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Tax Through the Growth Lens

Setting the stage

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February 26, 2007

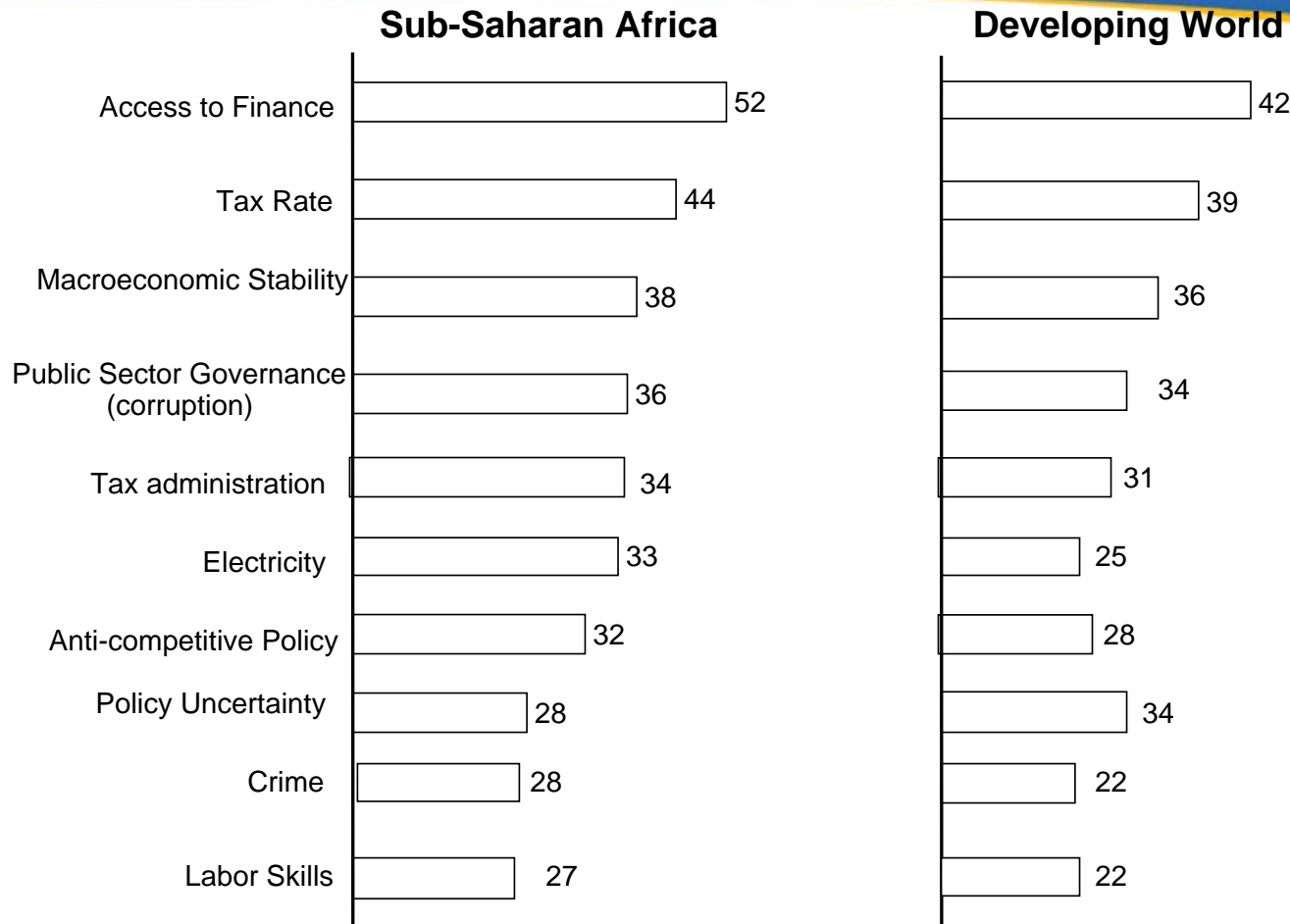
- **Why tax is one of the main pillars of the investment climate—some numbers**
- **How are tax and growth related**
- **Setting the stage—where we are in pinpointing the main issues**
- **Moving ahead: this conference and solution design**
- **What's next?**

Why tax is important: Some numbers from Africa

THE PROBLEM IS WHAT HAPPENS OUTSIDE THE FACTORY

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% of firms reporting external factor as major constraint

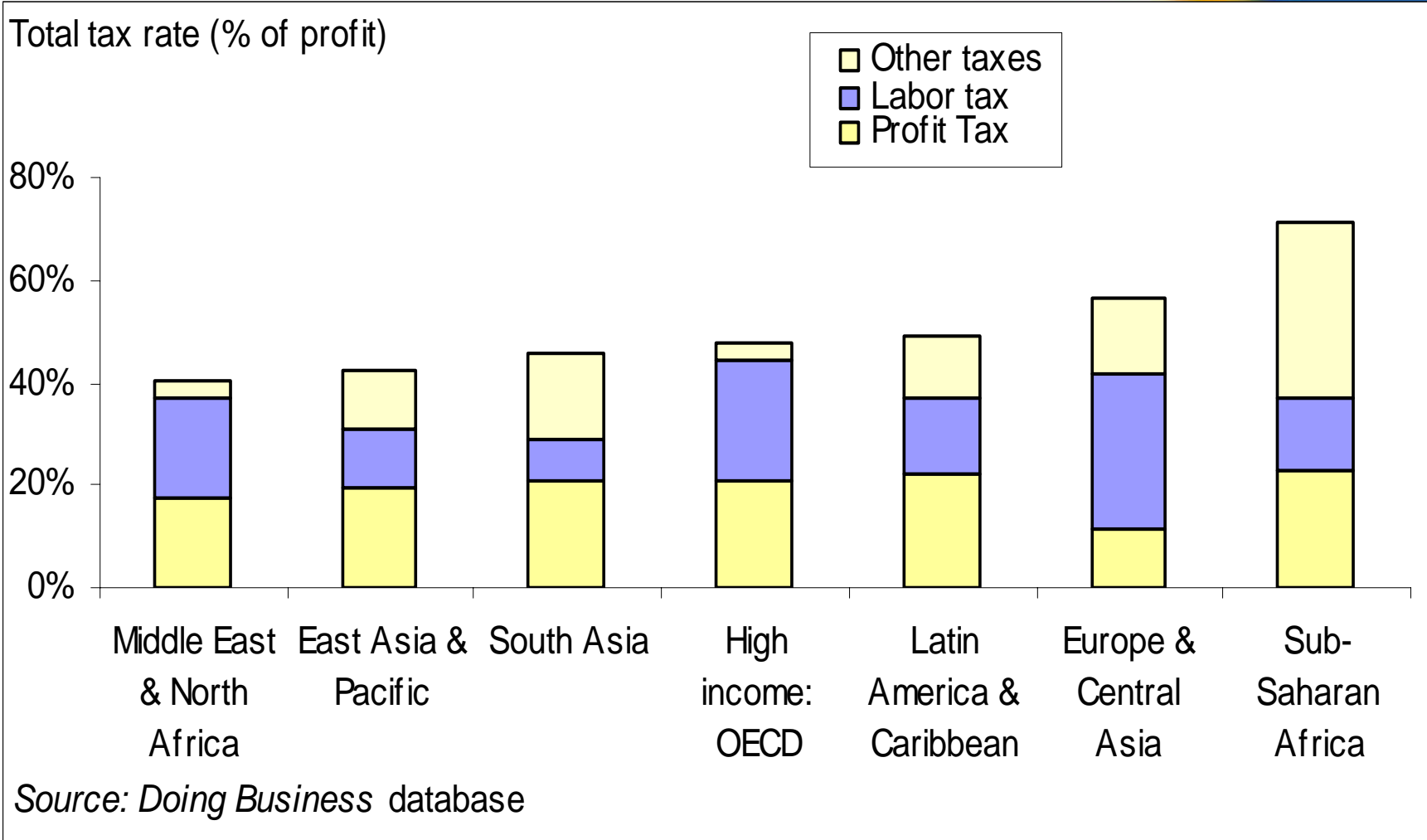


Note: Weighted average based on the number of firms surveyed in Benin, Burundi, Eritrea, Ethiopia, Kenya, Lesotho, Madagascar, Malawi, Mali, Mauritania, Mauritius, Senegal, South Africa, Tanzania, Uganda, Zambia.

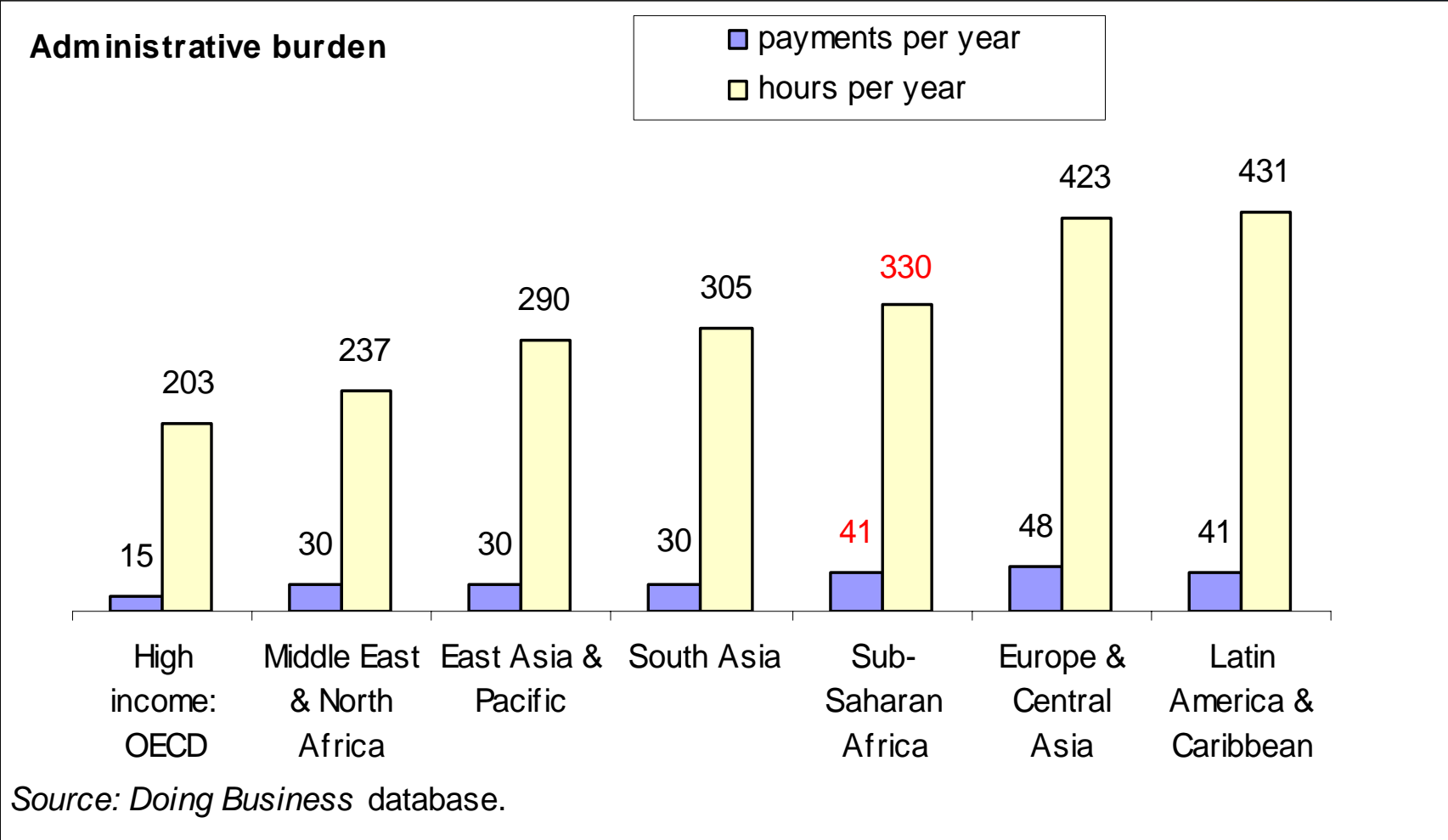
Source: Investment Climate Surveys (WB 2006)



Taxes rates highest in Africa



The administrative burden



Tax and Growth

- **Tax regimes affect international competitiveness—investor decisions**
- **Tax regime is a pillar of the legislative and regulatory system**
- **Tax compliance facilitates economic activity (can be part of the value chain)**
- **The tax burden (time and financial) is a key barrier to SME formalization**

Traditional Revenue Goal

- Raise Revenue for government expenditure

Development/Growth Goals

- Create a “culture of taxation”
regularization of the rule of law
- To increase the size of the formal sector
- To promote growth

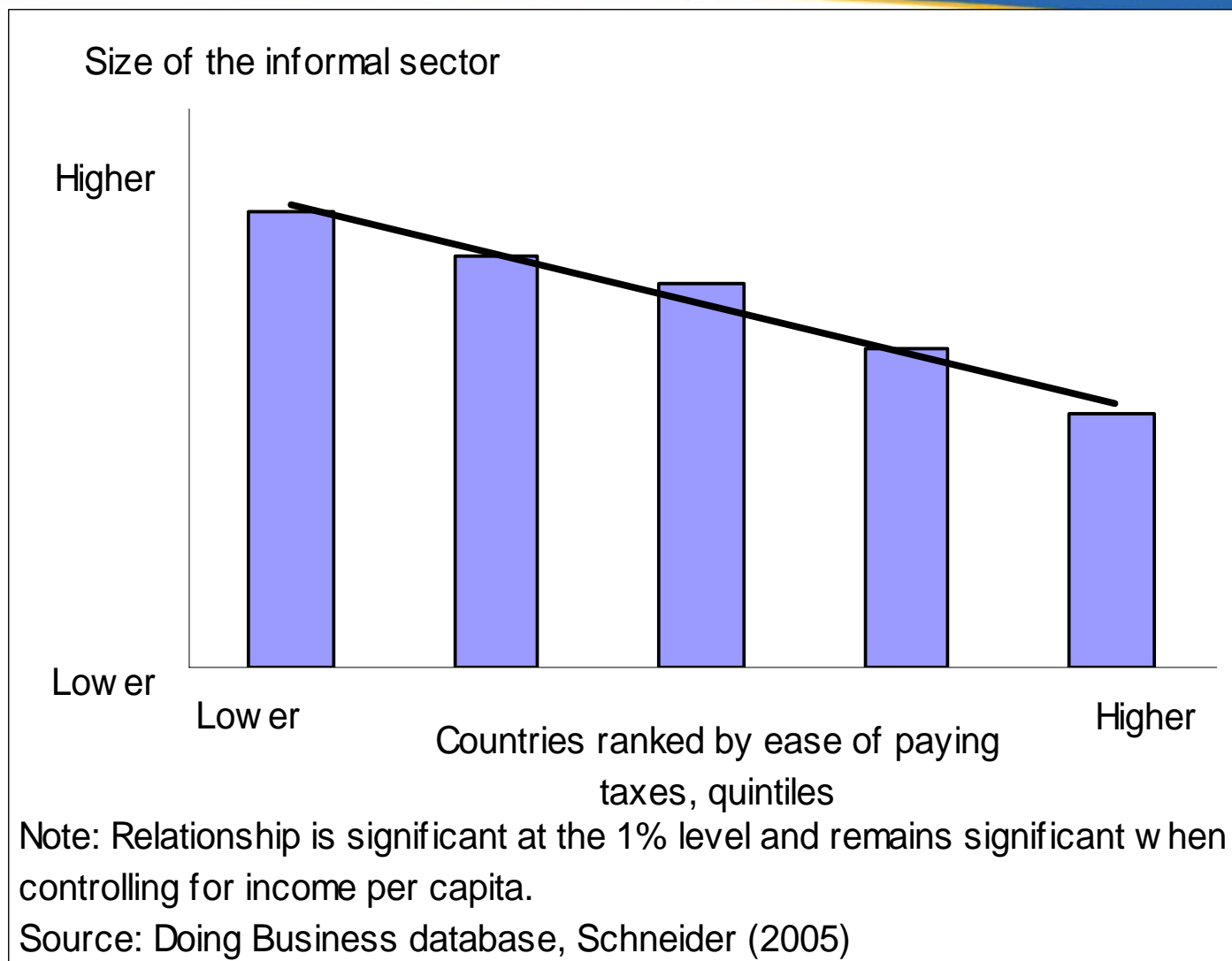
SMEs: INFORMALITY IS HIGH AND RISING

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Informal output as a percentage of total economic output



Source : Doing Business Database, World Bank



Squaring the circle



**Strong Enabling
Environment**

**Private Sector
Growth**

**Wider and
Deeper Tax Base**

Measuring the effects of tax on a firm's ability to grow: Diagnostic tools

What's in place now: Initial conditions

- Independent, modern revenue authorities in many countries, adapted to local contexts
 - Development of instruments appropriate to the economic environment
 - Years of TA on instruments and administration
 - In some cases, outreach programs, public-private dialogue mechanisms
- ... but problems especially in administration remain

Questions/issues addressed in the first phase

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- **How does the tax system work ?**
 - On paper
 - In reality
- **How can we measure the impact of tax in a comparative framework**
- **How can we “model in” subjective information**
- **How can we assess the efficacy of the tax authority to carry out the administration of tax**

Quantitative Diagnostic tools

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we use so far

- **METR to determine the relative tax burden of any future investments**
- **AETR is used to measure the tax burden of past and present investments.**
- **In addition to determining the tax burden, drill down to determine the “value chain of compliance” (compliance cost survey)**

What the measures tell us

- **Quantitative instruments enables us to compare the tax burden within countries by sector, as well as between countries**
- **These metrics enable us to pinpoint which instruments and rates are driving the results, and is a useful diagnostic tool**
- **It is a vehicle for simulating policy changes, and allows us to adjudicate the effects on business.**

Some results from Africa from the first phase:

Issues for discussion

METRs in Selected AFR Countries

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(Data from FIAS Studies 2006, category avgs)

in percent

<u>Country</u> Sector	Manuf	Tourism	AG	Fin	Min	Small Business (No VAT)
Zambia	5	5	10	30	0	25
Rwanda	29	14	7	38	15	34-51
Madagascar	24	14	15	29	11	60
Tanzania	15	15	20	29	23	30-32
South Africa	27	28	23	31	10	22-32

Cross-cutting tax issues which affect investment and growth

- **Large Taxpayers-- VAT issues: refunds for exporters, VAT, CIT rates and coverage**
- **Sector issues: mining sectors tend to be under taxed, manufacturing over-taxed, uneven incentives especially in tourism**
- **Large vs. Small: should firm size matter in terms of how and what to tax?**

- **Uneven application of tax regime within and between sectors**
- **“Vicious circle of mistrust”**
- **Corruption on all sides**
- **Lack of effective education, information flows, and outreach**

- **Top unresolved issue among tax authorities**
- **Top issue for SMEs in deciding to operate formally**
- **Most controversial issue among donors and IFIs (depends on the “lens”)**
- **Issue which needs the most radical solution design and implementation**

Other issues raised

- **Sub-national tax (municipal/local tax, fees, licenses)—who decides? Who sets rates? Who collects? Who benefits?**
- **Tax/customs interface—
Instruments/mechanisms (VAT issues, duties) and administration (customs officer as revenue collector)**

What is being done so far?

Old solutions

- **Simplifications (process, forms etc.)**
- **Exemptions**
- **Raising of thresholds**
- **Presumptive methods**
- **Standard assessments for groups in specific sectors or businesses**
- **Estimated or minimum taxes (generally based on turnover)**
- **Flat rate or equalization rates in lieu of VAT**

We can do much better
That's why we're here

New solutions require new lenses

- Need to think long term as well as short term

PSD and Growth = wider tax base/ more revenue

- Creative solutions especially when dealing with SMEs results in wider tax base, increased culture of compliance

I. System design

- **Make the tax system work—clean out the quick fixes**
- **Adjust instruments to reflect capacity**
- **The tax system is a complete system, not a sum of small pieces**

II. Administration

- **Admin reform should focus on reducing interface between client and tax official (risk based and trust based)**
- **Sectoral differences in admin should be eliminated**
- **The architecture of administration should focus on firm size/issues**

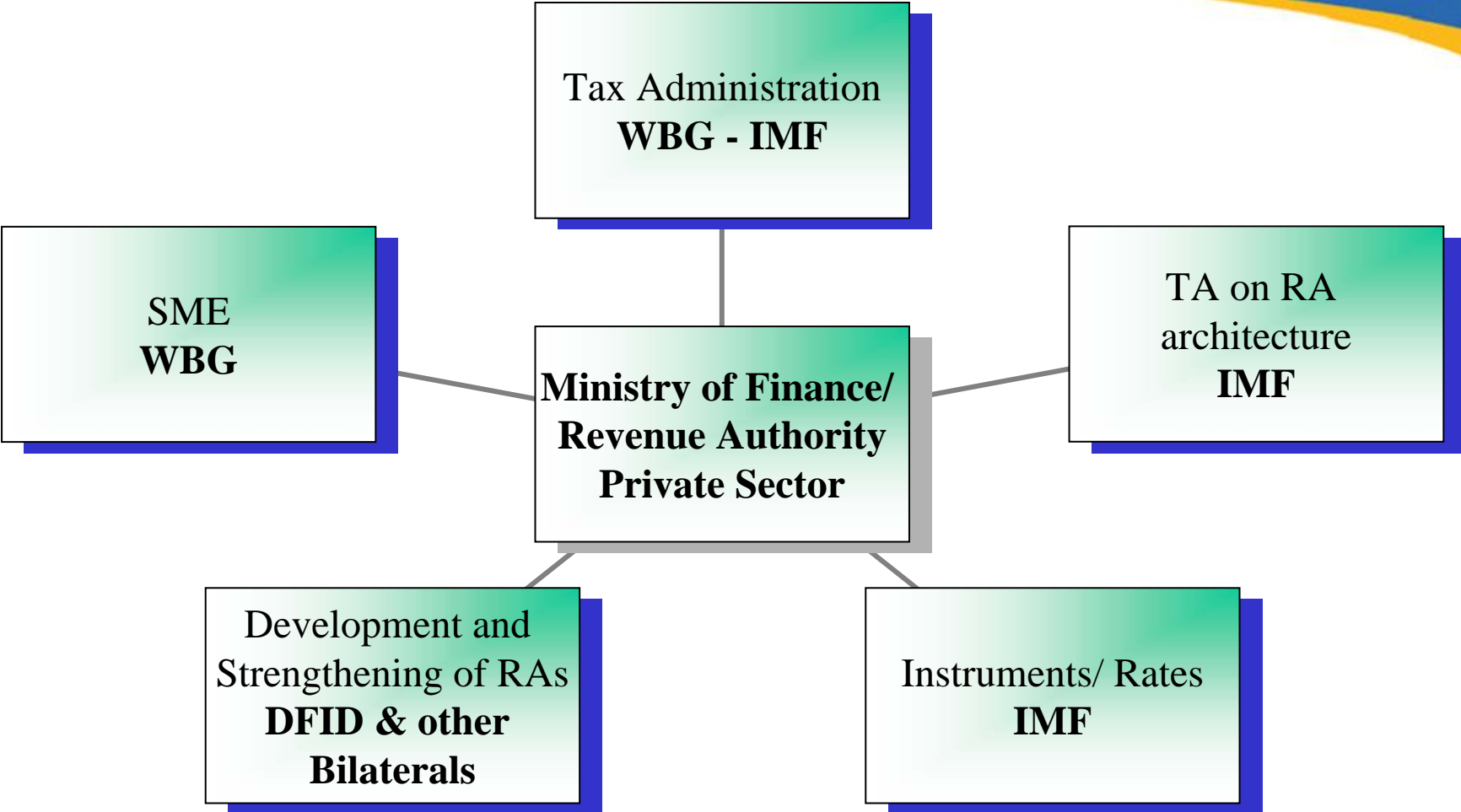
III. Small Business

- **SME tax system should address SME issues (compliance cost, informality, capacity)**
- **SME system should not be separate but should reward “graduation” (TZ, SA)**
- **SME administration will involve many stakeholders (MoF, RA, MoC, etc.)**

Possible Solutions require partnerships

- Within a country, public-private partnership
- Donor partnerships with government
- Donor coordination and support especially of pilot projects

Development Agency Landscape



Three things to think about

- 1. A policy (instrument) change that will facilitate tax compliance**
- 2. A change in tax administration to remove barriers to compliance**
- 3. A concrete plan to address the SME tax/administration problem**