

Domestic Resource Mobilization

Political Economy Dynamics Underpinning DRM

Lessons from the EAC and South Africa

**Wilton Park
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Outline of Presentation

- **Brief Background of AfDB DRM Study**
- **Five aspects underpinning the political economy dynamics of taxation**



Outline of Presentation

- **Brief Background of DRM Study**
- **Five aspects underpinning the political economy dynamics of taxation**

- ATAF is collaborating with the AfDB on a study aimed at sharing lessons of experience from DRM in East Africa, South Africa, and South Korea
- Objective is to make recommendations for the EAC member states on the priority DRM reforms, their sequencing and implementation
- Achievements and lessons of experience will inform a policy note



Outline of Presentation

- Brief Background of DRM Study
- **Five aspects underpinning the Political Economy Dynamics of Taxation**



Five aspects underpinning political

Economy

- Level of economic development and economic structure
- Societal factors: culture, values, trust and “tax morale”
- War and taxes: bureaucratic modernization as a response to threat;
- Political institutions and tax systems
- Taxation and the “fiscal contract”



Burundi

- Level of economic development and economic structure:
 - Burundi's economy is mainly agrarian with heavy reliance on coffee and tea
 - Several years of civil strife impeded economic activity.
 - RGDP growth projected at 4.5% and 4.8% in 2011 and 2012 [IMF]
- Societal factors: culture, values, trust and “tax morale”:
 - Prominent socio-culture x-c **was** conflict and “fear” amongst the population as a result of violence and unequal distribution of economic resources and political power





Burundi

- Societal factors: culture, values, trust and “tax morale” cont’d:
 - Role of politicians in the past hostilities and perception of widespread corruption has sustained a high-level of distrust of political leaders—adversely affecting tax morale
- War and taxes: bureaucratic modernization as a response to threat:
 - In spite of war, bureaucracy remained largely intact—albeit demoralized and with diminishing capacity—possible influence of the legacy of the Belgian colonial administration
 - Taxes continued to be collected to pay public servants and the military





Burundi

- Political institutions and tax systems:
 - It could be argued that the colonial administration “bequeathed” successive Burundi regimes a tax system embedded in public administration structures
 - However, conflicts and instability associated with war led to rampant corruption in PSM, including tax admin—instability provides incentives for leadership to “grab what they can when they can” [USAID 2008]
 - Not much change even with onset of peace, but establishment of an ARA expected to address these challenges





- Taxation and the “fiscal contract
 - Bureaucracy enforced the tax system because it was critical to its own survival
 - Thus tax base remained narrow and largely focused on handles that were easily enforceable—which has remained the case until currently
 - E.g., 200 large taxpayers contribute 80% of total domestic tax revenues
 - One firm—Brarudi Brewery—contributes over 20% of non-customs tax revenues [USAID 2008]
 - In addition, efforts to build a fiscal contract has been impeded by the availability of substantial external resources—21% and 25% of GDP in 2007 and 2008, respectively



- Level of economic development and economic structure:
 - Economic and social development in 1st two decades following independence bequeathed Kenya with a relatively well developed socio-economic infrastructure including robust institutions
 - Subsequent two decades marked by slowdown, but economic turnaround at the turn of the century
 - Broad based economic growth, fuelled by strong macro and a resourceful private sector
 - Growth potential contingent on Kenya remaining peaceful—biz community concerned that tensions with in the coalition have led to the relegation of the economic agenda from the national platform





Kenya

- Societal factors: culture, values, trust and “tax morale”:
 - Harambee—emphasized the culture of self help and community working relationships
 - [Public] Harambee projects—schools, health facilities etc were built with GoK supervision
 - As such, a culture of trust evolved, and so did tax morale via this form of “indirect taxation”
 - Elite capture in 1980’s and 1990’s destroys Harambee social values: diminished accountability eroded citizen trust and consequently tax morale



Kenya

- War and taxes: bureaucratic modernization as a response to threat:
 - At independence, need to build socio-economic infrastructure and to deliver public services necessitated vast and fast mobilization of development resources
 - Weakening reform efforts in the late 1990's resulted in reduction in aid levels
- Political institutions and tax systems:
 - KRA [1995] was part of the TMP—launched in 1986, but political interference resulting in frequent change of guards both at KRA and Treasury undermined KRA during initial 20 years



Ubiquitous public sector corruption didn't spare KRA



○ Taxation and the “fiscal contract

- Corruption, socio-economic decline, deterioration in public services and institutions starting in the 1980's shredded the initial fiscal contract
- This changed with the coming into power of the NARC regime in 2002
- However, lapses in the fight against corruption have eroded some of these gains
- Compliance low and tax base remains narrow: 830 taxpayers contribute 75% of all domestic tax revenues [USAID, 2009]



Rwanda

- Level of economic development and economic structure:
 - Commendable economic growth since late 1990's, economy largely agric based, but GDP share of manufacturing and construction sectors has been increasing
 - IMF projects GDP growth of 6% between 2010-2013
- Societal factors: culture, values, trust and “tax morale”:
 - 1994 genocide marked culmination of decades of intense ethnic distrust, tensions, and hatred
 - RPF regime has prioritized rebuilding of the social fabric, coupled with improvements in public service delivery, will reinforce regime legitimacy





Rwanda

- War and taxes: bureaucratic modernization as a response to threat:
 - Rwanda's run-ins with her great lakes neighbors and the resultant threat of reduced external support underpin GoR's zeal to enhance DRM
 - Such considerations for instance explain the strong political support for the RRA since its inception
- Political institutions and tax systems:
 - Frustration with DPs focus on consumption rather than development expenditures influenced RRA's focus on phasing out aid dependency
 - President has championed a change in public attitudes towards paying taxes and addressing related challenges such as corruption





- Taxation and the “fiscal contract
 - “...RRA is seen to be contributing to developing a culture of participation and citizenship as part of a wider process of establishing the norms and practices of democratic governance and bringing government closer to the people.” [Torero et al, 2006]



Tanzania

- Level of economic development and economic structure:
 - Decade-and-a half of strong economic growth, although economy remains agrarian. Nonetheless, mining, construction, financial services, and manufacturing sectors have recorded high growth rates
- Societal factors: culture, values, trust and “tax morale”:
 - Tradition and the enduring impact of the Ujamaa (Socialism) era have left Tanzania society with a significantly egalitarian and camaraderie culture. But tax morale has been difficult to sustain





Tanzania

- War and taxes: bureaucratic modernization as a response to threat:
 - TZ has only been involved in one war since independence—against Uganda’s Idi Amin. However, former President—late Mwalimu Nyerere declared “war” on hunger, disease and ignorance.
 - However, President Nyerere didn’t fall back on “poor” Tanzanians to mobilize resources for his nation building, but rather on external resources—contributing to low tax morale





Tanzania

- Political institutions and tax systems:
 - Role of Parliament in DRM is limited by the constitution—which has only two articles on fiscal matters.
 - This presents both challenges and opportunities: TRA has been largely insulated from political interference. However, executive (and not Parliament) controls the “demand side” state institutions and thus public accountability is difficult to achieve
- Taxation and the “fiscal contract”
 - 400 large taxpayers contribute about 70-80% of domestic taxes while 40% of budget is financed by external resources. Thus majority of citizens do not pay taxes and not much effort has been made for them to do so





Uganda

- Level of economic development and economic structure:
 - Two decades of steady economic growth, GDP share of services sector now 50%, but agriculture sector employs 70% of population
 - Large investments in energy, mining, tourism and roads have only been made during last 5 years
 - Uganda expects to earn US\$ 2 million p.a from oil by 2015
- Societal factors: culture, values, trust and “tax morale”:
 - PSM shortfalls have over the years eroded trust in government





- War and taxes: bureaucratic modernization as a response to threat:
 - A history of civil strife and economic mismanagement starting in the 1970's disrupted the development of revenue administration
 - NRM government had to set-up its DRM efforts so as to sustain its operations but also to achieve regime legitimacy
- Political institutions and tax systems:
 - Distrust and conflict between URA and Ministry of Finance led to former's patronage by national political leadership

Ad hoc intervention in tax policy and administration





- Taxation and the “fiscal contract”
 - Narrow tax base, “easier” external resources, and PSM shortfalls have impeded development of fiscal contract



South Africa

- Level of economic development and economic structure:
 - Downward trend in economic growth and fiscal performance in sunset days of apartheid regime
 - Small group of white, colored and Asian population owned any wealth
 - Economic reconstruction since 1994 restored macro and fiscal stability and hence DRM
- Societal factors: culture, values, trust and “tax morale”:
 - Growth of registered taxpayers more than doubled since “liberation” in 1994: increased trust in government has contributed to higher tax morality





South Africa

- War and taxes: bureaucratic modernization as a response to threat:
 - Apartheid regime responded to sanctions by international community by adopting a high tax regime
 - Post-apartheid regime faced with high unemployment, poverty, and resultant crime: as such DRM remains a priority
- Political institutions and tax systems:
 - Katz Commission (KC) in 1994 necessitated by the ANC's need to fund growth and poverty reduction agenda

Interim report of KC led establishment of SARS in 1997

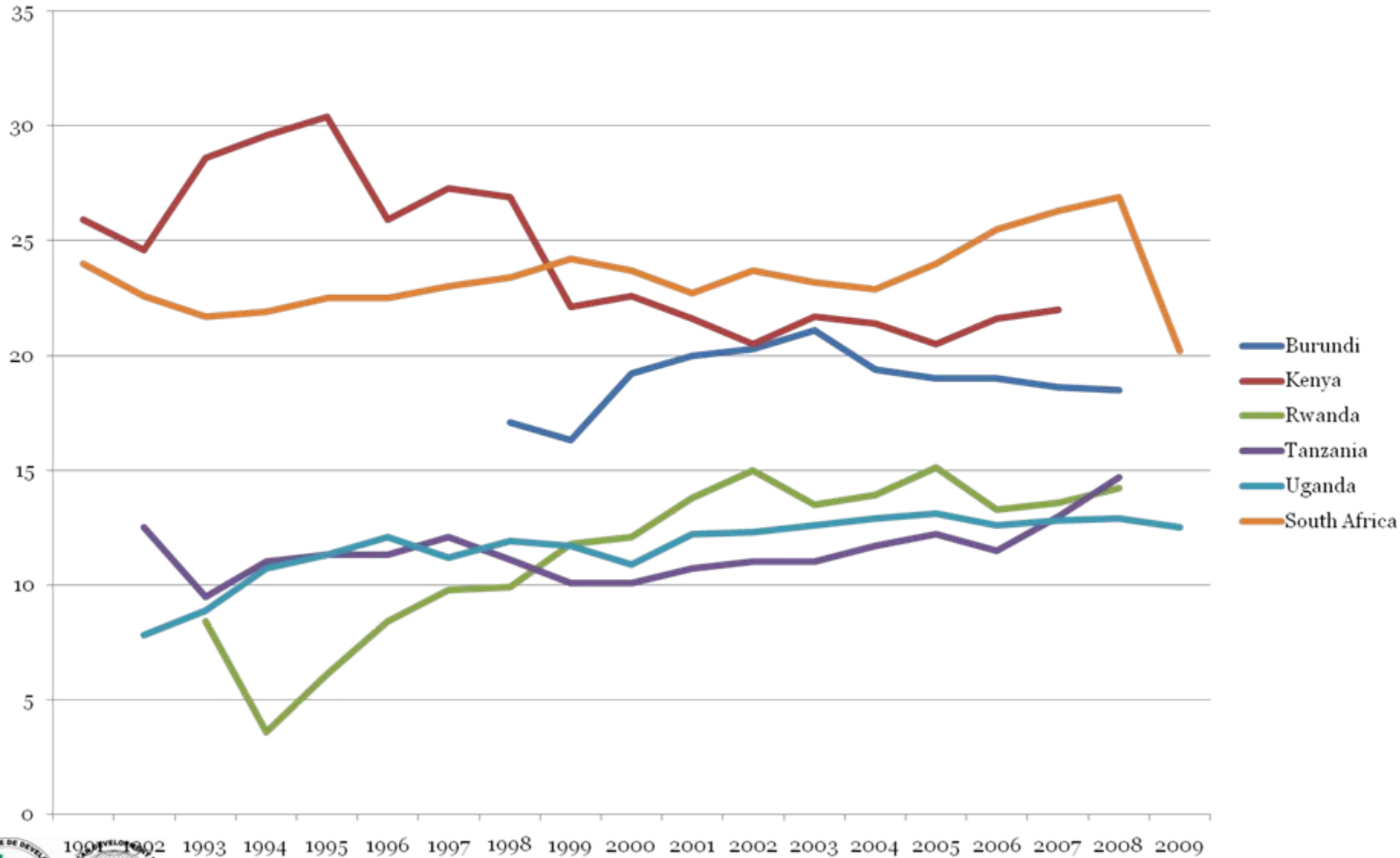




- Taxation and the “fiscal contract
 - Growth in number of registered taxpayers in post-apartheid SA stems from belief that ANC will deliver on pledges to improve social services, create employment and combat poverty
 - Majority of black elite support the need to expand the size of government and thus a compelling case to pay taxes
 - Thus an implicit fiscal contract exists



Government Revenue, % of GDP



- **Finalize country case studies**
 - with input from Tax Authorities and other stakeholders
- **Synthesis paper/ policy note**
- **Dissemination**



THANK YOU

