

TAXATION AND DEVELOPMENT —WHAT'S NEW?

Michael Keen

October 24, 2011

Views should not be attributed to the staff, management or
Executive Directors of the IMF

Interest in issue comes and goes—now an up-phase:

- Donors, academics and CSOs...
 - Reflected in ICTD
- At the IFIs:
 - Expansion of TA at IMF
 - OECD informal Task Force and Tax-Development work
 - G20 2010 request...

Outline

- What *was* new?
- Differences: Geography and Institutions
- State-building
- Resource taxation

WHAT WAS NEW?—BEWARE OF
FADs

Advice has been marked by a series of big
idea—with chequered histories:

Progressive personal taxation (Shoup, Kaldor)

- Not a success: “...in most developing countries [PIT] is...neither global nor progressive, nor personal, not often even on income” (Bird-Zolt)
- But why?
 - Right model, but resisted by elites given limited capacity (with incentive for former to keep latter)?
 - Wrong model, naively imported from advanced countries? E.g. should thresholds be much higher?

VAT

- More of a success...
 - Evidence of efficiency gains from introduction, though weakest in SSA
 - Revealed preference: removers bring it back...at least to the extent hard to envisage wholesale (conscious) removal
- But retains a stigma—why? Because it works, or because it doesn't?

Revenue Authorities

- Following success of SUNAT, now in more than 40 countries, including nearly all SSA
- Experience seems mixed:
 - Expectations may have been too high
 - Reforming RAs is sensitive and can be costly (Ghana early 1990s, Malawi...)
 - But encouraging signs, notably URA

Large Taxpayer Offices

- Perceived as a success—at least uncontroversial
- But not without issues:
 - Incentive for firms to keep out of LTO (but not a big issue if take into account in setting the threshold)
 - Risk that government will protect larger firms, a concern for both efficiency and state-building

What are the big ideas now?

- Links between institutional development/state-building and stronger/better tax systems, with two strands:
 - Capacity to tax requires prior investment, incentives for which—political stability, common interests—become critical (Besley-Persson)
 - State-building: Taxation can encourage bargaining that promotes accountability, responsiveness (Brautigam et al vol)

- Big gains from improved implementation international tax rules—both transfer pricing and evasion by wealthy

A 'new' area rather than a new idea:

- Resource tax design and implementation

DIFFERENCES: GEOGRAPHY AND INSTITUTIONS

- Large differences in geography, history, politics, culture, institutional structure...
—to which development economics increasingly sensitive
- Do they matter for tax? If so, how?

Geography:

- Natural resources—perhaps the single most important tax difference
 - 1980s to 2005, resource-rich SSA countries increased tax-GDP about 7 points of GDP; in rest, stagnant
- Small islands—more efficient VATs, though less likely to adopt
- Even shape matters—re-exports and Gambia

Politics and institutions

- Much evidence linking institutions to tax outcomes: Revenue is variously higher, cet.par.,
 - In parliamentary systems (Persson-Tabellini)
 - In democracies (Ehrhart)
 - With political stability (Besley-Persson; Aizenman-Jinjarak)
 - Where accountability high (Pritchard)
- Constitutional constraints
 - 1935 Government of India Act continues to shape tax policy in India and Pakistan
- Colonial history?

Tax Performance in sub-Saharan Africa

<i>Ln (YPC)</i>	-0.015***	-0.015***
	(0.005)	(0.005)
<i>OPENNESS</i>	0.078***	0.080***
	(0.025)	(0.025)
<i>VAT</i>	-0.071***	-0.080***
	(0.023)	(0.023)
<i>VAT*LnYPC</i>	0.014***	0.014***
	(0.004)	(0.004)
<i>VAT*OPEN</i>	-0.078**	-0.093***
	(0.032)	(0.031)
<i>ANGLO</i>		0.268***
		(0.168)
<i>VAT*ANGLO</i>		0.020***

But...so what for practical advice?

- Can't affect broad geography and history: constitutions are *ultra vires*, oil is where it is —though an accidental de Tocquevillian role?
- We must believe we can improve matters within (and improve) existing institutions:
 - Revenue administration reform as cutting edgeBut is this blind faith? Glacial progress in some countries

- Scope to learn more of how deep institutional differences affect taxation
 - Almost nothing comparative on Francophone vs. Anglophone vs. Latin America
 - May need e.g. to pay more attention to simultaneous PFM and legal reforms
 - In the meantime, conclusion is not that one size never fits all
 - Withholding on wages, turnover taxes distort..
- We do have principles—just need better ones

STATE-BUILDING

- What difference does this perspective make?

“A reform agenda focused on issues of state-building...would look substantially different”

Brautigam, 2008

“ ...[standard] agenda broadly serves state-building as well as economic policy objectives”

OECD, 2008

Speaking prose: Much standard advice motivated by similar concerns but without the label

- We know strong case for ‘incentives’ for most mobile investments, including collectively...
...but counterargument is largely an (unsophisticated) slippery slope one
- Stress on tax expenditure analysis
- Stress on public consultation

Focus on two of the main areas in which could see potential difference:

- **Earmarking**
 - Ghana raised VAT 5 points, earmarking to health and education
- **Smaller enterprises (SEs)**—A case for taxing beyond revenue concerns?

Earmarking

Has a bad name among technocrats:

- Too inflexible if it constrains total spending on particular items...
- ...“An exercise inmisleading taxpayers rather than expanding democracy” (IFS) if it doesn't
 - E.g. mobile phone excise in Kenya
- Can become a source of nuisance taxation

Nonetheless:

- Is a theoretical case for earmarking to constrain use of funds when type of future policy maker unknown—a sign of (warranted) distrust
- And issue is current in advanced economies too:
 - Integration social contributions and income tax
 - Proposals to earmark VAT increase in US and Japan
 - Search for ‘innovative sources of finance’

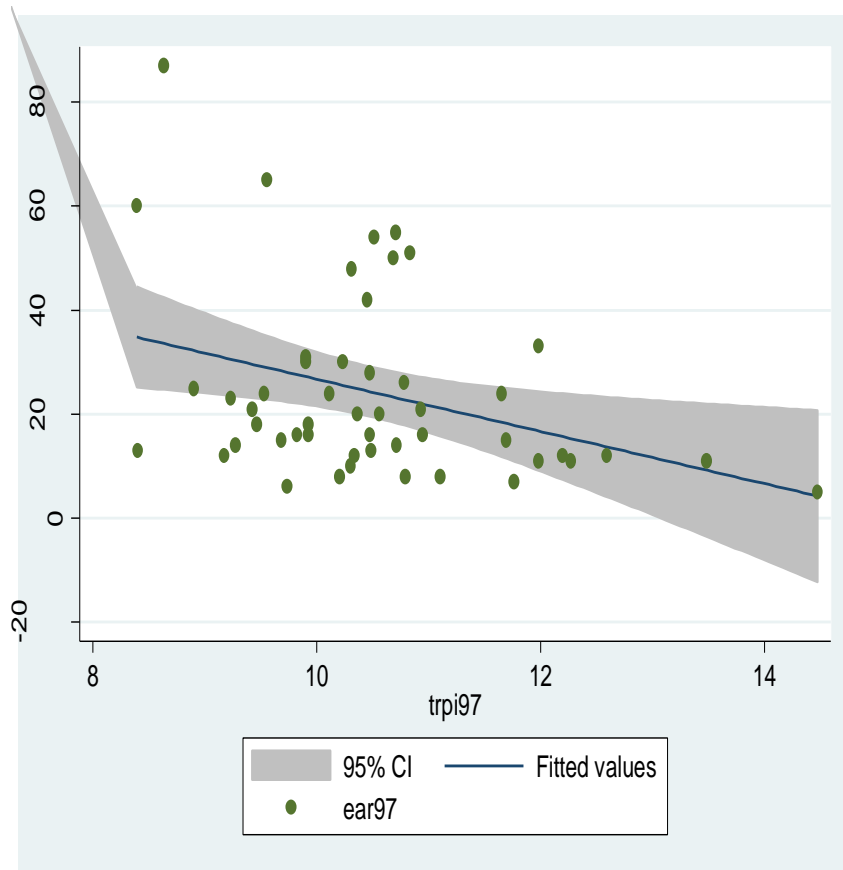
Much anecdote and opinion, no real evidence

- Data (only?) for the US states:
 - Extensive earmarking: 23% on average in 2005
 - Considerable variation across states: minimum 2.2% (Wisconsin), max 87% (Alabama)...
 - ...and over time: Average in 1954 was 52%

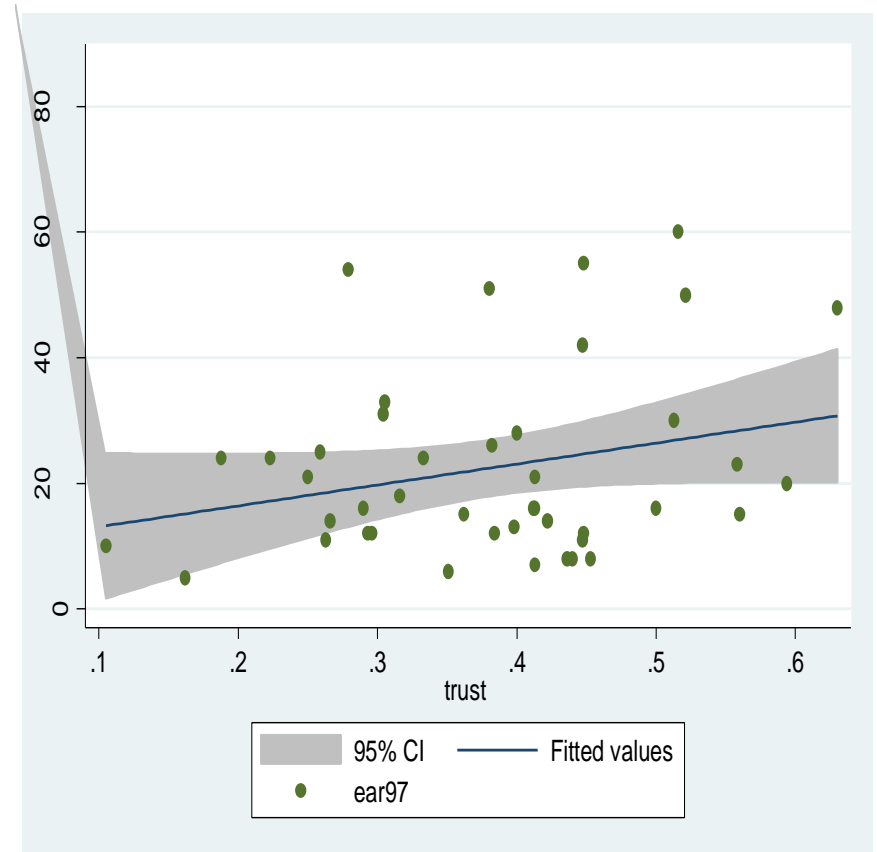
So should be something to learn....

Extent of earmarking turns out to be:

—Negatively related to tax revenue:



—Unrelated to corruption, but positively related to trust:



So, counter-intuitively:

- Earmarking is not greatest where electorates want to discipline policy-makers...
(Though notable too that it has fallen least in the most corrupt states)
- No obvious sign it helps raise taxes where they are already high

- ..which leaves some important puzzles
- Broader issue is need to make links between tax and spending:
 - More combined analyses tax and spending policies; but may not be enough
 - More linkages PFM and tax reform?
 - More on spending side in state-building work?

Inclusion and small businesses

- State-building literature stresses tax-bargaining benefits from involving more citizens in taxpaying
- How far should treatment of SEs look to more than revenue (relative to implementation costs)?

In practice:

- Revenue considerations have been paramount in reform design
 - though next step (move to M/STOs) now underway in some countries
- Some RAs take an active role in fostering SEs...
 - arguing that developing book-keeping needed to pay tax helps capital market access

...but views differ

But what does the theory say?

- Suppose a taxed CRS sector competes with a DRS sector of untaxed SEs, producing a consumption good with fixed world price

Then a small tax on output of latter:

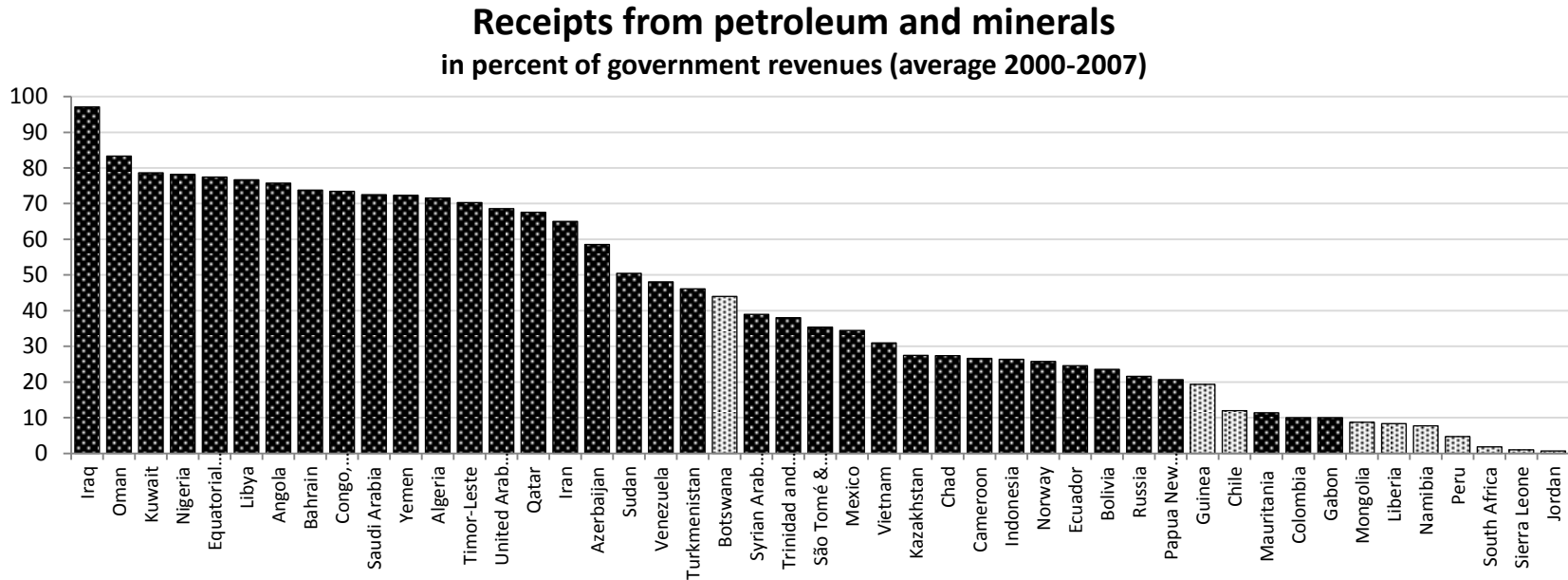
- Raises revenue from SEs (net of implementation costs)
- Hurts welfare of SE owners
- Increases revenue from taxed sector

So:

- Even if the associated net revenue is negative, aggregate welfare is increased by taxing SEs if the value of revenue gained from taxed sector exceeds – by enough – direct welfare loss to SEs
- Standard theory thus points in same direction as state-building...past faults may lie more with policy advice than administration
- But how far (and how) the prescription should be pressed remains unclear

RESOURCE TAXATION

No doubt of its (increased/ing) importance:



- Displacing tax revenues, around 20 cents per \$1
- New discoveries (Ghana, Uganda)...more to come?

But many unresolved issues, such as:

- Progressive resource taxation
 - Shifts risk to the government but...
 - May help credibility

Theory and evidence on the trade-off (and if there is one), and on best form of progressivity, is missing

- Tax competition and coordination:

Huge sunk costs, meaning a potential hold up problem, can imply gains from coordinating on

- Minimum tax breaks for exploration
- But *maximum* tax rates for fields in exploitation

CONCLUDING REMARKS

Methodological advances:

- Increased use of micro administrative and household level data—is beginning....
(Scope for experimental work?)
- Evaluation—we are streets behind
Some aspects not amenable to randomized experiments—e.g. revenue authorities, VAT...
...but others?