Report on Wilton Park Conference S10-01

ENHANCING DOMESTIC RESOURCE MOBILISATION IN SUB-SAHARAN AFRICA[1]

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in co-operation with The North-South Institute

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SUMMARY

Domestic Resource Mobilisation (DRM) had been considered the poor cousin as a development financing mechanism by the wider development community until the Financing for Development Summit at Monterrey in 2002[2] where it was placed firmly on the agenda. The Monterrey summit and the Doha (2008)[3] review summit acknowledged DRM as an important approach in moving countries away from aid dependence, enhancing policy ownership and space. There is a growing trend for tax and development specialists to co-operate, especially on sub-Saharan Africa (SSA). The OECD now has a strong focus on DRM and in 2009 helped to set up the African Tax Administration Forum (ATAF)[4] . Studies carried out to date reveal that there is potential

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[1] Full documentation of the conference, including the country case studies is available at http://www.wiltonpark.org.uk/en/conferences/policy-programmes/key-countries-and-regions/?view=Conference&id=22565976

[2] On the conference and subsequent follow-up, see: http://www.un.org/esa/ffd/

[3] On the Doha meeting, see: http://www.un.org/esa/ffd/doha/

[4] The tax administrations that signed the agreement are those of Botswana, Chad, Egypt, Eritrea, Gabon, Gambia, Ghana, Kenya, Lesotho, Liberia, Malawi, Mauritania, Mauritius, Morocco, Namibia, Niger, Nigeria, Rwanda, Senegal, Sierra Leone, South Afria, Sudan, Uganda, Zambia and Zimbabwe.

for African countries to mobilise domestic resources more effectively and efficiently. There is also evidence that reforms initiated within tax systems spill over into other areas of public sector reform. Administration reform is one area where aid and technical assistance can have a real impact.

One of the issues highlighted for SSA was the dependence on resource tax revenue, which distorts the overall picture. Taking these revenue streams out of the equation reveals that very little progress had been made in the majority of SSA countries in building a broader tax base and increasing tax mobilization in the 1980-2005 period.

There is sensitivity around the issue of aid dependence. The role of donors was highlighted as being able to do more and work differently in order to assist countries build institutions, systems and infrastructure, foster trust and engage with the population. Aid had a role to play and was anticipated to be contributing to SSA's development for many years to come, but an 'Aid Sunset' should be considered as desirable. In the bigger picture the aid and tax mobilization relationship was found to be ambiguous. While a negative correlation between the two over a long period (1972-2008) in SSA was found, this relationship was not significant. Foreign aid seems to have had neither a negative nor a positive impact on SSA countries' ability to mobilize fiscal resources.[5] One reason for this could be that a very small share of technical assistance has gone towards building tax capacity. However, from a political economy perspective aid can serve to undermine government accountability to its people (as with resource taxes) as the accountable relationship is formed between the government and external actors rather than with the government and its people.

The role of women requires more detailed discussion, especially with regard to the building of a tax base, a tax morality and engagement with the fiscal contract. Working to their strengths of greater collaboration and working for the collective good,

[5] The study instead found economic structure (share of agriculture in particular) and openness to trade, were the main variables that explain tax mobilization performance. Authors also found a long list of countries that had managed to reduce dependence on aid substantially, including from SSA (such as Mauritius, Tunisia, Kenya, Botswana). In most cases enhanced tax mobilization played a key role (a large positive and significant correlation between aid and taxation was also found in these countries). So a question for further investigation is why some countries are able to make this transition while others are not.

governments could 'recruit' women as tax ambassadors, especially in the informal sector, using the mobile technology that is gaining ground.

One of the key issues limiting DRM in SSA is the prevalance of tax incentives and exemptions. Too many inward investors had been given tax incentives lasting for many years in order to attract them as fledgling businesses. Now as established businesses, there is a case for them to pay higher taxes, but exemptions have a ratcheting effect and are hard to remove once in place as they create complex political-economy incentives around their application. Exemptions are often viewed as 'zero cost' because detailed cost-benefit analyses are undertaken rarely, and they are handed out on an ad hoc and discretionary basis.

Much greater disaggregation of data is needed to make accurate assessments of the costs/benefit of exemptions. For many countries the information is simply not there, which makes informed analysis for policy direction almost impossible.

Improving tax systems is positive for a wide range of developmental objectives:

i) Increasing tax revenue combined with sustainable economic growth is the eventual exit strategy for developing countries from aid dependency.

ii) Taxes, if designed well, can promote economic growth, lessen extreme inequalities, tackle climate change and fund the delivery of the Millennium Development Goals (MDGs), significantly improving the lives of all citizens and especially poor people.

iii) Tax is a core part of state-building. Fair and transparent tax collection demonstrates good governance and shapes government legitimacy by promoting accountability of governments to tax-paying citizens, and by stimulating effective state administration and good public financial management.

iv) Evidence of partner countries' 'tax effort' matters for sustaining public support in OECD countries for international development.

v) External resources, such as aid, and revenues from natural resource exploitation tend to be pro-cyclical as well as highly volatile as compared to domestic resource bases.

vi) Aid effectiveness concerns include the analysis that aid can become a 'resource curse', undermining the relationship of accountability between state and taxpaying citizens.

vii) Improving tax systems is essential to maintain public finances during the current financial crisis.

viii) Anti-corruption, rent-seeking and tax evasion are closely inter-connected with weak governance. Anti-corruption strategies only work well in contexts where states can effectively tackle tax avoidance and evasion, and corrupt tax expenditures, through building the 'social contract' of accountability between citizen and the state.

DOMESTIC RESOURCE MOBILISATION AS AN EMERGING ISSUE ON THE AFRICAN POLICY AGENDA

1. If taken in aggregate for the region, the picture for DRM in sub-Saharan Africa is far from bleak with 76 per cent of development finance resources having been mobilised domestically in recent years, representing four times the level of aid to the region. However, whilst it does look as though the continent as a whole is doing quite well, the devil is in the detail and aid does exceed tax income in many countries.

2. When compared with Asia, the SSA region raises half the level of domestic resources of the Asian countries, representing a significant differential. Additionally, the bulk of African taxes is levied on natural resources or trade, so are essentially 'external' resources that do not contribute to the consolidation of a domestic tax base with which governments can build relationships or a 'tax contract' with its citizens.

3. The global financial crisis has highlighted even further the need for Africa to generate its own resources and become less dependent on stagnating and often volatile external resources, such as aid. It is generally accepted that a 20 per cent tax revenue to GDP ration is an acceptable level, but that below 15 per cent generally does not represent a viable level of revenue generation. Few of the economies in SSA have achieved 20 per

cent. Those that have are either very small or the economy is dominated by natural resources (the only exception is Ghana).

4. That tax is not just a technical issue. This point requires detailed exploration. The societal and political forces required to galvanise populations and encourage them to pay taxes are just as important as having the systems in place to deal with those taxes. Currently, domestic tax bases in many SSA countries are extremely thin with the richest taxpayers (corporate and individual) numbering in their hundreds being responsible for between 75 – 80 per cent of all domestic tax revenue. For this to change, a much greater understanding of these processes has to enter the currently highly technical analysis and policy design.

KEY THEMES

5. The external international environment has a significant impact on domestic processes. The relationships between the external influences and domestic processes thus dictate much of the domestic reality.

EXTERNAL

The role of donors/relationship with aid

6. Aid is often discussed as though it was the principal development financing mechanism, whereas there are other larger flows such as remittances, foreign direct investment (FDI) and domestic resources. This may be because the emphasis on achieving the MDGs through the 'Big Push' whereby most public financing to achieve the MDGs is assumed to be external rather than domestic. Whilst the thrust of DRM is to move countries away from dependence on external resources such as aid, aid is still a highly necessary form of development finance for many African countries (especially the poorest) and will continue to be so. There are areas where aid could be more focused in efforts to foster greater mobilisation around domestic resources. For US $1 of aid spent helping collect taxes and enhance the tax environment, a further US $10 could be expected to be collected, which is a significant return by any standard. Governments in receipt of aid must commit to development expenditure in their own National Development Plans. A caveat also needs to be made, namely that all

governments should be held publicly accountable for revenue collection and expenditure. Ultimately countries' ability to foster a virtuous cycle between mobilization and utilization rests on being accountable to citizens on how they taxes were put to use.

7. Donors could do more in their own countries in terms of greater information exchange, systematic review of reciprocal tax arrangements and action on the global stage for greater transparency within fiscal transactions in the case of money laundering and capital flight.

8. Greater policy coherence is also critical. Too often donors tend to view themselves as operating within silos, as distinct from trade, finance and other ministeries and agencies. In reality, trade liberalization and other demands can easily erode the positive impact of aid and developmental objectives.

9. Discussions around whether receipt of aid affected taxation negatively concluded that this was not the case, as it seems in the bigger picture, there is no significant relationship. One of the decisive analytical questions is how some countries have reduced their aid dependency and increased their ability to tax.

10. Donors could also play a greater role in linking aid with capital flight and tax cooepration, and the DRM agenda with the 'doing business' and investment climate agenda. Donors could assist in development of financial sector infrastructure, in particular credit histories, land registries and capital market infrastructure.

Resource Taxes

11. Taxes on natural resources such as oil, diamonds and other natural/mineral resources remain the largest revenue source for many African countries, and is expected in the near future to become a more important source for countries such as Ghana and Uganda.[6] The rise in tax revenue over the 1980-2005 period in the SSA region is almost entirely attributable to natural resource taxation. Significant dependence on resource revenue further constrains the emergence of a genuine state-

[6] An expert compilation drawn together by the IMF has recently been published. See: P. Daniel, M. Keen and C. McPherson (eds), The Taxation of Petroleum and Minerals: Principles, Problems and Practice, Routledge and the International Monetary Fund, Abingdon and New York , 2010.

citizen fiscal contract as the relationship with external actors such as large extractive industries becomes more important. Therefore unless resource revenues are shared widely and directly with the population the demand for transparency and therefore 'ownership' will remain problematic. The former Minister of Finance in Nigeria, Ngozi Okonjo-Iweala (the first woman to hold the post), made a rule that all state and district income received from oil revenues had to be published in the local papers.[7] This enabled people to call their local government to account if there were discrepancies. As has happened with other senior figures trying to address corruption in some African states, she did not last, and this requirement is no longer in place.[8] It is a real and human demonstration of how to link tax revenue with expenditure. If you have a family stating that they know X thousand Naira came into the local government that month and demanding to know 'where are the resources for my children's school?', they are holding their local government directly accountable. If the government does not deliver, this is damaging for the tax morality and the fiscal contract.

12. Global initiatives such as Extractive Industries Transparency Initiative (EITI)[9] and civil society groups like Publish What You Pay (PWYP)[10] are playing an important constructive role in bringing greater accountability and standards to the oil, gas and mineral sector revenues. Several SSA resource rich countries are already engaged in such initiatives, EITI and PWYP provide a global platform for local groups working on resource revenues.

International architecture

13. In SSA 'domestic' resource mobilization has a significant international dimension. More effective tax information exchange is required at an international level. The

[7] See: http://www.ted.com/speakers/ngozi_okonjo_iweala.html

[8] See also the high profile case of John Githongo in former anti-corruption officer in Kenya, Michela Wrong, It's Our Turn to Eat, HarperCollins, 2009; http://www.harpercollins.co.uk/Our_Titles/Pages/Home.aspx?objId=37000

[9] See: http://eiti.org/

[10] See: http://www.publishwhatyoupay.org/

OECD's Tax Information Exchange Agreement (TIEA) standards have been criticised as relatively weak.[11] There is scepticism about the effectiveness and impact of this approach. However, since the April 2010 G20 meeting 50 new TIEAs have been signed.[12] Critics argue tha there is no real incentive for an individual country, such as Switzerland, to share information. Banking is a principal source of income and business would go elsewhere if, for example, Switzerland was forced to disclose hitherto private information. It was widely recognised that illegal funds require a highly regulated, legal environment for them to be effectively concealed and protected. This is one of the reasons the majority of tax havens operate out of developed economies with strong regulatory environments, or with strong links to such a country.

14. Capital flight remains a significant problem. US $358 billion an estimated (conservative) illicit outflows from sub-Saharan Africa occurred between 2000 and 2008. Other figures report between US $500 and $800 billion lost through illegitimate transfers per year from all developing countries. Capital flight from SSA is estimated at higher than the external debt stock of the region, and nearly twice ODA flows. This makes SSA a 'net creditor' to the rest of the global economy. Even if a small fraction of these huge figures could be brought back in to finance development, it would help close the financing gap in a number of SSA countries.

15. If the motive for people keeping their money overseas could be better understood for each country, then policy instruments could be put in place. For example, there are at least two obvious motives: precautionary or portfolio choice, and illicit flight. If people are keeping their capital overseas for 'insurance' purposes because they do not trust their own banks or the economy is highly unstable or fragile, a policy could be instituted whereby investors can keep their money where they wish, but they must pay taxes on it in their own country. The current global crisis presents an opportunity to reinvent systems and look at new ideas. It has been difficult in the past to get people to consider new sources of development finance but now there is more openness for innovative ideas as resources become scarcer – this opportunity should be capitalised on.

[11] http://www.oecd.org/dataoecd/15/43/2082215.pdf

[12] http://www.taxationinfonews.com/2009/09/tax-information-exchange-agreement-update/

DOMESTIC

Institutions and the Regulatory environment

16. Capital flight cannot be viewed in isolation as it is a symptom of the domestic climate. With a poorly regulated financial sector, those with home grown profits are not going to reinvest locally. They will go where their money is not at risk and where they can get the greatest return. If a government is not accountable to its populace and the people do not believe in or trust that government and the policy environment, money will continue to flow out.

17. Savings, by the same token, suffer under weak regulatory environments as people perceive their money to be at risk. Poorer people are also not used to 'hiding their money away' (traditional practice often has it that people's wealth is immediately conspicuous, for example as cattle, jewellery and land. To persuade people to 'hide their money away' by depositing it in a bank goes against many traditional norms, which means that in order to convince people to save, the system has to be watertight and known to be so.

18. Much more transparency is required around the banking system, both internationally and domestically. Measures need to be in place that act as deterrents to illegal behaviour. If an individual or organisation feels they might be investigated, it has been shown to have a salutary effect. However, a good regulatory environment and institutional infrastructure does need to be in place in order to police this. If tax evasion were criminalised it would affect banking practice also. The idea of a 'Tax Inspectors sans Frontieres' has been raised.

19. A relatively recent trend in SSA has been the setting up of autonomous revenue authorities (ARAs). Results have been somewhat ambiguous. In their initial years the performance of ARAs is high, but these top out after a few years of operation (of course, tax collection does not happen in isolation and there are several factors such as growth rates, changes in tax policy that are also at play). There are inherent tensions between 'autonomous' tax authorities and the Minister/Ministry of Finance or President in some countries. The decision-making rests with the Ministries (and ultimately the President or

some form of political leadership) but the implementation is via the tax authority. In many cases, especially in the area of exemptions, the tax authority is overriden; decisions are taken, often as favours, by senior politicians on an ad hoc basis without systematic cost-benefit analysis. This separation of the two roles has an impact on the design of tax policy and tax reform. A technical assistance team needs to know where the effective authority lies. For example, Ghana has four different tax authorities, all using different systems with different objectives; the Tax Board, VAT, Customs and Income Tax. All deal in different ways and with different sections of the population.

20. Ideally an automated system would be in place, in which everyone has a tax number, reminders are sent out and records kept of who has paid what. This is good for countering corruption but difficult to implement, both in terms of the initial setting up of the system and the regular maintenance of the system in good working order, by well trained and diligent staff. This is especially the case for those countries with a significant informal economy and a poor electrical infrastructure to maintain the computerised system, which is the case for most SSA countries. However strides are being made in these areas across African tax administrations, and supporting tax authorities with both hardware and software (such as building management capacity, as well as supporting domestic policy communities working on tax issues) is an area for continued donor efforts.

21. Effective use of IT has the potential to significantly enhance tax revenue collection. There are already initiatives underway in Asia (particularly India), where agents take the technology in portable units to the villages, rather than expecting individuals to come to the banks. This is working very well for savings and has obvious uses in revenue collection. One significant disadvantage is the poorly functioning internet and electricity infrastructure in many SSA countries. All SSA Governments need to ensure the widespread broadband access for Africa will benefit their countries – especially the landlocked ones. IT can also reduce the chances of corruption. For example, in Tanzania, taxes used to be paid by cash to the Tanzania Revenue Authority (TRA), as there was no way of paying via the banks. This left the system wide open to corruption. Now the system is computerised and fully integrated with the banking system which cuts out the leakage problems of handling cash.

22. For a pro-poor orientation on mobilising domestic resources, credit restraints needed to be relaxed to provide greater access to capital at the lower end of the income scale. By tying people into credit arrangements, they have a record on the system which gives them an identity (and institutional 'legitimacy'). This would not only have the advantage of encouraging a flourishing private sector at the lower end, but also provide government with greater access to the informal sector in terms of revenue gathering. In most African countries there are larger informal enterprises which could and should be paying taxes.

Building the tax base

23. Tax is not just a technical issue - it is highly political at every level. The social dimensions around tax cannot be avoided if one is seeking to understand behaviour and encourage people to pay taxes. The willingness to pay versus the utility to the taxpayer leads into the crux of the engagement issue. At this interface an accountable government, sound institutions and clear policy directives, as well as improvements in the welfare and wellbeing of the taxpayer are crucial. This is the tax morality and the foundation of the fiscal contract, and again, an area where revenue and expenditure are indissolubly linked.

24. The importance of this fiscal contract also relates to considerations of state-building, ownership and how to grow the tax base. The International Covenant on Economic, Social and Cultural Rights[13] enshrines the concept of trust and the right to expect governments to provide basic services. This is also a key link between tax and expenditure. These points are important within the wider notion of governance and stability in sub-Saharan African countries. If a population feels its government is serving it well through the provision of basic services, there is less chance of instability and internal conflict.

25. A major issue is taxing the informal sector. This is a widespread and historical problem. Lowering the tax rate does not necessarily grow the tax base and inducements are not a realistic option for many of the lower income countries of sub-Saharan Africa.

[13] See the full text at: http://www.hrweb.org/legal/escr.html

A high poverty rate decreases the potential tax base, there is much greater sensitivity to tax increases and a susceptibility for tax officers to become corrupt.

26. Currently, most SSA tax bases are extremely thin. In Tanzania for example, there are 400 tax payers who account for between 70 – 80 per cent of the domestic tax revenue (40 per cent of Tanzania's budget is financed externally); in Kenya, 830 high tax payers account for 75 per cent of the domestic tax revenue. With populations of 41 million and 39 million respectively, this is an extremely narrow tax base.

27. There is a dearth of civil society knowledge surrounding tax issues in most African countries. There needs to be greater awareness built around these issues, what governments should be expected to provide in exchange for people's hard earned income taken in taxes and the obligations of a 'citizen taxpayer'.

28. Heritage and tradition also play a role. For example, in Kenya the 1920 colonial model prevailed at independence but in its post-independence state, other regulations were then introduced. However, with 42 tribal groups, each with its own political system, this proves dysfunctional.

29. Lessons could be learned from the socialisation of the banking sector that started in the late 1960s in India. During the 1990s the infrastructure built apace with self-help groups, regional rural development banks, Kisam credit cards (farmer loans essentially) and No Frills accounts. This enabled lower income and rural people to access banks and finance. There was still the issue of travelling to and from the bank, which can take days out of the working month that poor people can ill afford. Andhra Pradesh has the highest rural penetration for banking and the state government subsidises, the use of smart cards and a portably terminal, thereby enabling the bank to go to the people. This had an additional bonus of addressing the issue of 'ghost' payments that were costing the government 20 per cent of all its benefit payments. Agents are appointed and trained how to use the machines (mainly women as they were considered to have greater integrity). Initial suspicion on the part of the communities (who would deposit and then immediately withdraw) has now given way to trust and a trend towards net savings.

30. The value of embracing such technology by a tax revenue authority is obvious. This infrastructure could be set up and any deposit taxed at source by the Government – much as UK savings interest is currently. According to some reports, in West Africa many people are not as concerned about interest payments, they were more interested in having a service that was accessible, quick and nearby and were even willing to pay for such a service. To deduct tax at these points would merely be an extension of this.

31. Women's access to capital is frequently limited, often due to lack of collateral against which to secure a loan, as well as 'traditional' cultural practices. In many countries their land rights and inheritance rights are limited or non-existent. This inhibits their ability to perform in the marketplace to their true potential. In Kenya, many (admittedly more middle class) women are turning to the Stock Market as a means of enhancing their resources; they do not need land or their husband's permission to open up an account with a broker, so it is a more straightforward and accessible vehicle for them. It is obviously risky though as all investments on the Stock Market can go down as well as up.

32. The positive aspects that women can bring to broadening the tax base include the following: In many households it is the women who manage the money. It is also acknowledged that women act more collectively and less competitively than men; they are naturally predisposed to the notion of contributing to a system that might ensure a greater collective good, therefore 'buy in' to the fiscal contract and be more willing to pay taxes; women have a role to play in building the tax base in the longer term and intergenerationally. They have the greater responsibility for child rearing so can foster the concept of paying into the collective good in their children.

33. In terms of corporation tax, state-owned oil companies often become too powerful with opaque practices subject to poor governance. Contracts should be in the public domain for transparency.

34. Exemptions are one area where significant leakage takes place. Many exemptions are in place without time limits for companies and investors that initially needed to be attracted into the country to build their businesses. Now that they are flourishing, most of the income is going back to their countries of origin, and the only benefit for the

country is that they might be good employers. This needs to change. However, there cannot be a blanket policy in place. Every case needs to be looked at in terms of indivdual merit, but it was agreed that time limits need to be introduced right at the start. There are some instances where exemptions are beneficial, for example, for intermediary bodies and importers. More work needs to be done on gathering information on the exemption architecture for each country to see what the costs and benefits are of each one.

35. Many suggest that it is the structure of the economy (in particular the extent of agriculture and openness to external trade) which is essential to understanding and targetting efforts, so that it is known where the taxes are coming from and where there is potential to get them from. These factors were found to be key determinants of a country's tax base. The idea of development of the understanding of and application of International Covenant on Economic, Social and Cultural Rights has been mentioned earlier. There is no effective implementation which requires that a government has the legal obligation to provide basic public services (in respect of their power/right to tax). This is the human aspect of the link between tax and expenditure. We have a Human Rights Watch, we have Transparency International, we have a Doing Business Index – what about a 'Tax Rights Watch' or something similar that names and shames those goverments that are not performing in this obligation to their people. In Africa, many MPs argue for the value of a Constituency Development Funds that could push this from an idea to a reality – although any such source of power and resource allocation must also have built-in mechanisms for accountability.

NATIONAL CASE STUDIES

36. The African Development Bank has also been carrying out a study on a number of countries on domestic resource mobilisation. Where their case study countries overlapped with those of the North-South Institute study, they have been included in the matrix attached in Appendix 1. Five case studies were considered: Cameroon, Ethiopia, Uganda, Burundi and Tanzania.

Cameroon

37. Growth has slowed to less than 3 per cent per annum and the poverty rates is around 40 per cent. Less than 5 per cent of Cameroonians have access to the financial sector (compared to Namibia's 55 per cent). There are three companies on the Stock Exchange, no bond market and no development banks. VAT is at 19.5 per cent and income tax rate is also very high. 90 per cent of land is not registered and is ancestral – this is difficult to tax and so it was agreed that it would not be taxed. Tax revenue runs at 16 per cent, compared to the average of 20 per cent for SSA. Public savings are below 10 per cent with private savings below 15 per cent. The informal sector is large – accounting for 50 per cent of GDP and 90.4 per cent of all employment. There is a high level of corruption in the tax/customs administration and the country ranks very low on the Doing Business Index (171/183).[14]

38. *Long term recommendations :* Incentivise officials; link enterprise with services; stimulate payments of property taxes; set up a Development Bank; build a viable Bond market, build confidence; build a viable collection package; improve access to other resources such as agricultural inputs; enhance economic governance.

39. *Short term recommendations*: linking and consolidating taxes collected locally with government; improve access to finance; enforce that all members of the informal sector have to open a bank account; 'one stop shops' for businesses throughout the country to cut down on registration time (currently takes 1400 hours on average – SSA average is 600 hours), which represents 35 and 15 40 hour weeks respectively ie: over 8 months to set up a business in Cameroon); empower tax officials to broaden tax base; link information and social service delivery; non-cash payment infrastructure; 'name and shame' tax cheats; and strengthen the border with Nigeria, thereby reducing illicit night time trafficking.

[14] See: http://www.doingbusiness.org/

Ethiopia

40. Savings are low and investments dropped to less than 20 per cent; domestic savings ratio is lower than the low income SSA countries and fragile states average. The tax effort is low and has been declining over the past few years, there is low tax compliance primarily owing to the limited organisational capacity and a lack of commitment to develop the organisational capacity of the tax collection system. One of the reasons behind low tax-effort (despite recent strong growth performance) is the vast proliferation of exemptions. The country is generally 'underbanked' and capital flight is a problem. There is a large Ethiopian diaspora (over 500,000) but remittances are low compared to other African countries. There are high tax exemptions to the private sector which have proved a mechanism for fraud. There has been a large increase in resource flows to the private sector but these have not translated into increased taxes, in fact the share of corporate income tax has decreased. Tax exemption has resulted in a doubling of revenue foregone between 2005 and 2007 whereas the private sector has doubled in value during the same period.

41. ***Recommendations***; Tax the agriculture sector (but redefine 'agriculture' in order to tax commercial farming but not subsistence peasant farming); limit exemptions to time bound agreements (however there is a lack of capacity within the tax authority to deal with this); join the Common Market for East and Southern Africa (COMESA) system; need to deal with the issue of Corporation Tax, since the economy is growing but corporation tax is declining; raise VAT levels to be in line with other African countries as it is currently low by comparison; reduce the Income Tax rate from 35 per cent to reduce evasion; enhance capacity within Tax Revenue Authority and linked systems; there is a need to get a positive interest rate to encourage savings, since currently inflation is high in Ethiopia; raise the Bond rate, as at the moment it is very low and so there is no incentive to invest.

Uganda

42. There has been a high growth rate between 2000 and 2008, reaching as much as 7.9 per cent. This has slowed since but is still high at 7.2 per cent. Aid used to account

for over 50 per cent of the budget, now accounts for around 30 per cent. Agriculture has continued to shrink and this growth is mainly driven by the services sector. However, savings performance has been poor and returns are well below current account requirements. Much has been done on reforming the tax administration but as yet this has not translated into enhanced revenue collection. There are limited tax handles and an over-reliance on excise duties and domestic VAT. Low revenue performance has been attrbuted to the structure of the economy with a large agricultural sector (21.4 per cent of GDP in 2007/08). As with many SSA countries there is a large informal sector which remains pretty much untouched. SMEs constitute 75 per cent of all companies in Uganda and are largely unregulated. There is tax evasion and avoidance as well as tax incentives, which are unstructured and random. The financial market overall is slow and small, banks are mainly urban focused and few, lending to specific sectors, there are few financial products available and credit risk is a problem, mainly because of a lack of information available. Investors are not coming to Uganda because electricity infrastructure is weak. This needs to be boosted, however the discovery of oil will change relationships, with oil revenue being used to finance infrastructure.

43. ***Recommendations for revenue collection:*** Tap the informal sector as VAT has not been fully implemented at the retail stage; register all informal traders for VAT on the commodities they trade in; streamline incentives after looking at costs and benefits in greater detail**; i**mplement a National Identity Card, for ease of tracking small informal businesses**; i**mplement presumptive taxes as this works with small enterprises that do not keep financial records. This provides an estimate of what they should be paying. It already exists in Uganda but implementation has been weak; introduce a property tax to be levied on residential and commercial property; simplify the tax system since there are those willing and able to pay tax but who simply find the process far too complicated; and address corruption since raising wages for revenue officers has not worked.

44. ***Recommendations the for financial sector as a whole***: increase availability of development finance for investors in priority sectors of the economy; encourage opening of alternative sources of long term capital; strengthen the Credit Reference Bureau; modernise the land and company registration institutions – computerisation

started in 2007; widen financial instruments eg: mortgages for which there is currently a very shallow market. There is limited access to long tem financing.

Burundi

45. Burundi has a strong reliance on external resources with negative private savings and a narrow tax base (200 taxpayers account for 80 per cent of domestic tax revenue). Fraudulent exemptions and undertaxation are partially responsible for this. There is a lack of capacity and skills, limiting effectiveness, additionally, whilst tax officials have a position of high responsibility there are low financial incentives which exposes them to corruption, which is already widespread in the upper echelons of state. The Burundi Revenue Authority (BRA) is already in place and a code of conduct adopted. The BRA needs to be left to act autonomously without interference from the Government. It has been suggested that donors could play a role here by linking disbursement of budget support to the achievement of rates set over a given period, as well as provide oversight of the process. Recently banks from Nigeria and Kenya have set up in Burundi which has increased competition and this has already been felt through the lowering of borrowing rates and higher deposit rates. Microfinance institutions (MFIs) have experienced an annual growth of 40 per cent in recent years in response to the poor access to financial institutions by low-income people. In order to build on public confidence in MFIs, for example, better supervision is needed to combat pyramid schemes where people have been cheated.

46. ***Recommendations***: ***For tax revenue increases***: BRA to have no interference from government in its management and administration; fight corruption by providing tax officials with sufficient financial reward; set a target of raising government revenue level by 1.5 per cent of GDP in the first year by eliminating fraudulent duty exemptions, for example; look to Rwanda for lessons learned and best practice, as Burundi is very similar and also in a state of post-conflict recovery (by implementing tax reform, Rwanda has tripled its revenue in seven years).

47. ***Recommendations: For private savings increases:*** Enhance the social security system which currently has very limited coverage; increase coverage of medical

insurance; increase competition in the banking sector; reduce barriers to credit; set up a credit reference bureau; increase the effectiveness and integrity of institutions charged with protecting private property and the enforcement of commercial contracts; establish a capital market (bonds); better supervisory structure for microfinance initiative (MFIs); donors could play a role in strengthening and extending the existing MFI network through; technical assistance and training for staff in MFIs; provide original seed resources during the first few years of set up; guarantee fund for small traders and farmers, as they face the greatest difficulty accessing credit; and facilitate grants for equipment and infrastructure

Tanzania

Background

48. Tanzania is politically the most stable of all five case study countries, however the global financial crisis has reduced the annual growth rate. There is a large informal sector comprising very poor people who are in the informal sector because they are so poor rather than because they are seeking to evade tax. Inflation is running at 10 per cent with deposit rates between 2 – 9 per cent, so a negative interest rate prevails for savers. Bank charges are also very high. Tanzania's spending needs are growing rapidly and outstripping the amount external resources are able to meet. Domestic revenue is expected to contribute 56 per cent of total revenue and 33 per cent from foreign grants and loans. A few large taxpayers account for 70 per cent of total tax revenue (the number of large taxpayers increased from 100 in 2001 to 370 in July 2006). This accounts for around 38 per cent of all Tanzania Revenue Authority (TRA) collections. Domestic savings are low, primarily because of the high charges on customers and high lending rate on loans.

49. Parliament's role is limited. One of the challenges is that it is not active in submitting fiscal proposals, the flip side of this being that there is the opportunity for proposals to be implemented without political interference. Cooperative law from the socialist past inhibits development of financial mechanisms. Guarantee schemes need a strong regulatory environment. Collateral for loans is an issue as all land is state owned and

the financial system does not recognise land alone as collateral. There has to be a building on it, but few will risk investing in building on the land when the President could remove the title at any time; mechanisms need to be introduced for capital management; capital markets have a huge potential, but in most SSA countries the markets are very thin. There is a need to mobilise the private sector to develop to a point where more companies can float on the stock market and then develop the capital market. In India, all workers on public works programmes have to open a bank account and salaries are paid directly into it. In Kenya there are electronic tax registers and the government gave people a refund when they filed their tax returns, resulting in greater efficiency.

50. ***Recommendations***; exploit property tax potential; collect taxes from the informal sector, through a process of organisational/collective mobilisation around their demands for some form of public service or facilitation. Perceived fairness is important here – tax collectors need to be seen to be behaving with integrity and objectivity. Presumptive taxes for small enterprises might be a solution; enhance private savings; address constraints that discourage banks to deal in rural areas; lower bank charges and make loans cheaper and more accessible for longer term investment by reducing collateral requirements.

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APPENDIX 1: AFRICAN DEVELOPMENT BANK COUNTRY STUDY FOR DOMESTIC RESOURCE MOBILISATION

	Burundi	Uganda	Tanzania	Kenya	Rwanda
Level of economic development and structure	• Small economy with a reliance on coffee and tea exports • Civil strife • Growth of 4.5% in 2011 and 4.8 in 2012 predicted	• Good economic growth • GDP share of service sector 50%, agriculture employs 70% of population • Investment in energy, mining, tourism and roads in last 2 years • Expects to earn US$2billion from oil by 2015	• 15 years strong economic growth • Primarily agrarian economy • Mining, construction, financial services and manufacturing also recorded high growth rates	• Growth post-independence for first two decades and stagnation for next two. • Resourceful private sector • Must remain peaceful to grow	• Good growth and predicted to achieve 6% between 2010 and 2013 • Mainly agricultural economy
Societal aspects: trust and 'tax morale'	• Climate of fea • Eroded trust in politicians	• PSM shortfalls have eroded trust in government over the years • President has undermined trust, despite championing tax payment	• Ujamaa heritage have left the country with an egalitarian approach but tax morale has been difficult to sustain	• 'Harambee' – self help, collective spirit – schools were built etc • Culture of trust evolved • Elite capture in 1980s & 1990s destroyed Harambee and trust eroded	• Genocide culminated in decades of intense ethnic distrust • Regime has prioritized rebuilding of social fabric with improvements in public service delivery
War: Bureaucratic modernization as a response to threat	• Bureaucracy remained intact as the military needed to be paid	• Civil strife and economic mismanagement disrupted development of a revenue administration • NRM govt had to set up DRM efforts to sustain itself and also gain legitimacy	• Not at war. Nyerere's 'war on hunger' required resources but relied on external help, so tax morale not established	• Post independence mobilization of resources • 1990s – weakening of reform and aid reduced	• Wars with neighbours has reduced external support – DRM therefore critical • Strong support for Rwanda Revenue Authority (RRA)
Political institutions and the tax system	• Colonially bequeathed system • War let do corruption which included the tax system • Not much changed with peace but an autonomous Revenue	• Distrust and conflict between URA and MoF led to URA's patronage by national political leadership • Ad hoc intervention in tax policy and admin	• Constitutional limitations – only 2 articles on fiscal matters • Challenges and opportunities • Checks and balances not in place because of weak government input	• TMP launched in 1986 but political interference undermined Kenya Revenue Authority during initial 20 years	• Frustration with focus on consumption rather than development has influenced RRA's focus on phasing out aid dependency • President has championed public attitudes

	Authority is to be set up and changes may occur				towards paying taxes and addressing corruption
Tax and the 'Fiscal Contract'	• Bureacratically enforced tax system is vital for its survival • Narrow tax based – 200 taxpayers contribute 80 % of domesntic tax revenue • Abundance of external resources has impeded progress on the Fiscal contract	• Narrow tax base • Easy external resources and PSM shortfalls have impeded development of a Fiscal contract	• 400 large taxpayers contribute 70 – 80% of domestic tax revenue • 40% of budget financed externally • Majority of population do not pay taxes and not much effort is being put into them doing so	• Corruption shredded any initial contract there might have been • Gains under NARC (2002) but further lapses in fight against corruption have eroded these • Narrow tax base – 830 people pay 75% of domestic taxes	• RRA does seem to be contributing to the participation of citizenship and bringing population and government closer
	BURUNDI	UGANDA	TANZANIA	KENYA	RWANDA