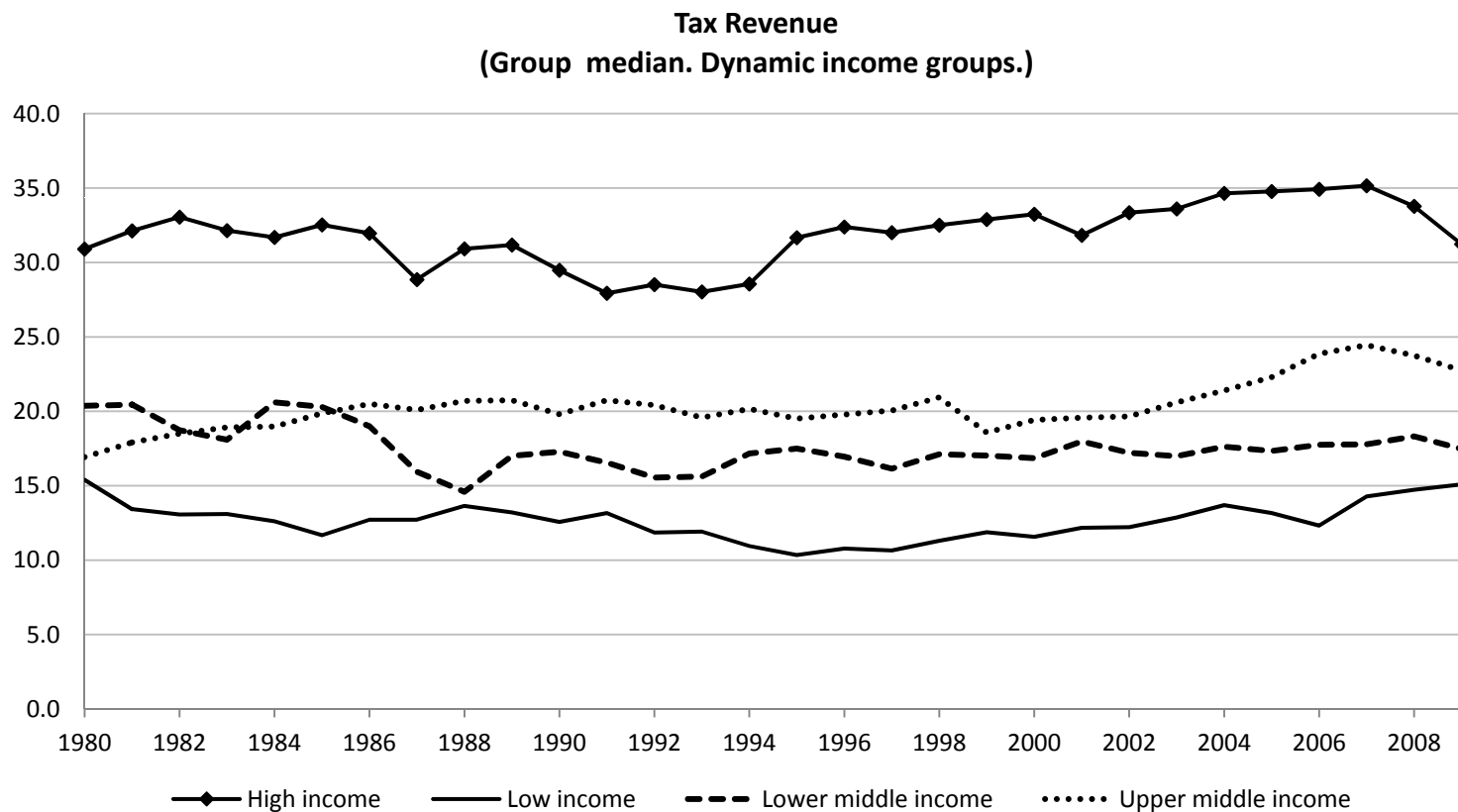
Strategies of reform must reflect both

- Some aspects of good practice are very general
 - E.g. managing largest taxpayers
- But differing capacities and priorities call for different emphasis and sequencing

Trends



Worldwide trends in tax revenue—LICs less affected by crisis



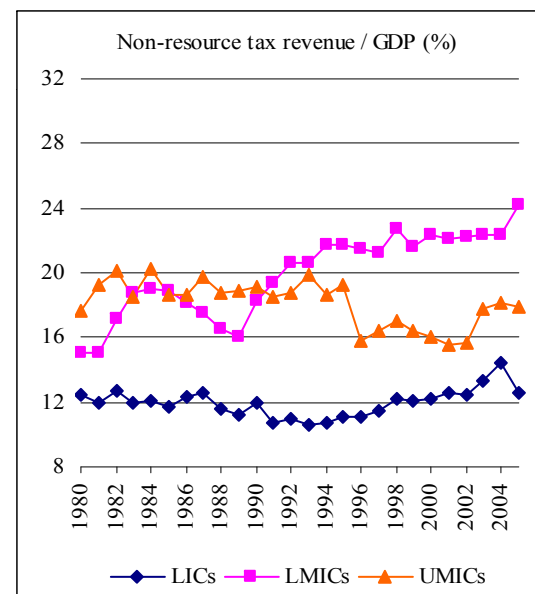
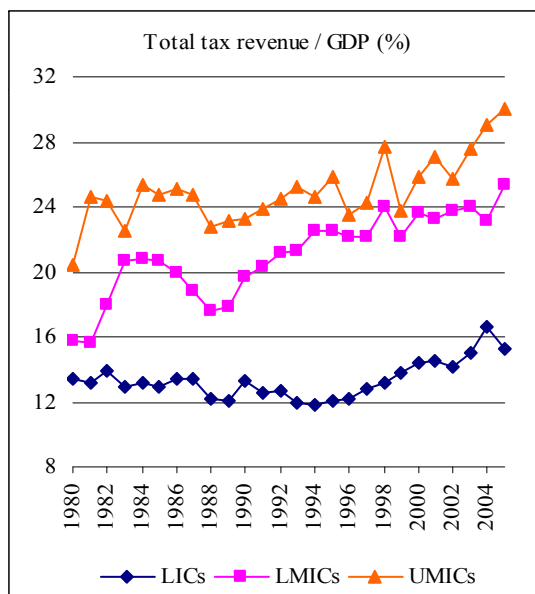


Resource wealth

- 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

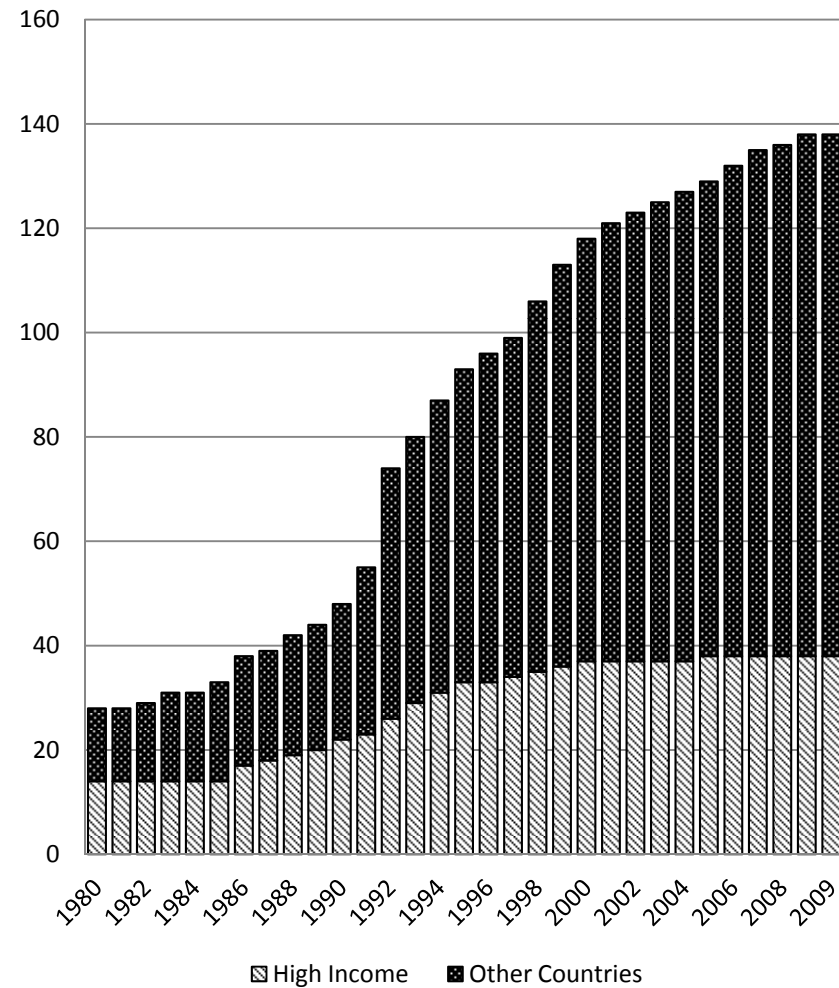


- Much to do:
 - Compliance costs high
 - Revenue administrations hampered by under-resourcing, misallocation
 - Tax-customs coordination poor
 - Compliance strategies (audit, dealing with hard-to-tax,...) under-developed
 - Corruption: progress can be made
- For all this to succeed, strong political commitment needed
 - and reforms need entrenching to avoid reversal

Value Added Tax

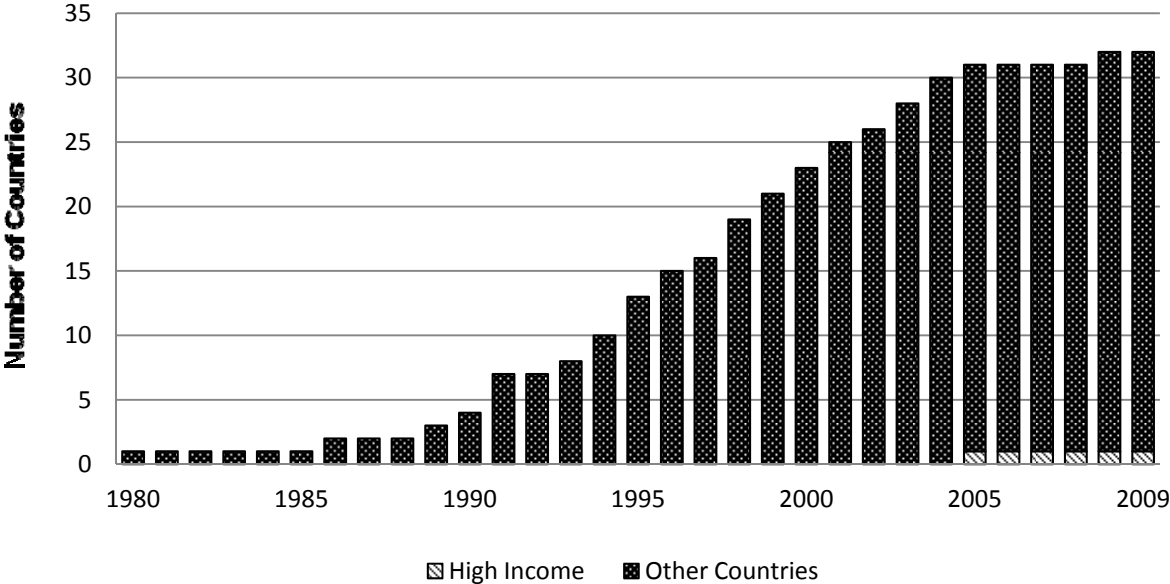


- Now the norm
- Often 25% all revenue
- Evidence that relatively efficient





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:

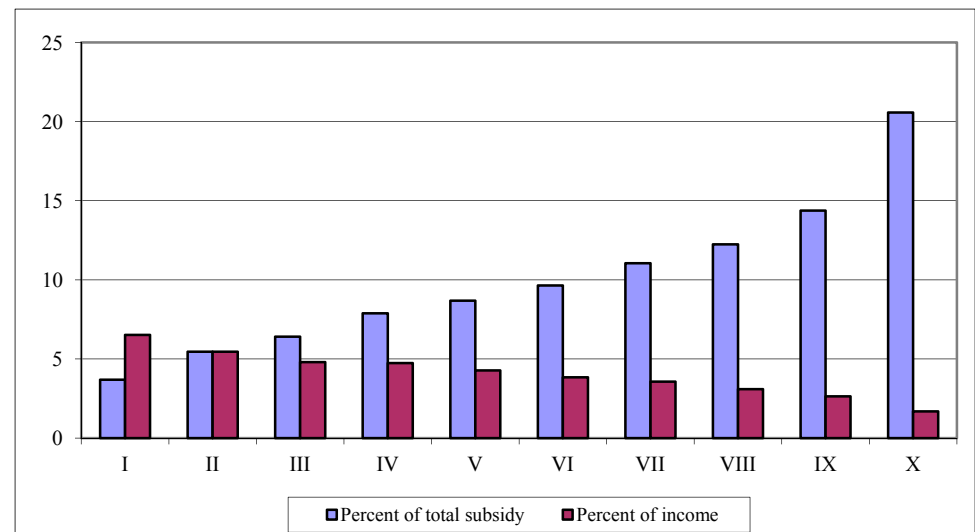
- Single rate
- Broad base—with only some exemptions (for hard to tax sectors, e.g., most financial services universally exempt; and consumption of a few basic commodities by the poorest, generally recommended in LICs)
- Reasonably high threshold

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



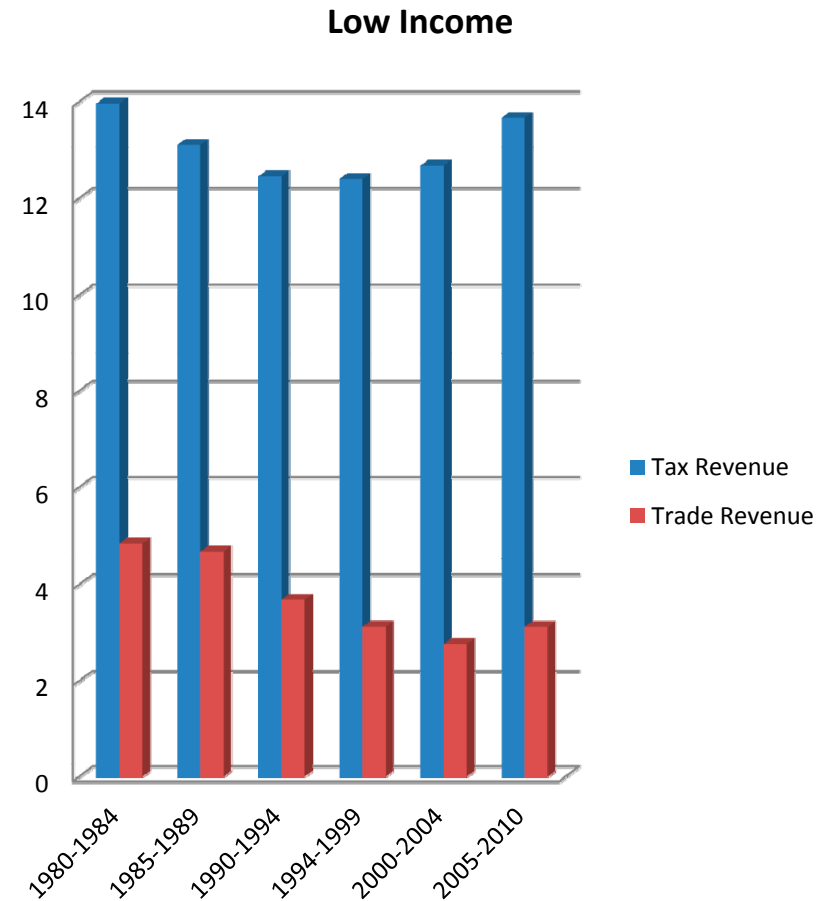
VAT challenges:

- 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

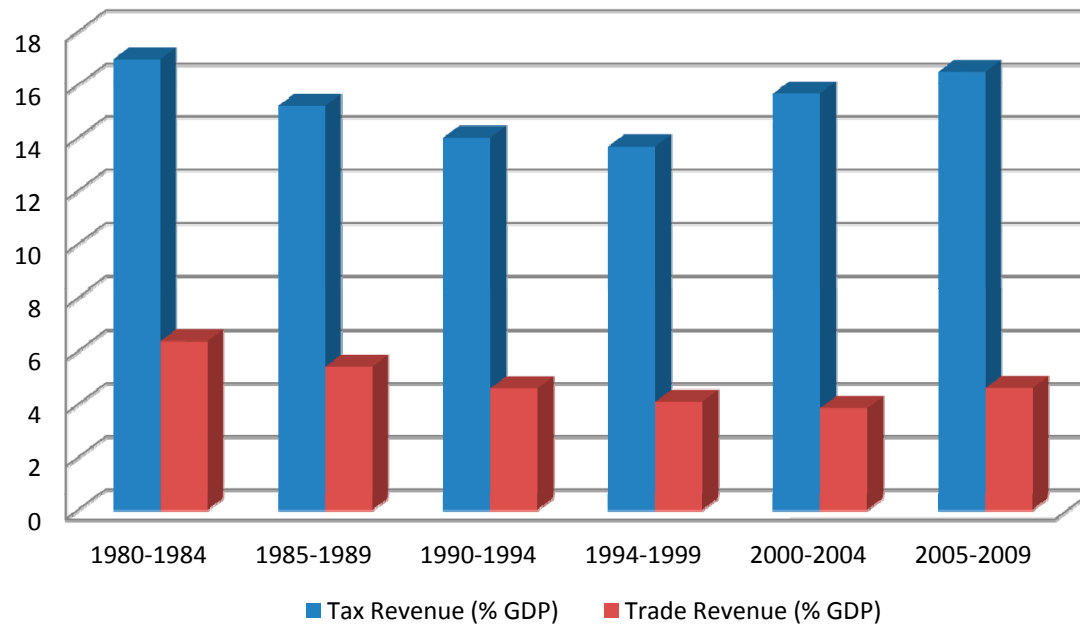
- Rates, revenue in decline
- Easy to collect, but bad for growth
- Challenges
 - Recovering lost revenue has been problematic in some LICs
 - Administrative challenges from formation of customs unions (how implement the VAT without internal frontiers?)





Tax Revenue and Trade Revenue SSA 1980 -2009

(Low and Lower Middle Income)





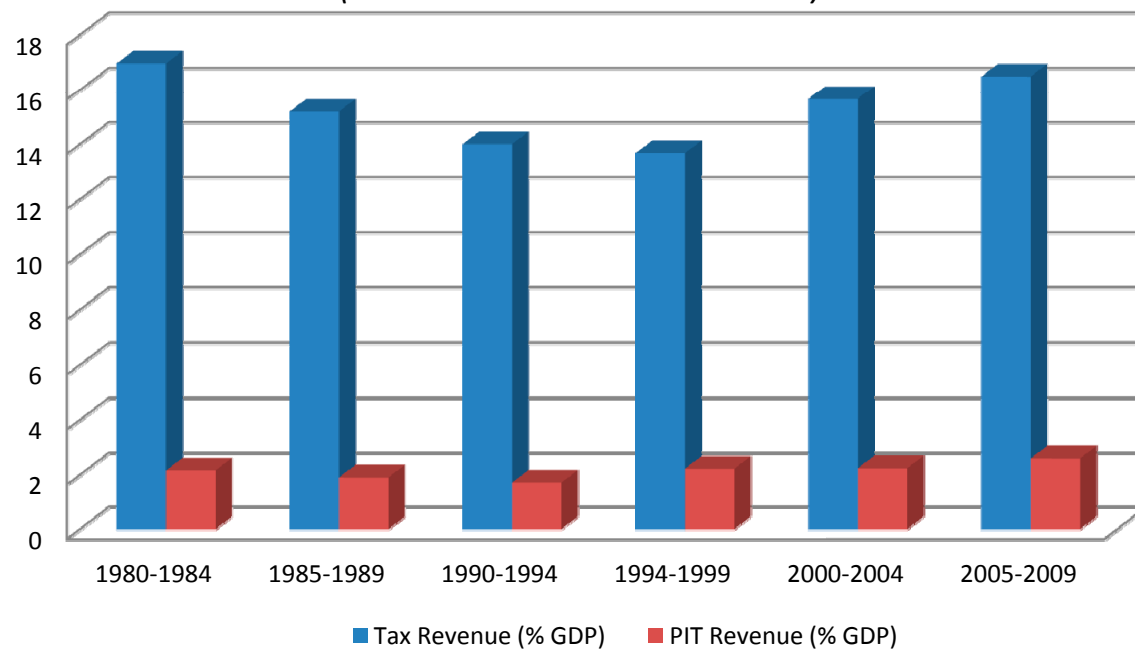
Personal income tax

- 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)





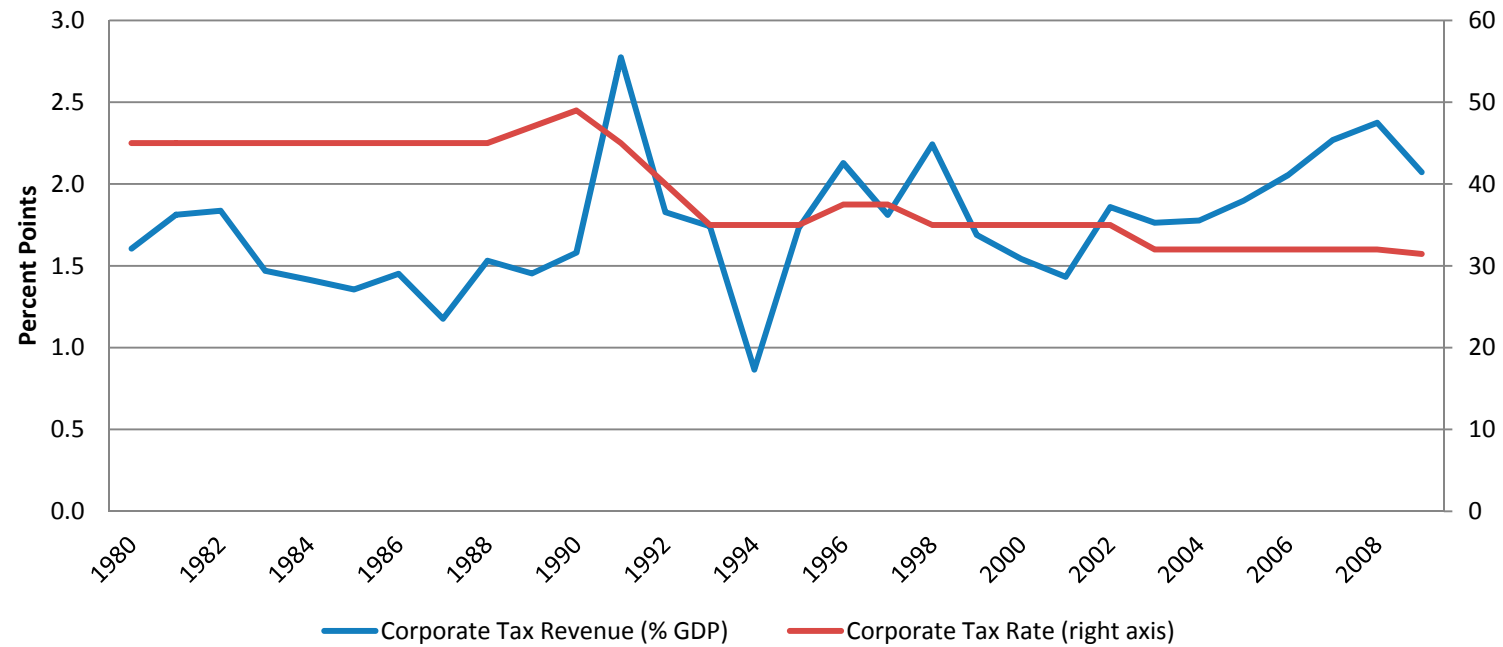
Corporate Income Tax

- 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...



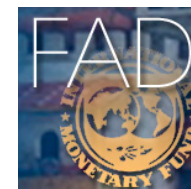
Developments in Corporate Tax Rates and Revenues SSA 1980 -2009

(Low and Lower Middle Income)

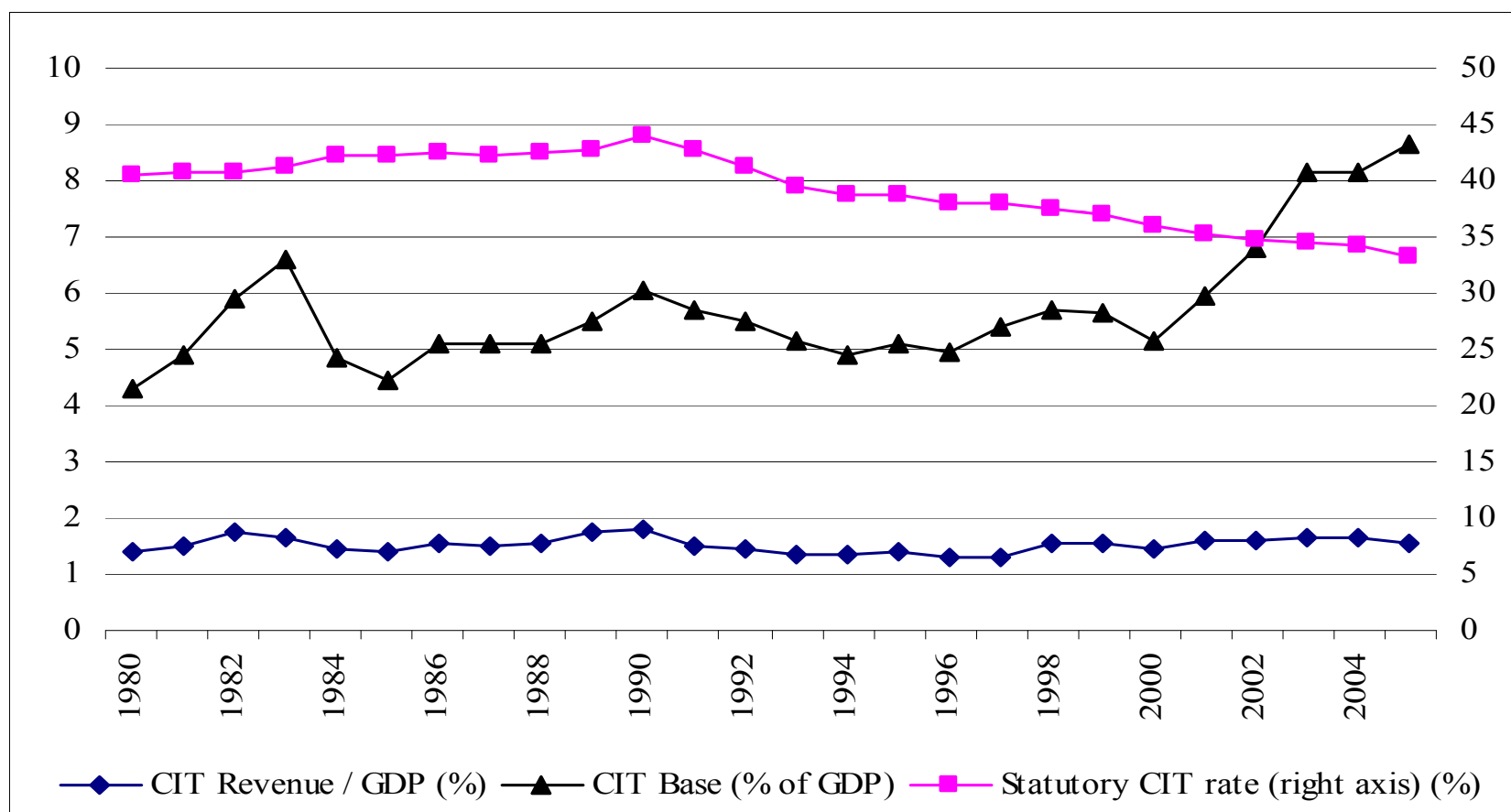




- ...but again, much of this is due to resource wealth
- When resource rich countries are removed, there is little positive impact from expanding tax bases on CIT revenues in SSA...



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