

Fiscal Affairs Department

TRENDS, CHALLENGES AND OPPORTUNITIES—POLICY FOCUS



Michael Keen

IMF Conference on Revenue Mobilization and Development

April 17, 2011



Design and implementation intimately connected—especially in lower income countries

Distinction thus to some extent artificial, but:

This session focuses on broad trends and on policy issues...

...and the next on administration



Overview

- Objectives
- Challenges
- Trends and possibilities
- Issues and lessons
- Concluding



OBJECTIVES



Revenue

Yes—but not the only concern

Efficiency and growth

- For advanced economies, hierarchy:
Real estate (best) – VAT/excises – PIT – CIT(worst)
- But limited evidence, especially for developing countries:
 - Some signs efficiency gains from VAT
 - And that trade liberalization fosters growth



Distributional effects

- Important in itself and for support of tax system
- Need to consider impact of all taxes (and spending)
 - Who really bears tax burden not always as it seems

Statebuilding and Governance

Taxation central to bargaining between state and citizens, hence to wider state building



CHALLENGES



Similarities and differences

Common challenges in developing countries: often same as in advanced—but bigger:

- Large hard-to-tax sectors
- Weak administration, 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 also differ greatly, in

- Resource wealth: Focus on this tomorrow
- Geography: e.g. small islands vs. large landlocked
- History: not just post-conflict, but legal tradition
- Constitutions: constraints on allocation of powers

Strategies of reform must reflect both

- Some aspects of good practice are very general
- But differing initial conditions, capacities and priorities call for different emphasis and sequencing



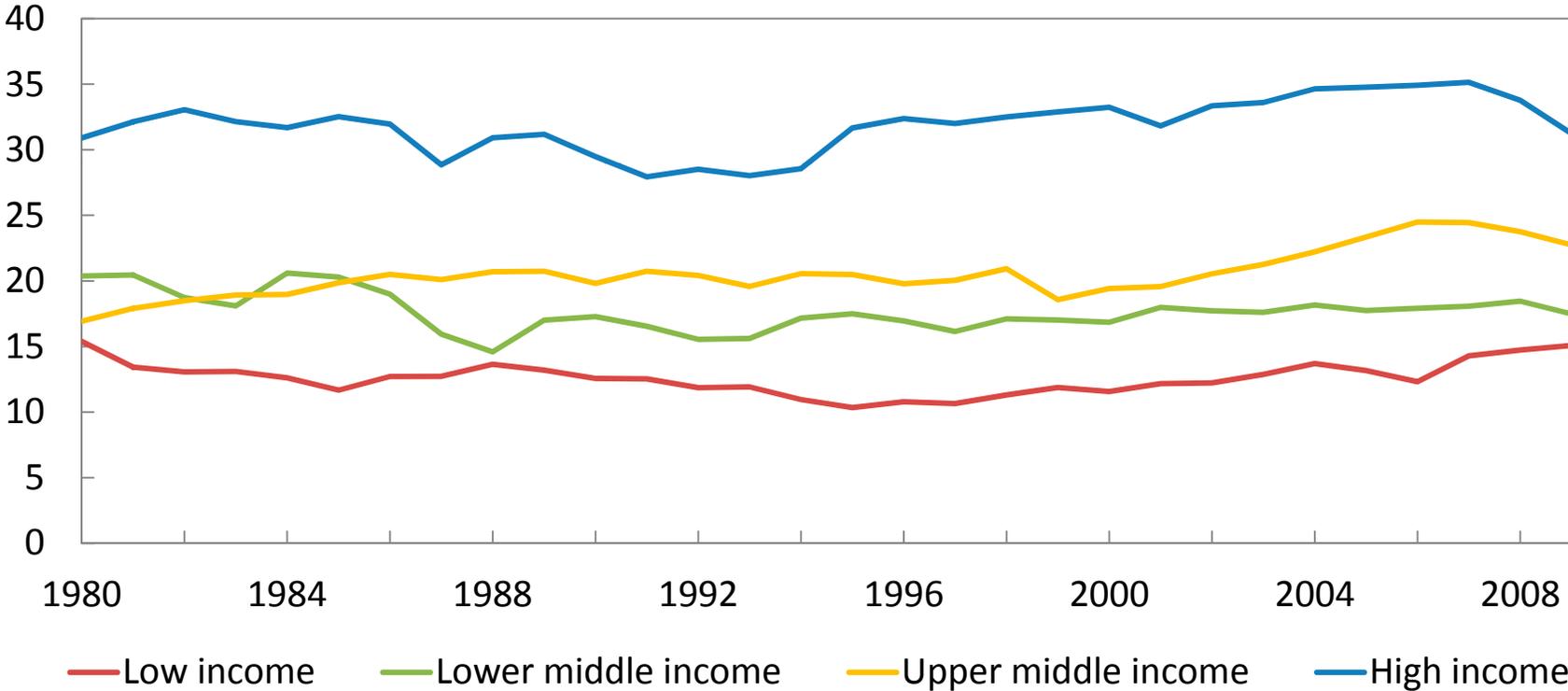
TRENDS AND POSSIBILITIES



Trends

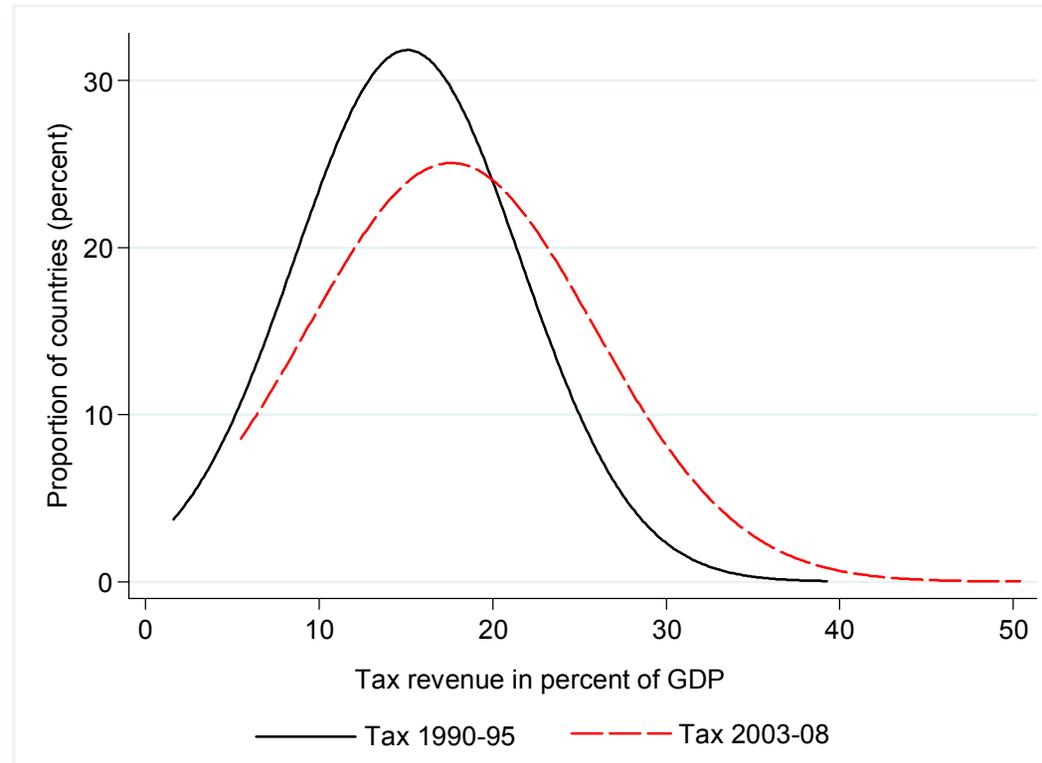
Lower income countries weathered the crisis well

Tax Revenue, percent of GDP



—and this was not only due to resources

Quite general improvement since early 1990s:

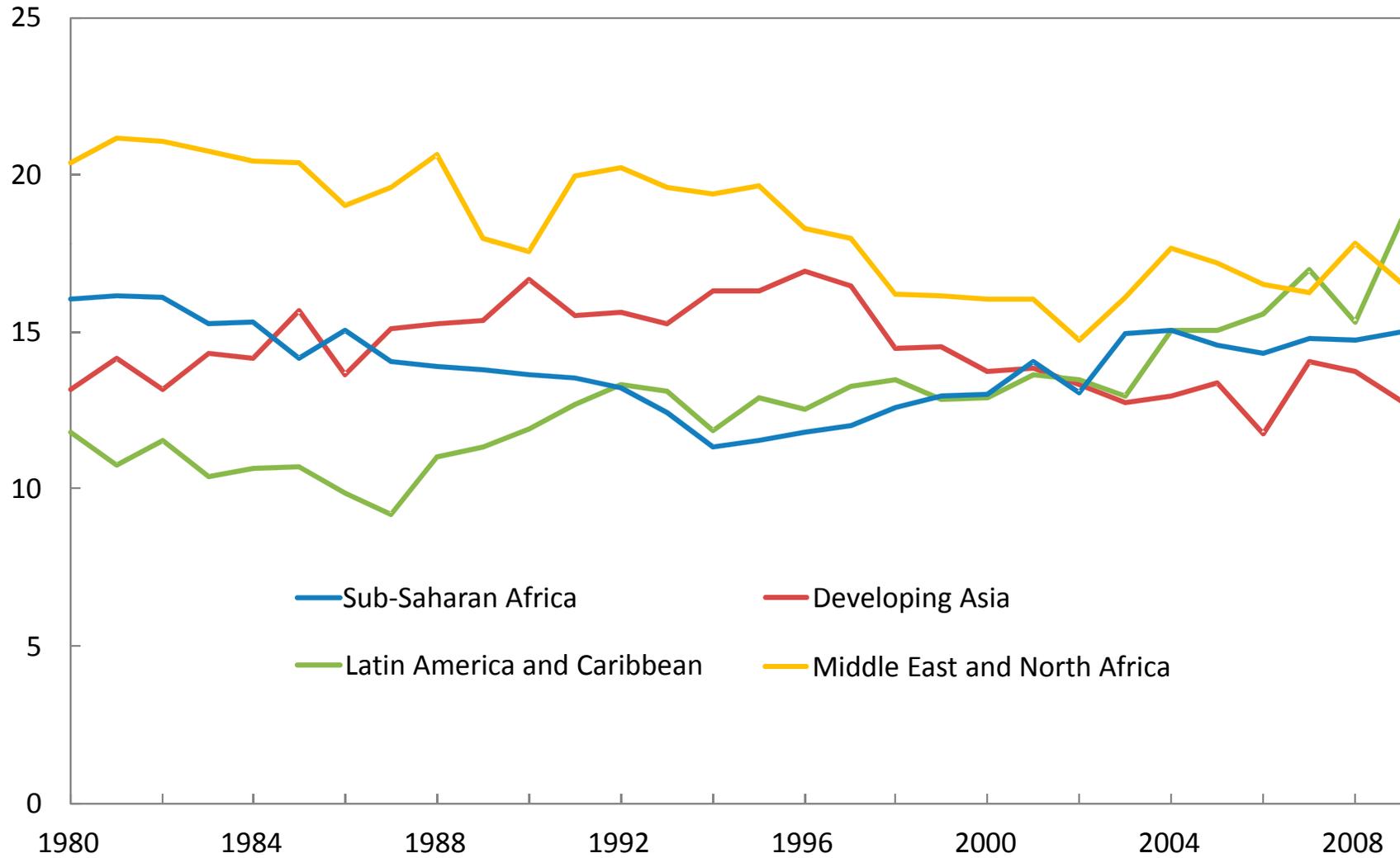


...reflecting stronger VAT and CIT, reduced trade revenues—trends since early 1980s



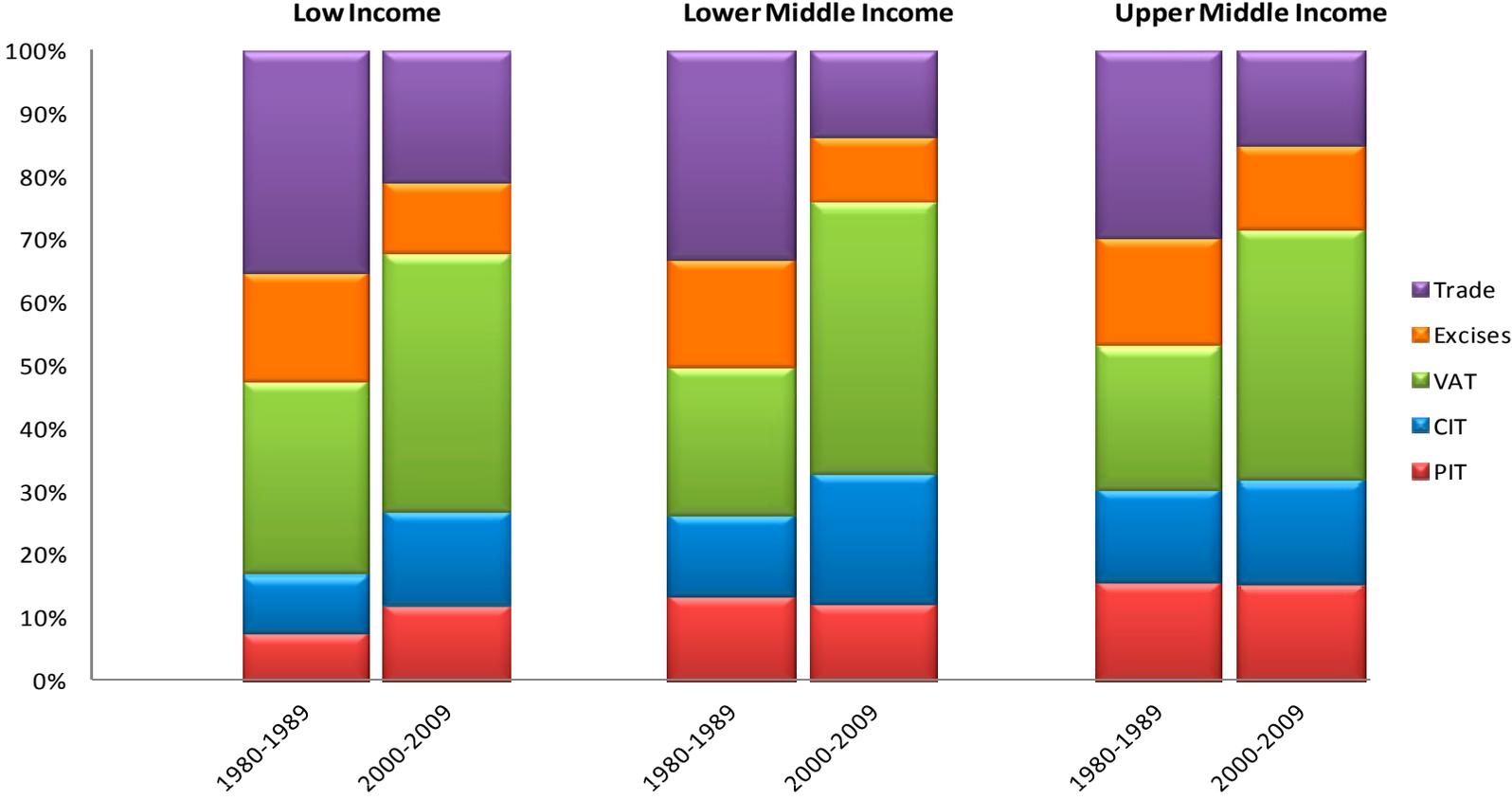
...but with regional variation

Tax Revenue, as percent of GDP





...and changes in the pattern of tax revenues





Assessing the scope to raise more

- Many factors affect tax ratios
 - e.g. resource wealth discourages it
- Econometric analysis suggests:
 - 'Effort' (= ratio of actual to potential revenue) not especially low in lower income countries
 - LICs with lowest effort could plausibly raise 3-4% GDP more...as several lower income countries have



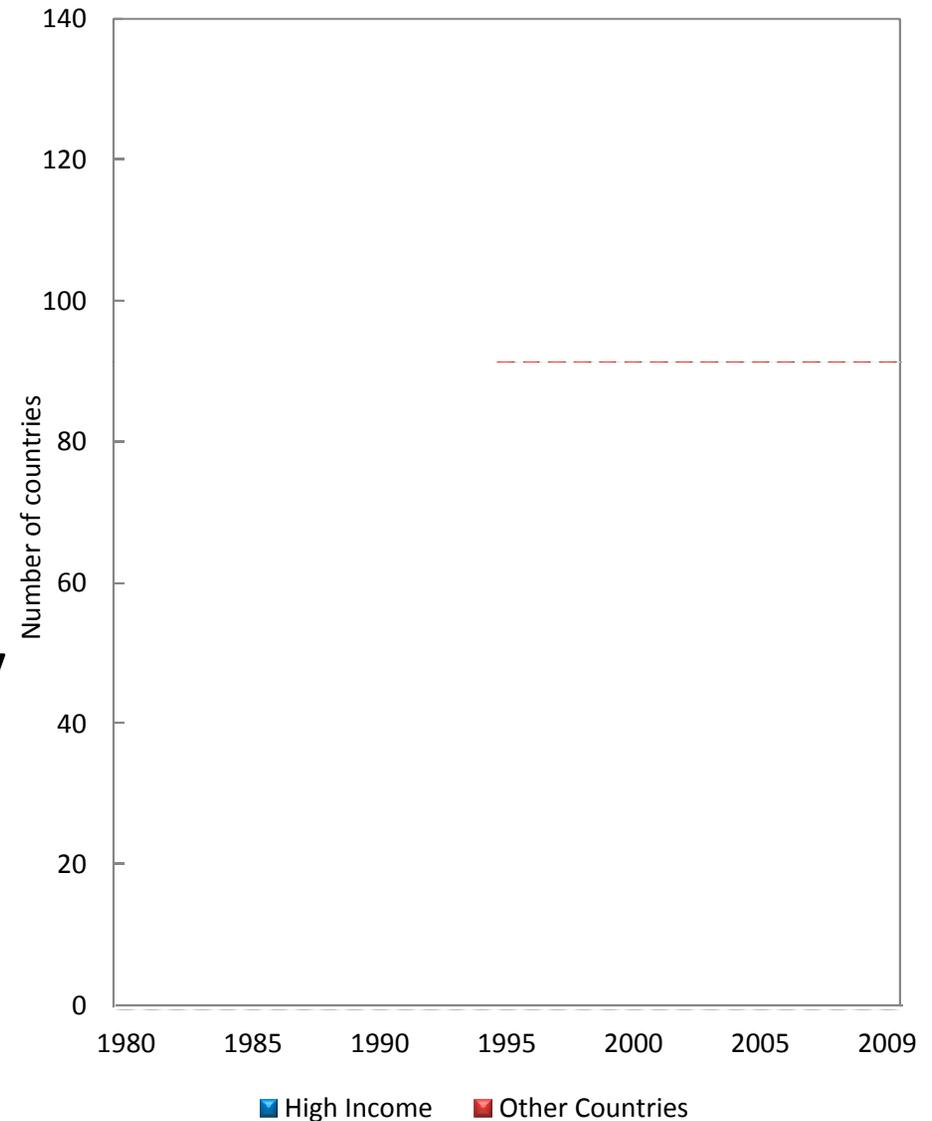
ISSUES AND LESSONS

Value Added Tax



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

The Spread of the VAT, 1980–2009





To capitalize on potential strengths of VAT (substantial revenue, reasonably fair and easy to comply with and administer) standard advice is for:

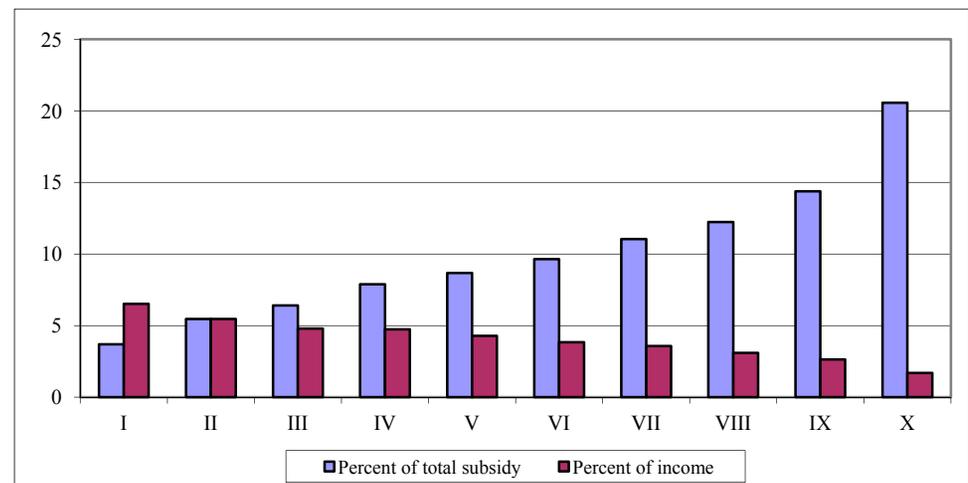
- Single rate
- Broad base—some exemptions (almost) unavoidable
- Reasonably high threshold

What about equity?



- Most studies find VAT no less progressive than taxes it replaces—and may underestimate fairness (e.g. 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



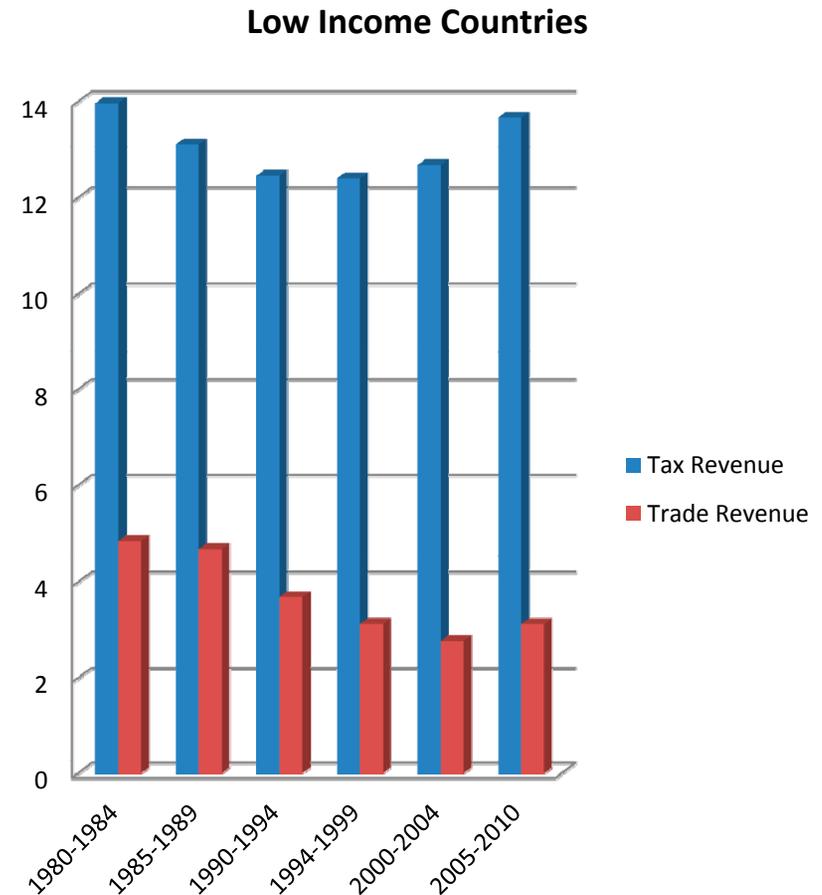
VAT challenges:

- Understanding and managing non-compliance
 - e.g. How to encourage ‘good’ VAT chains?
- Improving refund procedures and audit
- Little room to raise standard rates in many lower income countries
 - but gains from broadening base policy and improving compliance: 2% of GDP in some lower income countries



Trade taxes

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





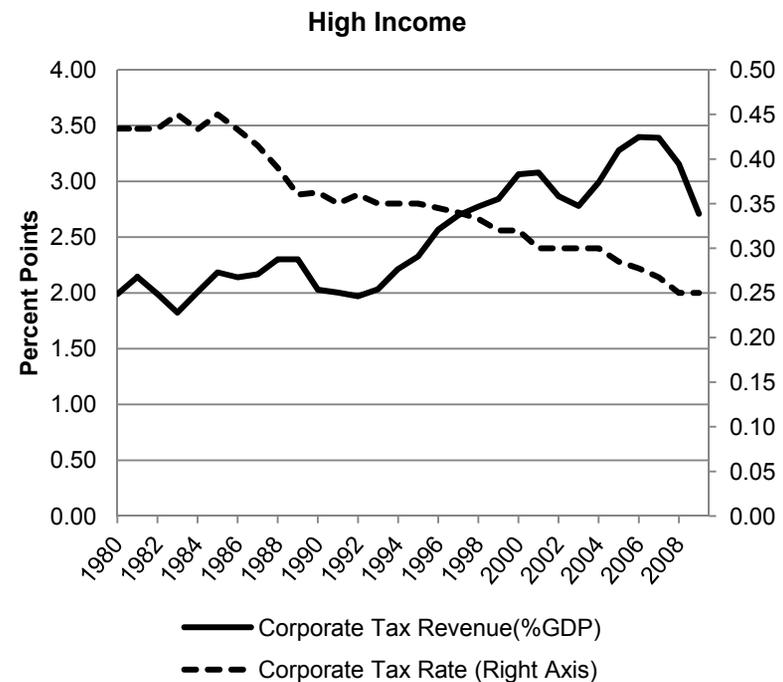
Personal income tax

- Revenue stagnant in LICs
 - Almost all is wage withholding by large firms
- ‘Global’ PIT (tax on sum of income from all sources) has failed
 - move to schedular systems with more coherent taxation of capital income?
- More action on high-income individuals?
 - Limit exemptions; strengthen international cooperation..



Corporate income tax

Rates falling, but revenue has held up—though less (pre-crisis) than elsewhere



May reflect spread of incentives in some regions



Challenges:

- Incentives
 - Threaten revenue, including from profit-shifting
 - Only attract FDI if governance good
 - Adversely affect governance, especially if discretionary
- Profit-shifting
 - How much can one reasonably expect to control this?
- Case for regional/wider cooperation, including on policy, becoming stronger?



Excises

Attractive for revenue and addressing externalities, but seem to be in trend decline (except Asia?)

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 pay tax on inputs
 - ...but importance goes beyond that
 - competitive distortions, tax morale, state building
- Simplified regime, aligned to VAT threshold?
- 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 (Senegal, Morocco)
- Capable tax policy units
- Other lessons from recent work?



CONCLUDING



- 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