

Political economy perspective

Taxation and accountability

- Bargaining over taxes is central to building relations of accountability between state and citizens based on mutual rights and obligations
- The emergence of a representative government is more likely when the state faces incentives to increase income through bargaining with citizens than through foreign aid
- For taxation to have a positive effect on accountability taxes must be 'felt' by a majority of citizens

Encouraging constructive state-private sector engagement around taxes

1. Mobilising the private sector by taxing it
 - Engage the attentions and political energies of a substantial fraction of the private sector in taxation issues
 - Broad tax base

2. Levy taxes as consensually and as transparently as possible
 - Put an end to arbitrary assessments, forcible collections, and extortion
 - Increase the extent to which taxation becomes a predictable, negotiated process, securing taxpayers' rights

- Always an element of compulsion in taxation
 - Quasi-voluntary compliance

Does the current tax reform agenda and tax administrative practices accommodate a constructive government-private sector engagement around taxes?

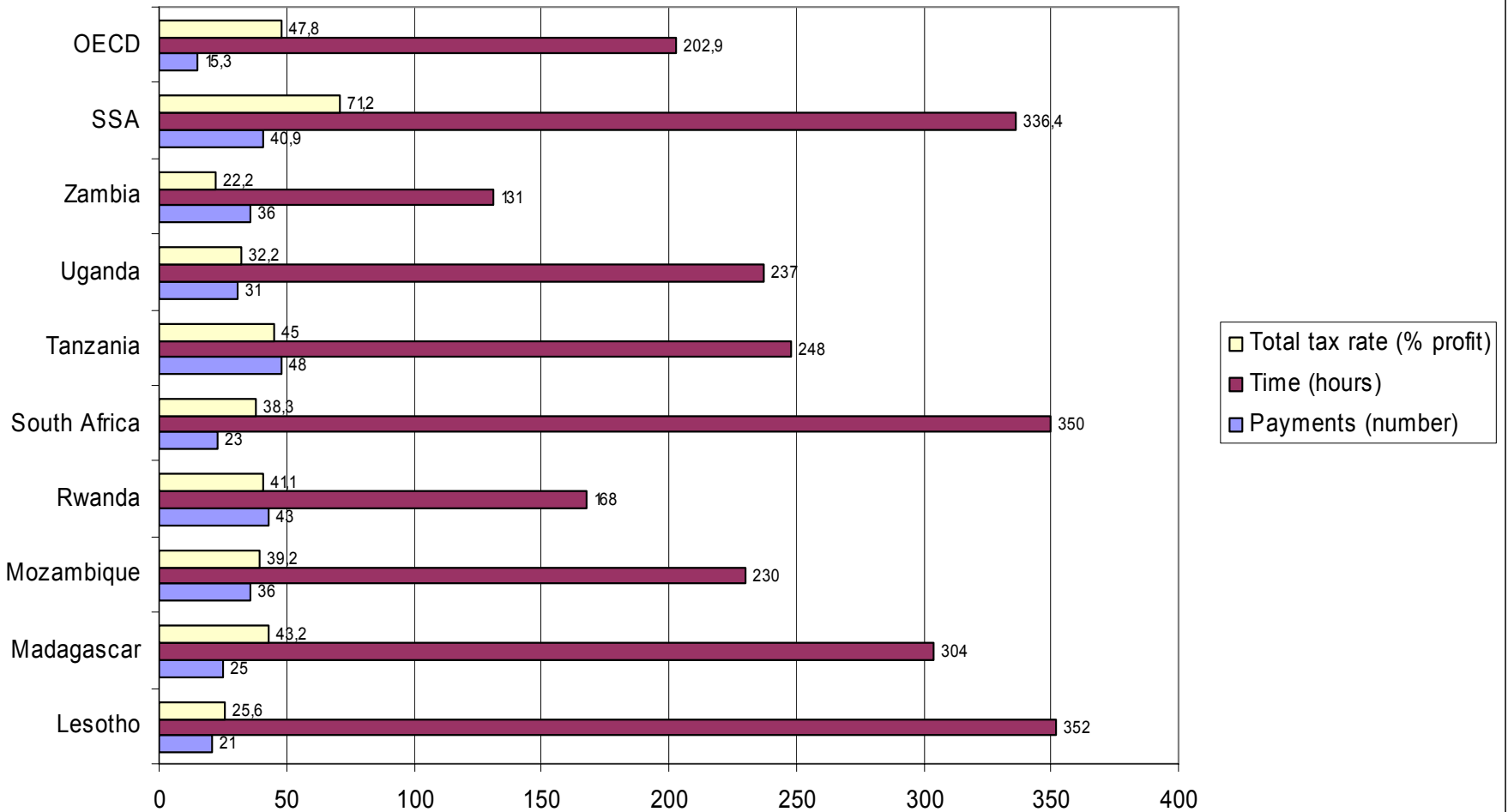
- 1. Simplification of complex tax systems**
- 2. Strengthening taxpayers rights**
- 3. Broadening the tax base**
- 4. Reducing tax exemptions**
- 5. Increase revenues**

1. Simplification – not always simple

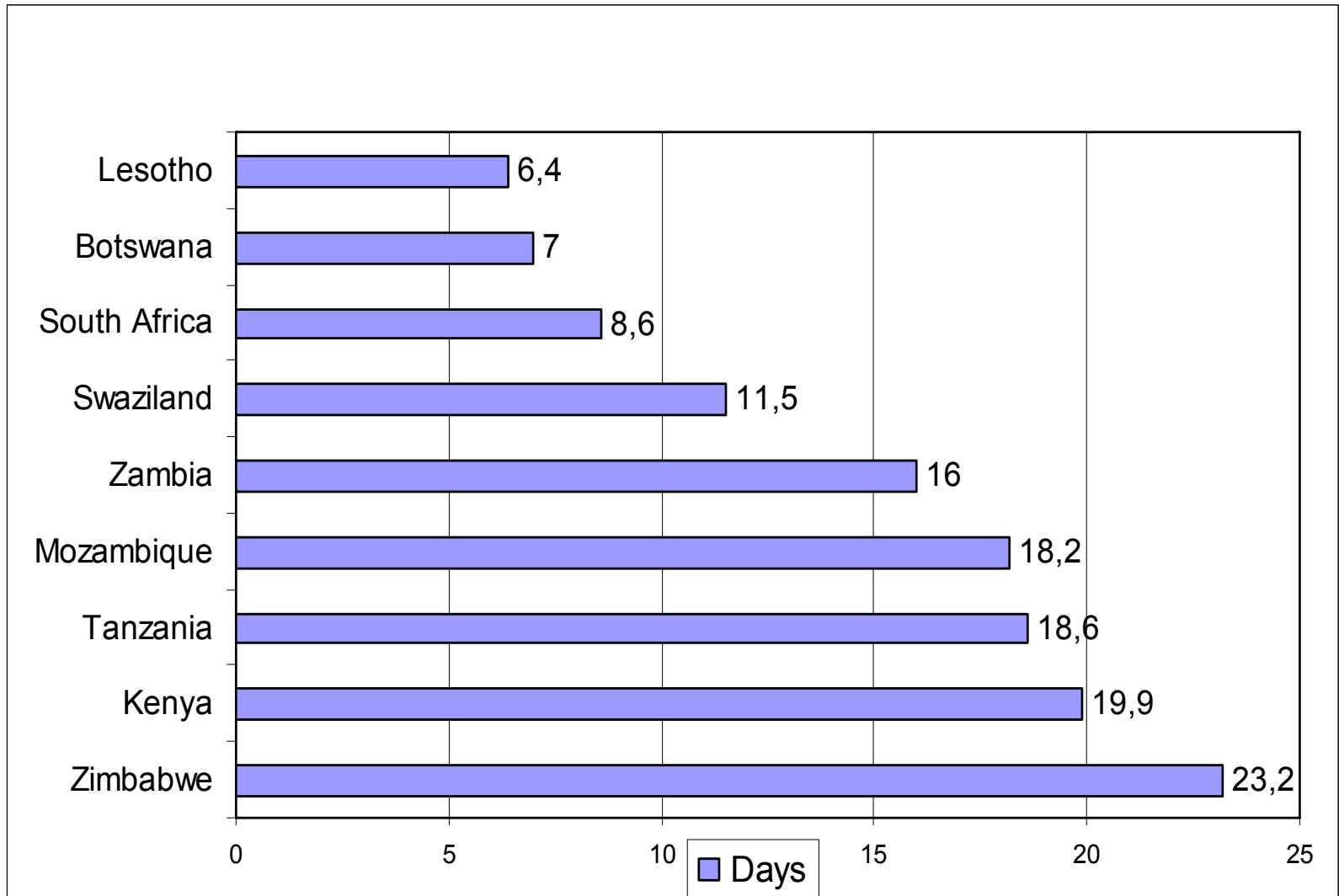
- Central government tax system has become more predictable and transparent
 - Compliance costs reduced
 - Administrative costs reduced
- Local gov. revenue system requires more attention
 - Often complicated and non-transparent
 - Disincentives for small- and micro enterprises
 - Oppressive revenue raising
 - Duplication and inconsistencies between LG taxes & CG policies
- Further simplifications of procedures and regulations required
 - VAT-refund schemes

Doing Business 2006

Paying taxes



East & Southern Africa: Average number of days required for import clearance in 2000



2. Taxpayers rights – some improvements

- Large corporate taxpayers' rights strengthened
 - Customer friendliness - rational for RA to be on good terms with LTs
 - Tax Appeal Tribunals
- Small and medium sized enterprises
 - TATs not yet a real option for small and medium sized enterprises
 - Tax administration often indifferent – sometimes hostile

3. Broadening the tax base – not achieved

- Likely that the number of registered taxpayers has been reduced in some countries
 - Thresholds for income taxation and VAT registration increased
 - Justified in terms of reducing administrative and compliance costs, but...
- The political arguments for a broad tax base not heard
 - Shaping state-society relations
 - Fiscal contract
 - A broader set of performance criteria than Tax-to-GDP required

Narrow base:

- Relative high tax burden on those who pay
- Incentives to split businesses to avoid tax registration

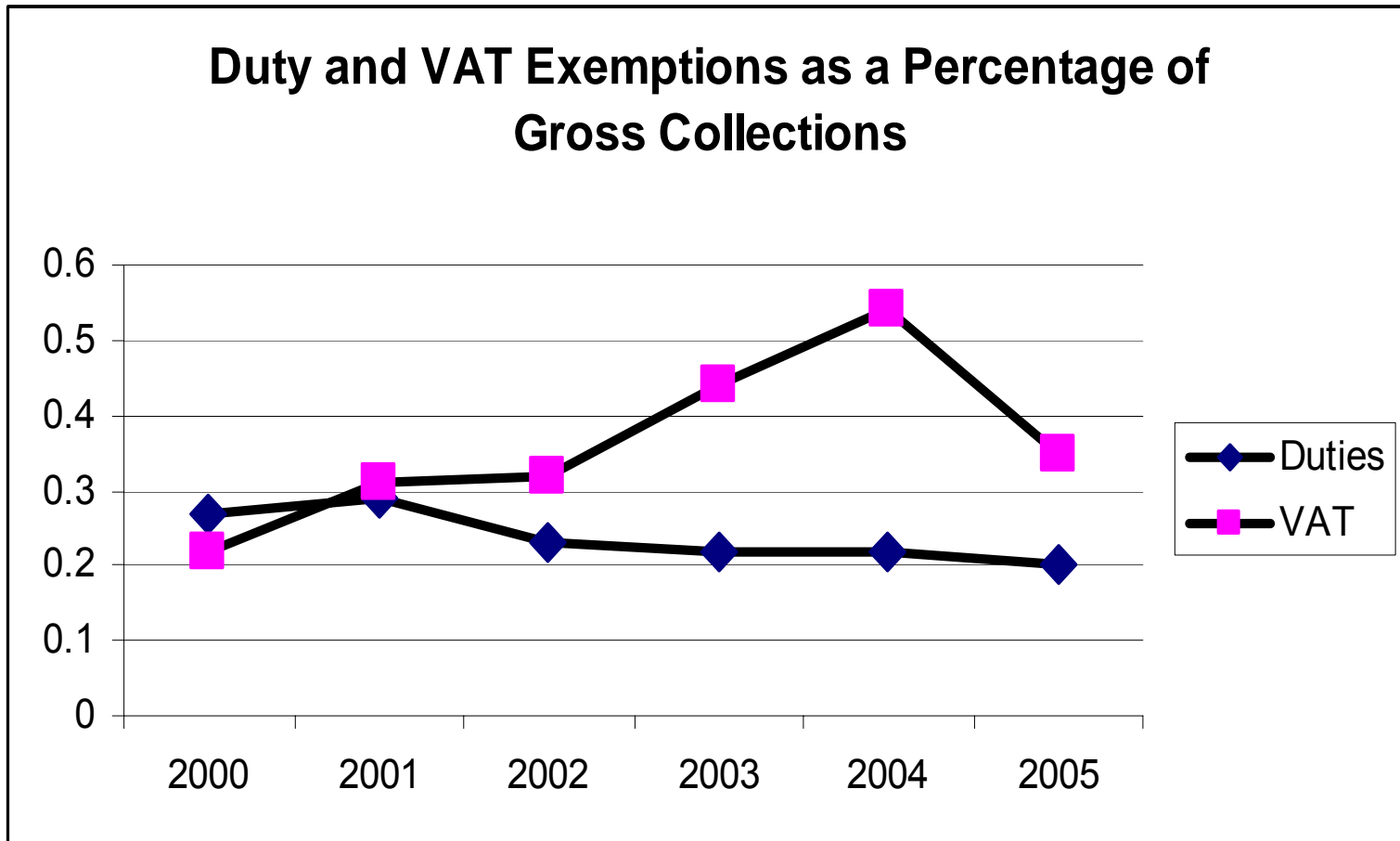
Examples of narrow tax bases (From FIAS country reports)

- Rwanda
 - 13 companies pay $\approx 80\%$ of total taxes
 - 3,000 registered companies pay national taxes
 - 280 covered by LTD pay $\approx 90\%$ of total taxes
- Tanzania
 - 286 large firms contribute 70% of total taxes
 - 10,000 medium sized firms $\rightarrow \approx 30\%$ of revenues
- ‘Small’ taxpayers little voice in the creation of tax policy

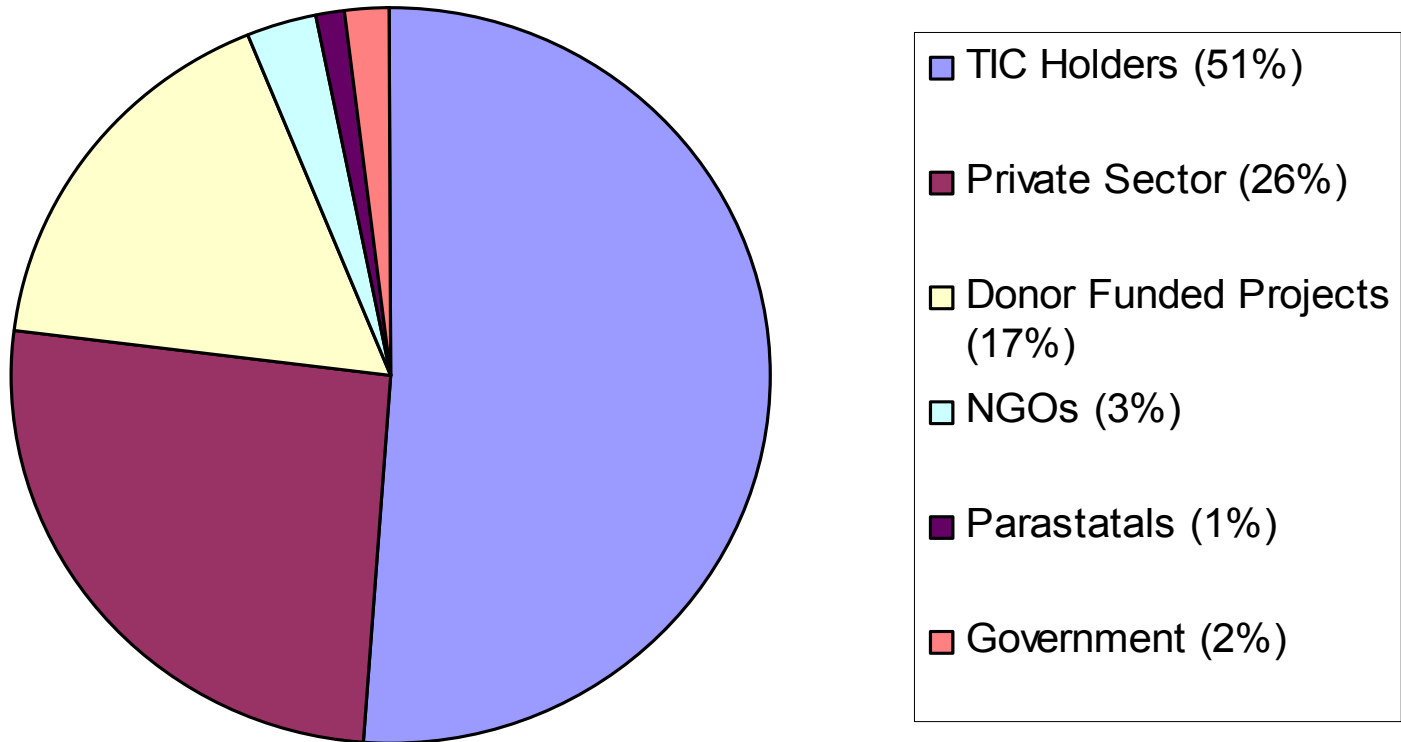
4. Reducing tax exemptions – not achieved

- Extensive – and sometimes increasing
 - Discretionary
 - Firm specific
- Exemption regimes
 - Distort investments
 - Divert resources into unproductive rent-seeking
 - Facilitate corruption
 - Undermine the revenue base
 - Erode the credibility of the tax system
 - ‘Legitimate’ tax evasion
- Exemptions used as a political tool
 - Positive discrimination of political supporters (granting tax exemptions)
 - Negative discrimination against opponents (tax audits and harassment)

Tanzania: Discretion in application of tax laws & political interventions → Tax exemptions erode the revenue base



Beneficiaries of customs exemptions in Tanzania (2005)



5. Revenue targets - the rule of the game

- Strong pressure on the RAs to meet revenue targets
 - Tax administration responds with a combination of:
 - A tighter squeeze of registered and easy accessible taxpayers
 - ‘Hunting in the zoo’
 - Attempts to meet externally set tax-to-GDP targets may undermine democratic accountability if legal processes and taxpayers’ rights are set aside in response
- >> Narrow tax base and tax exemptions major parts of the problem

Improving tax compliance by building trust: 3 dimensions

1. Trust in the government to use revenues to provide expected services
 - a) Establish better links between taxes paid and service delivery
 - b) Build a culture of transparency and accountability
 - Bring private sector into tax reform process
 - Continuous monitoring of tax adm's performance → indicators
 - Updated databases and statistics on revenue potential and collection disaggregated on sectors and geographic areas
 - c) Regular and widespread dissemination of accessible and reliable information to the public on revenue collection and allocations

Improving tax compliance by building trust (cont):

2. Trust in the authorities to establish fair procedures for revenue collection

- a) Harsh enforcement methods can be counterproductive → undermines trust
- b) Credible punishment of tax defaulters
 - In some countries, the judicial system is a bottleneck
- c) Strengthen the dialogue with stakeholders
 - Business associations
 - Taxpayer information centres
 - Taxpayer education
- d) Continued simplification of tax laws, rate structures and procedures

Improving tax compliance by building trust (cont.):

3. Trust in other citizens to pay their share

- Move towards a no-exemption regime: NGOs, donors etc should start paying taxes
- Data on tax exemptions should be made public