PD-AAT-998
46408

SENEGAL

AFRICAN ECONOMIC POLICY REFORM PROGRAM

PROJECT ASSISTANCE APPROVAL DOCUMENT

685-0291 (685-K-605 & 685-K-605A)

AGENCY FOR INTERNATIONAL DEVELOPMENT

Auth: August 15, 1986

Amount: $15,000,000

/1/ PD-AAT-998

AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON D.C. 20523

ACTION MEMORANDUM FOR THE ASSISTANT ADMINISTRATOR FOR AFRICA

FROM: AFR/PD, Laurence Hausman

SUBJECT: Senegal African Economic Policy Reform Program (AEPRP), 685-0219

Problem: Your approval is required to authorize a program grant to the Government of Senegal (GOS) of $15.0 million from Section 531(a)(1) of the Foreign Assistance Act of 1961, as amended, Economic Support Fund (ESF) appropriation. It is planned to obligate the total life-of-project funding of $15 million in FY 1986 and to disburse in three separate tranches of $5 million, $5 million and $4 million each when conditions precedent to each disbursment have been met. The remaining $1 million will be reserved for studies and technical assistance.

Discussion: The purpose of the grant is to support a series of tax reforms being undertaken by the GOS as part of the structural adjustment process to which Senegal and the major international donors are committed. The AEPRP will focus on four aspects of the tax system: customs and tariffs, direct taxes, the investment code and the establishment of a real estate cadaster in and around Dakar. The reforms are intended to remove disincentives to savings and productive investment by reducing customs tariffs and direct tax rates, to increase the equity of the tax system by widening the tax base and reducing evasion, and to reinforce the thrust of the overall economic reform effort aimed at reducing government interventions and at providing incentives for the growth of a competitive, private sector.

The CFA equivalent of the $14 million cash transfer will help the GOS meet its budgetary shortfall. Expenditures from a special account to be established at the Central Bank of West Africa will be agreed upon mutually by USAID and the GOS. These expenditures will be selected from activities in the Ministry of Finance's Financial Operations Table which affect the performance criteria used by the IMF and other donors. The principle for selection will be that local currency use must both reduce Senegal's arrears and contribute to productivity and job creation. The implementation management of the funds will be the shared responsibility of the GOS Ministry of Economy and Finance and the USAID Mission. The USAID officer responsible for implementation of the grant is Harold Lubell, Program Officer, USAID/Senegal. Cameron Pippitt, AFR/PD/SWAP, will provide backstopping services in AID/W.

The program grant was recommended for approval on July 25, 1986, at the Africa Bureau ECPR chaired by Lois Richards, DAA/AFR/WCA. Modifications to the PAAD resulting from the AID/W review process were concurred in by the USAID representative at the ECPR and have been incorporated into the final program document. In order to strengthen the Mission's negotiating position with the GOS, it was agreed to convert two of the covenants concerning the direct tax issue to conditions precedent. In addition, the evaluation and monitoring plans presented in the PAAD were revised as to allow for closer examination of changes in GOS tax policies.

In addition to the standard conditions precedent (legal opinion, specimen of signatures, and designation of authorized representatives), the following conditions precedent will in substance be included in the Program Grant Agreement:

Prior to release of the first tranche of $5 million, the GOS will provide evidence of (a) adoption by the National Assembly of the new Customs Code, (b) publication of the first round of reduced tariff rates scheduled for July 1, 1986, and (c) publication of regulations implementing removal of quantitative restrictions on selected products scheduled for July 1 and October 1, 1986.

Prior to release of the second tranche of $5 million, the GOS will provide evidence of (a) announcement by the GOS of the second round of reduced customs tariff rates scheduled for July 1, 1987, (b) publication of regulations implementing removal of quantitative restrictions on additional products scheduled for January 1, March 1 and July 1, 1987, and (c) that the GOS Tax Department's working group on tax reform remains in existence after adoption of the revised General Tax Code by the National Assembly and has a plan for studies on further possible reforms of the direct tax system, including especially transition to a global or unitary income tax and further reduction in the maximum marginal rate.

Prior to release of the third tranche of $4 million, the GOS will provide evidence of (a) announcement by the GOS of the third round of reduced customs tariff rates scheduled for July 1, 1988, (b) publication of regulations implementing removal of quantitative restrictions on additional products scheduled for January 1, 1988, (c) publication of a new Investment Code compatible with the announced and planned reductions in customs tariff rates, and (d) the working group on tax reform of the GOS Tax Department will prepare a preliminary draft, acceptable to A.I.D., of a further reform of the direct tax system embodying a transition to a global income tax, reduction in marginal rates and a simplification of the system.

In addition, the third tranche will include the following covenants:

(a) The GOS will report on progress in renegotiation of special agreements (conventions spéciales) granted under the present Investment Code, and

(b) The GOS will provide to USAID/Senegal evidence of progress in carrying out the fiscal cadaster for the Dakar-Cap Vert region, evidence that the cadaster is being used to improve collection of property taxes on real estate and of income taxes on property income from real estate, and evidence that a more realistic rate schedule is being applied.

On July 31, 1986, the Africa Bureau's Environmental Officer approved the mission recommendation that the program be granted a Categorical Exclusion as it only involves a cash transfer and does not have an effect on the natural or physical environment.

A Congressional Notification was prepared and sent to the Hill on July 29, 1986. The waiting period expired on August 13, 1986 without objection.

Recommendation: That you sign the attached Program Assistance Approval Document facesheet and thereby approve life-of-program funding of $15 million for the Senegal AEPRP program.

Attachment:
Program Assistance Approval Document

Clearance:

| | | | |
|---|---|---|---|
| DAA/AFR/WCA:LRichards | LR | Date | 8/15/86 |
| GC/AFR:AVance | (draft) | Date | 8/7/86 |
| AFR/SWA:PDichter | (draft) | Date | 8/13/86 |
| AFR/CONT:TRattan | (draft) | Date | 8/12/86 |
| AFR/PD:CPeasley | (draft) | Date | 8/12/86 |
| AFR/PD/SWAP:JHradsky | (draft) | Date | 8/7/86 |
| AFR/DP:JPatterson | (draft) | Date | 8/7/86 |
| PPC/PB:RMaushammer | RM | Date | 8/14/86 |
| M/FM/PAD:EOwens | EO | Date | 8/15/86 |

drafted:AFR/PD/SWAP:CPippitt:x78243:8/6/86:faf:3425M

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CLASSIFICATION:

AID 1120-1

**PAAD**

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT

| | |
|---|---|
| 1. PAAD NO. | 685-0291 685K605&605A |
| 2. COUNTRY | Senegal |
| 3. CATEGORY | Dollar Disbursement Program Grant |
| 4. DATE | July 1, 1986 |
| 5. TO: Mark L. Edelman, Assistant Administrator for Africa | 6. OYB CHANGE NO. |
| 7. FROM: Sarah Jane Littlefield, Director, USAID/Senegal | 8. OYB INCREASE<br>TO BE TAKEN FROM: |
| 9. APPROVAL REQUESTED FOR COMMITMENT OF: $ 15.0 million | 10. APPROPRIATION - GESA8631685KG31 14.0mil. GESA8631685KG39 1.0mil. |

| 11. TYPE FUNDING | 12. LOCAL CURRENCY ARRANGEMENT | 13. ESTIMATED DELIVERY PERIOD | 14. TRANSACTION ELIGIBILITY DATE |
|---|---|---|---|
| ☐ LOAN ☒ GRANT | ☐ INFORMAL ☐ FORMAL ☒ NONE | | Dec. 31, 1989 |

15. COMMODITIES FINANCED

| 16. PERMITTED SOURCE | | 17. ESTIMATED SOURCE | |
|---|---|---|---|
| U.S. only: | | U.S.: | $0.7 million |
| Limited F.W.: | | Industrialized Countries: | $0.2 million |
| Free World: | $1.0 million | Local: | $0.1 million |
| Cash: | $14.0 million | Other: | $14.0 million |

18. SUMMARY DESCRIPTION

1. An AEPRP program grant of $15 million will support a package of tax reforms in Senegal designed to:

- remove disincentives to savings and productive investment,

- increase the equity of the tax system,

- reinforce the thrust of the overall economic reform effort which aims at reducing government interventions and at providing incentives for the growth of a vital and competitive private sector.

| 19. CLEARANCES | | DATE |
|---|---|---|
| REG/DP | JWF for JP | 8-13-86 |
| REG/GC/AFR | | 8/15/86 |
| AA/PPC | | 8/15/86 |
| M/FM | | 8/15/86 |
| AFR/PD | CB for | |
| AFR/CONT | CTR | 8-12-86 |
| AFR/SWA | for | 8-12-86 |

20. ACTION

☒ APPROVED ☐ DISAPPROVED

Mark L. Edelman 8/15/86

AUTHORIZED SIGNATURE DATE

Assistant Administrator for Africa

TITLE

CLASSIFICATION:

18. Summary Description (cont'd)

2. Of the $15 million program grant, $14 million will be made available to the Government of Senegal (GOS) as a cash transfer for budgetary support to be released in three tranches of $5 million, $5 million and $4 million over a period of three years, and $1 million will be reserved for studies and technical assistance concerned with tax reform.

3. Disbursements of dollar cash transfers will be made to the GOS in three tranches of $5 million, $5 million and $4 million upon fulfilment of conditions precedent described below and specified in the Program Grant Agreement.

4. Concurrent with the signature of the Program Grant Agreement covering the $14 million cash transfer, a Limited Scope Grant Agreement will be signed with the GOS in the amount of $1.0 million for direct payment by USAID of the foreign exchange and local currency costs associated with studies and technical assistance related to reforms of the GOS tax system.

Conditions Precedent

5. In addition to the standard conditions precedent (legal opinion, specimen of signatures, and designation of authorized representatives), the following conditions precedent will in substance be included in the Program Grant Agreement.

6. Prior to release of the first tranche of $5 million, the GOS will provide evidence of (a) adoption by the National Assembly of the new Customs Code, (b) publication of the first round of reduced tariff rates scheduled for July 1, 1986, and (c) publication of regulations implementing removal of quantitative restrictions on selected products scheduled for July 1 and October 1, 1986.

7. Prior to release of the second tranche of $5 million, the GOS will provide evidence of (a) announcement by the GOS of the second round of reduced customs tariff rates scheduled for July 1, 1987, (b) publication of regulations implementing removal of quantitative restrictions on additional products scheduled for January 1, March 1 and July 1, 1987, and (c) that the GOS Tax Department's working group on tax reform remains in existence after adoption of the revised General Tax Code by the National Assembly and has a plan for studies on further possible reforms of the direct tax system, including especially transition to a global or unitary income tax and further reduction in the maximum marginal rate.

8. Prior to release of the third tranche of $4 million, the GOS will provide evidence of (a) announcement by the GOS of the third round of reduced customs tariff rates scheduled for July 1, 1988, (b) publication of regulations implementing removal of quantitative restrictions on additional products scheduled for January 1, 1988, (c) publication of a new Investment Code compatible with the announced and planned reductions in customs tariff rates,

and (d) the working group on tax reform of the GOS Tax Department will prepare a preliminary draft, acceptable to A.I.D., of a further reform of the direct tax system embodying a transition to a global income tax, reduction in marginal rates and a simplification of the system.

Covenants

9. Third tranche covenants:

(a) The GOS will report on progress in renegotiation of special agreements (conventions spéciales) granted under the present Investment Code.

(b) The GOS will provide to USAID/Senegal evidence of progress in carrying out the fiscal cadaster for the Dakar-Cap Vert region, evidence that the cadaster is being used to improve collection of property taxes on real estate and of income taxes on property income from real estate, and evidence that a more realistic rate schedule is being applied.

Proposed Local Currency Uses

10. The CFAF equivalent of the $14 million cash transfer will help meet GOS budget shortfalls. Expenditures out of the Special Fund will be decided upon jointly by USAID and the GOS. These expenditures will be selected from activities that affect the performance criteria in the Ministry of Finance's Financial Operations Table (TOF) used by the IMF and the other donors. The principle for selection is that the local currency use must both reduce Senegal's arrears and contribute to productivity and job creation.

Waiver

11. If required, waivers will be requested on a case-by-case basis.

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ANNEXES



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# I. Executive Summary

## A. Amount and Purpose

USAID/Senegal recommends authorization of an Africa Economic Policy Reform Program (AEPRP) Grant of $15.0 million to the Government of Senegal (GOS). Of the grant, $14.0 million will be in the form of a cash transfer for budgetary support to be released in three tranches of $5 million, $5 million, and $4 million over a period of three years, and $1.0 million will be reserved for studies and technical assistance concerned with tax reform.

The purpose of the grant is to support a package of tax reforms being undertaken by the GOS as part of the structural adjustment process to which the GOS and the major international donors are committed. These tax reforms are intended to:

- remove disincentives to savings and productive investment by reducing customs tariff and direct tax rates;

- increase the equity of the tax system by widening the tax base and reducing evasion;

- reinforce the thrust of the overall economic reform effort which aims at reducing government interventions and at providing incentives for the growth of a vital and competitive private sector.

## B. Policy Reforms and their Expected Impact

The Government of Senegal's overall tax reform package includes (a) revision of the customs code, progressive reduction in customs tariff rates over the next two years, and progressive removal of quantitative restrictions on imports, (b) revision of the investment code to eliminate many of the loopholes created by currently legal exemptions and exonerations, (c) reform of the structure and rates of the direct tax system, and (d) implementation of a real estate cadaster in greater Dakar and in other urban centers.

This AEPRP grant will be USAID's contribution to aid donor community support of the tax reform package. The World Bank has been providing technical assistance to reform of the customs code and customs tariff rates and to implementation of a pilot fiscal cadaster. The IMF has fielded several tax advisory missions to Dakar over the past few years. The French have expressed interest in providing assistance to computerization of the Customs Department.

The part of the tax reform package related to reduction of foreign trade protection is the furthest along. It is a component of the New Industrial Policy formulated by the GOS with technical assistance for UNIDO and the World Bank. The timetable for reducing import tariff rates and removing quantitative restrictions has been agreed to by the GOS and the World Bank as one of several criteria for release in CY 1986 of the $35 million second tranche of the World Bank's second Structural Adjustment Credit (SAC-II). The AEPRP grant will bolster the World Bank's position on reform of the tariff and protection system by providing a further financial incentive for the GOS to keep to the timetable after the SAC-II second tranche is released. To put it crudely, we will be supplying a second set of teeth to the donor community to keep pressure on the GOS to implement its timetable on reform tariffs and protection, while we encourage reforms in the direct tax system.

Revision of the Investment Code is also part of the New Industrial Policy. The Investment Code is an important component of tax policy because it creates a massive set of legal tax exemptions that are in many cases not economically justified. Finalization of a draft revised code is still some months away.

A draft revision of the General Tax Code covering direct and indirect taxes was published in April 1986. USAID/Senegal and the IMF are pushing for a more fundamental reform of the direct tax system than is now envisaged by the GOS. Specific aspects of further reform that need to be studied and worked out in detail include a transition to a global tax system and further reduction in the maximum marginal rate of the general income tax.

A fiscal cadaster is essential for rational assessment of property taxes on real estate and for identifying rental income from real estate, most of which evades taxation in Senegal. The Ministry of Finance is now carrying out a pilot fiscal cadaster in six small sections of Greater Dakar. The GOS is discussing with the World Bank the possibility of funding completion of the cadaster for the whole of the Dakar-Cap Vert metropolitan area. We have a strong interest in encouraging and in following up on implementation of the cadaster as part of the tax reform package.

We expect the medium term impact of the tax reform program on the economy to be to increase the flexibility of Senegalese industry and to encourage its progressive adaptation to the larger international economic environment through the pressure of reduced protection and the incentive of lowered direct tax rates. However, the immediate impact of the reduction in protection is likely to be a weeding out of some of the more inefficient lines of import-substituting industrial activity. The New Industrial Policy package includes a proposal for making available credits for restructuring existing plants, presumably to be financed out of a future World Bank industrial development loan. Reduced direct tax rates should encourage increased economic activity and productive investment. More effective taxation of real estate property and income from property made feasible by implementation of the fiscal cadaster will reduce present incentives to invest in urban real estate, much of which now escapes taxation.

## C. Relation to World Bank Conditionality

The World Bank's $70 million second Structural Adjustment Credit (SAC-II) issued in January 1986 deals with a wide range of areas of economic reform that constitute the Senegal Structural Adjustment Program: agricultural incentives; industrial incentives; public investment policy; the parapublic sector; and rehabilitation of the financial situation of the GOS. Reform of the Customs Code, reduction of import tariffs, and progressive removal of quantitative restrictions on imports are part of the package for changing industrial incentives. Agreement on these elements of the industrial incentive package is only one element of the conditionality for release of the second tranche ($35 million) of SAC-II. The following are some of the other conditions: acceptance by the World Bank of the GOS Cereals Plan as satisfactory (the satisfecit was announced on June 17, 1986 at the Agriculture Sector Meeting of the donors' consultative committee for Senegal held in Dakar); establishment of a three-year rolling investment plan; and establishment of criteria for privatization or retention of parts of the GOS enterprise portfolio and publication of the lists of enterprises falling within the several categories (announced on June 7, 1986). Since the World Bank's conditions are close to being met, the release of the second tranche is expected some time between now and October 1986.

The area of import tariff reform and removal of quantitative restrictions thus represents an intersection of interests between ourselves and the World Bank as a part of two broader programs: the World Bank's as described above; and our own concern with all the elements of tax reform. In that area of intersection of interests, our AEPRP conditionality will pick up where the World Bank's stops.

D. Program Mechanism

The cash transfer of $14 million will be converted to CFAF at the rate of exchange prevailing at the time of transfer of each of the three tranches of $5 million, $5 million, and $4 million, for deposit to a special account at the Banque Centrale des Etats de l'Afrique de l'Ouest (BCEAO). Disbursement will be made from this special account only with USAID concurrence and for purposes jointly agreed upon by USAID and the GOS.

Subject to the availability of funds and mutual agreement of the GOS and USAID to the terms and conditions set forth in the attached Program Assistance Approval Document (PAAD), the cash transfer will be disbursed to the GOS in three tranches of $5 million, $5 million and $4 million upon fulfilment of conditions precedent described below and specified in the Program Grant Agreement.

The Ministry of Economy and Finance will act as the principal implementing agency.

Concurrent with the signature of the Program Grant Agreement covering the $14 million cash transfer, a Limited Scope Grant Agreement will be signed with the GOS in the amount of $1.0 million for direct payment by USAID of the foreign exchange and local currency costs associated with studies and technical assistance related to reforms of the GOS tax system.

E. Conditions for Disbursement

The $15 million grant is provided to the GOS to support implementation of the policy reforms outlined above and described in more detail in section III.B below. Disbursements of $14 million cash transfer in three tranches will be subject to the conditions precedent and covenants described in detail in section III.F. The conditions precedent are tied to the GOS timetable for progressive reduction in customs tariff rates, progressive removal of quantitative restrictions on imports through July 1988, and revision of the Investment Code. Covenants will deal with revisions of the direct tax system, renegotiation of existing special agreements granted under the Investment Code, and progress in carrying out the fiscal cadaster for the Dakar-Cap Vert region.

The $1.0 million reserved for studies and technical assistance will be used for direct payment by USAID of costs associated with such studies and technical assistance, in consultation with the GOS.

F. Local Currency Uses

The CFAF equivalent of the $14 million cash transfer will help meet GOS budget shortfalls. Expenditures out of the Special Fund will be decided upon jointly by USAID and the GOS. These expenditures will be selected from activities that affect the performance criteria in the Ministry of Finance's Operations Table (TOF) used by the IMF and the other donors. The principle for selection is that the local currency use must both reduce Senegal's arrears and contribute to productivity and job creation.

II. Background

A. Macro-Economic Framework

1. Economic Conditions and Growth Prospects

The economy of Senegal is still recovering from the crisis of the late 1970s and early 1980s. The crisis was due to inappropriate economic policies, unsustainable government deficits, excessive borrowing from abroad, and a poor record of tax collection. It was exacerbated by a series of drought years, an overvalued dollar, and excessively high world petroleum prices. The economy is now struggling through a period of severe adjustment, with some positive features and some negative ones. Among the positive features are a reduction in the GOS budget deficit (due, however, to severe limitations on current expenditures rather than to an improvement in receipts), a reduction in the balance of payments deficit, and good prospects for a second year of adequate rainfall in a row.

The GDP is projected to rise by 14.1 percent in current prices from 1985 to 1986 (see table 1) but by only 3.4 percent in constant prices. The good rains during the summer of 1985 and the initiation of some basic agricultural

Table 1. Senegal: Gross Domestic Product (Sources and Uses), 1981-1986
(in billions of CFAF at current market prices)

| | 1981 | 1982 | 1983 | Estimated 1984 | Estimated 1985 | Projected 1986 |
|---|---|---|---|---|---|---|
| Sources: | | | | | | |
| Primary sectors | 121.1 | 185.7 | 204.7 | 174.1 | 218.7 | 282.0 |
| Secondary sectors | 171.6 | 205.0 | 235.5 | 280.3 | 330.1 | 371.5 |
| Mining & quarrying | 12.8 | 10.0 | 13.7 | 16.5 | 20.4 | 23.2 |
| Oil pressing | 4.3 | 11.3 | 18.8 | 19.0 | 23.8 | 45.6 |
| Electricity & water | 8.2 | 11.1 | 12.8 | 16.2 | 18.8 | 19.8 |
| Construction | 42.8 | 60.0 | 71.2 | 72.3 | 78.1 | 80.7 |
| Other industries | 103.5 | 112.6 | 119.0 | 156.3 | 189.0 | 202.2 |
| Tertiary sectors | 254.6 | 316.8 | 349.3 | 393.9 | 465.0 | 520.8 |
| Wages and salaries of government and households | 122.5 | 136.6 | 150.0 | 167.1 | 173.0 | 180.4 |
| Gross domestic product | 669.8 | 844.1 | 939.5 | 1,015.4 | 1,186.9 | 1,354.7 |
| Uses: | | | | | | |
| Household consumption | 550.3 | 660.2 | 729.2 | 801.9 | 911.8 | 1,008.5 |
| Government consumption | 150.7 | 169.2 | 186.5 | 206.8 | 217.1 | 228.0 |
| Gross capital formation | 102.4 | 124.5 | 148.3 | 151.8 | 171.0 | 185.6 |
| Changes in inventories | 7.7 | 5.9 | 3.9 | -17.7 | 7.3 | 2.9 |
| Net exports | -141.3 | -115.7 | -128.4 | -127.4 | -120.3 | -70.3 |

Source: Ministry of Economy and Finance, Projections Department (Direction de la Prévision et de la Conjoncture), December 1985. These estimates are approximative at best.

policy reforms, in particular removing restrictions on the in-country movement of cereals and changing the official price of cereals to a floor price, made the 1985/86 agricultural campaign an excellent one for cereals production although less so for peanut production. Output of niébé (cow peas) recorded an increase from 10,000 MT in 1984 to 80,000 MT in 1985 as the result of a combined EEC-USAID emergency project based on improved CB-5 seed from California. There is reason to be optimistic about the 1986/87 agricultural campaign since the rainy season appears to be starting on time and the GOS is pushing liberalization of agricultural production and marketing as central themes of government policy.

The longer run prospects are good for river basin irrigation (Senegal River and the Casamance) if funding can be found for irrigation infrastructure. Unfortunately, resources are so scarce that there is little local funding available for agricultural production activities, as all GOS receipts are used to fund the current budget.

The modern sector of Senegal's economy is unstable because it is linked to fluctuations in the world economy that are beyond Senegal's control. Peanut oil pressing is in difficulty because the supply of peanuts has fallen off in Senegal and world prices have declined. Phosphate exports also have suffered from a fall in world prices. However, fishing is a valuable resource and fish canning is becoming a major industrial activity. The fertilizer producer, Industries Chimiques du Sénégal (ICS), came on stream in 1984 and is making a significant contribution to exports.

Senegal's industrial base is small, with value added by industrial production accounting for about 20 percent of GDP. Manufacturing is estimated to have employed some 56,000 persons full-time in 1987 and some 13,000 on a seasonal basis. 1/ The main branches of industrial output are either industries processing domestic primary output subject to wide fluctuations in world prices (phosphates and peanut products), or import substituting activities bolstered by high levels of tariff protection, quasi-monopoly import restrictions, special tax exonerations, and government subsidies (sugar and textiles). Table 2 shows the volume of output of the main industrial commodities produced in Senegal. Table 3 presents the official index of industrial production.

Local manufacturing is over-protected and, consequently, inefficient. The possibilities of easy import substitution are pretty much exhausted. At the same time, the domestic market is invaded by smuggled goods, smuggled partly because high import tariffs make smuggling particularly profitable. Reforms in the system of protection, including a reduction both in tariffs and in quantitative restrictions, are needed to increase efficiency of local manufacturing and to reduce smuggling. But a reduction in the degree of protection will, in the short run, put further pressure on modern sector industry.

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1/ Ministère du Développement Industriel et de l'Artisanat, Préparation du 7ème Plan de Développement, p. 16.

Table 2. Senegal: Quantity of Production of Principal Industrial Commodities, 1981-1985

| Commodity | Unit | 1981 | 1982 | 1983 | 1984 | 1985 |
|---|---|---|---|---|---|---|
| Phosphates | '000MT | 2075.8 | 1310.2 | 1587.6 | 2078.8 | 2377.0 |
| Marine salt | '000MT | 140.0 | 160.0 | 170.0 | 170.0 | 143.0 |
| Canned tuna | MT | 12203 | 23879 | 28174 | 28719 | 27407.0 |
| Shellfish | MT | 2489 | 2120 | 1303 | 1367 | 3460.0 |
| Processed fish | MT | 25088 | 28858 | 19632 | 12662 | 7724.0 |
| Condensed milk | '000MT | 22.1 | 28.8 | 26.4 | 22.1 | 23.4 |
| Natural milk | hl | 11562 | 14200 | 11055 | 12836 | 8828.0 |
| Unrefined oil | '000MT | 30.4 | 219.1 | 186.3 | 126.1 | 81.8 |
| Refined oil | '000MT | 19.9 | 36.1 | 47.2 | 31.6 | 26.3 |
| Oilcake | '000MT | 41.2 | 273.1 | 276.4 | 305.0 | 119.9 |
| Lump sugar | '000MT | 37.0 | 50.1 | 46.2 | 51.8 | 111.0 |
| Beer | '000hl | 177.6 | 176.1 | 188.8 | 163.5 | 168.0 |
| Carbonated beverages | '000hl | 329.4 | 287.2 | 257.8 | 238.0 | 266.3 |
| Thread | MT | 844 | 1075 | 1286 | 1875 | 1332.0 |
| Dyed and bleached cloth | '000 meters | 1373 | 7273 | 4676 | 1625 | 634.0 |
| Raw cotton | '000MT | 21.6 | 18.1 | 18.4 | 9.6 | 36.4 |
| Leather shoes | '000 pairs | 620.8 | 878.0 | 705.9 | 1311.6 | 613.1 |
| Plastic shoes | '000 pairs | 3071.9 | 3915.6 | 2644.4 | 2337.6 | 2384.2 |
| Petroleum products | '000MT | 632.4 | 542.3 | 270.9 | 341.6 | 435.9 |
| Paints and varnishes | MT | 2674 | 2761 | 3124 | 2755 | 3289.0 |
| Flour (wheat, millet) | '000MT | 88.9 | 80.3 | 88.9 | 86.6 | 66.3 |
| Fertilizer | '000MT | 74.1 | 47.0 | 63.6 | 63.1 | 63.2 |
| Soap | '000MT | 36.1 | 35.9 | 38.5 | 35.0 | 29.7 |
| Cement | '000MT | 396.0 | 375.4 | 388.2 | 423.6 | 408.2 |
| Assembled vehicles | No. | 277 | 269 | 348 | 504 | 341.0 |
| Metal packaging | mill. units | 94.9 | 120.4 | 143.58 | 146.4 | 139.5 |
| Household articles in enamaled metal | MT | 2738 | 3047 | 1726 | 1269 | 1068.0 |
| Electricity | mill. Kwh | 606.1 | 628.9 | 669.2 | 684.6 | 756.0 |
| Water | mill. m3 | 63.3 | 67.0 | 65.6 | 72.7 | 66.2 |

Source:
1981-1984: Statistics Department, Situation Economique du Sénégal, 1984.
1985: Statistics Department, direct communication.

Table 3. Senegal: Index of Industrial Production, 1981-1986
(1976 = 100)

| Industry branch | Weights (in %) | 1981 | 1982 | 1983 | 1984 | Prelim-inary 1985 | Proj-ected 1986 |
|---|---|---|---|---|---|---|---|
| Mining | 18.5 | 111.0 | 77.4 | 77.0 | 105.2 | 103.8 | 111.8 |
| .Phosphates | 16.2 | 110.2 | 69.9 | 78.5 | 106.7 | 105.8 | 117.4 |
| Food processing other than oil pressing | 30.9 | 116.1 | 121.2 | 122.7 | 124.4 | 126.6 | 128.0 |
| Food processing | 43.1 | 88.5 | 105.2 | 109.7 | 102.8 | 106.7 | 107.1 |
| .Fish Canning and preserves | 2.8 | 163.2 | 181.3 | 151.0 | 139.6 | 134.2 | 124.5 |
| .Oil pressing | 12.2 | 18.8 | 64.3 | 76.7 | 48.0 | 60.7 | 59.7 |
| .Sugar, confectionery | 13.2 | 140.5 | 140.7 | 138.1 | 154.0 | 157.6 | 162.1 |
| Textile, clothing & leather industries | 12.3 | 110.4 | 147.6 | 136.3 | 137.9 | 145.7 | 145.3 |
| .Textiles | | 123.3 | 166.3 | 153.8 | 153.4 | 162.0 | 160.9 |
| .Clothing and leather | | 54.1 | 66.2 | 60.0 | 72.6 | 78.2 | 81.5 |
| Wood working industries | 0.5 | 127.1 | 140.9 | 133.0 | 124.7 | 124.1 | 120.2 |
| Paper and cardboard industries | 1.8 | 120.6 | 121.0 | 137.5 | 132.0 | 135.1 | 138.8 |
| Chemical industries | 11.4 | 83.5 | 80.2 | 73.1 | 69.5 | 66.0 | 62.8 |
| .Petroleum refining | 1.6 | 96.3 | 80.1 | 40.9 | 48.8 | 41.2 | 34.9 |
| .Fertilizer, pesticides | 3.7 | 72.7 | 42.6 | 55.8 | 58.2 | 55.1 | 58.8 |
| .Plastic and rubber products | 2.8 | 71.8 | 91.8 | 75.0 | 74.8 | 75.6 | 72.0 |
| Construction materials | 3.3 | 94.7 | 91.1 | 109.0 | 112.6 | 117.5 | 125.3 |
| Mechanical industries | 4.0 | 61.8 | 74.3 | 95.0 | 98.0 | 110.0 | 121.4 |
| .Machinery and equipment | 1.9 | 29.4 | 37.6 | 43.3 | 55.5 | 65.0 | 74.6 |
| Energy | 5.1 | 134.6 | 141.4 | 144.3 | 155.3 | 161.0 | 166.3 |
| .Electricity | 2.7 | 132.5 | 138.0 | 146.2 | 149.7 | 154.4 | 158.7 |
| .Water | 2.4 | 137.0 | 145.2 | 142.1 | 157.4 | 163.0 | 167.7 |
| Sub-total excluding oil pressing | 87.8 | 108.2 | 108.3 | 108.4 | 115.4 | 117.7 | 120.5 |
| Total including oil pressing | 100.0 | 97.2 | 103.0 | 104.5 | 107.2 | 110.2 | 112.4 |

Source: Direction de la Statistique.

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The informal sector is not doing too badly in some of its many manifestations. Artisanal peanut oil pressing and rice milling in rural areas for the local market have expanded in the economic space created by government and formal sector fixing of high producer prices for procurement of agricultural output and even higher consumer prices for final products. Tailoring in urban areas remains the major source of producing clothing; the tailors complain of bad times but everybody in town with a job or another source of income is well dressed. The traders in legitimate and smuggled goods are doing well (and avoiding taxes). Indeed tax evasion is now becoming one of the main characteristics defining informal sector activity: economic activity goes "underground" to avoid recognition by the tax collector.

2. Balance of Payments

Senegal's balance of payments, although still heavily in deficit, showed continued improvement in 1985/86 (see table 4).

The trade balance registered a sharp decline of some $30 million in 1985/86. The trade balance has been improving since 1983/84 despite a sharp fall in peanut exports in 1984/85 and a further fall in 1985/86, because of a continued decline in the volume of imports (see table 5), the fall in the value of the dollar, and the drop in world prices of rice and of crude petroleum and petroleum products. Total exports increased despite a continued decline in exports of peanuts and peanut products (see Table 6). Exports benefited from the coming on stream of the Industries Chimiques du Sénégal (ICS) plant in 1984, exporting sulphuric and phosphoric acid and fertilizers. Phosphate exports rose through 1984/85 but declined in volume in 1985/86. Non-traditional exports, particularly fish, are encouraged by an export subsidy. Tourism is a major foreign currency earner.

Net service payments including interest due on public debt were heavily negative (over $170 million) including interest due on the public debt before debt rescheduling. The net deficit on services was offset to some extent by rescheduling of interest on the debt.

Senegal's balance on unrequited transfers continued at a high level (over $160 million), owing especially to inflows of foreign public grants including U.S. grants and the counterpart of EEC food aid, but also to private transfers and emigrant remittances from Senegalese workers in France.

The capital account was positive despite repayments (amortization) due on public debt before rescheduling. Public receipts on capital account (net of amortization due on public debt) in 1985/86 were above the level of 1984/85 but lower than in 1983/84. Debt rescheduling provided a partial offset to amortization due on public debt. The capital account reflects drawings on the World Bank's second structural adjustment credit (SAC-II), EEC transfers under the Lomé Convention's export stabilization scheme (STABEX), French Government loans through the Caisse Centrale de Coopération Economique, and other donor loans.

Table 4. Senegal: Balance of Payments 1983/84 - 1985/86
(in millions of dollars)

| | 1983/84 | 1984/85 | 1985/86 |
|---|---|---|---|
| Trade balance | 259.6 | -242.7 | -211.8 |
| Exports, f.o.b. | 602.2 | 534.9 | 617.8 |
| of which: Peanuts | (154.4) | (74.6) | (65.9) |
| Imports, f.o.b. | -861.8 | -777.6 | -829.6 |
| Services (net) | -156.6 | -158.0 | -172.9 |
| of which: Interest due on public debt | (-104.7) | (-109.7) | (-126.5) |
| Unrequited Transfers | 139.6 | 142.8 | 164.0 |
| Public | 109.3 | 112.5 | 127.8 |
| Private | 30.3 | 30.3 | 36.2 |
| Current account deficit (-) | -276.6 | -257.9 | -220.7 |
| Capital account | 197.9 | 120.2 | 156.0 |
| Public | 143.9 | 72.0 | 101.2 |
| of which: Amortization due on public debt | (-81.5) | (-89.4) | (-100.6) |
| Private | 54.0 | 48.2 | 54.8 |
| Errors and omissions | -19.6 | -5.4 | -18.0 |
| Overall deficit (-) | -98.3 | -143.1 | -82.7 |
| Debt rescheduling | 84.4 | 78.1 | 76.7 |
| of which: Interest 1/ | (22.0) | (26.8) | (30.7) |
| Overall deficit after debt rescheduling (-) | -13.9 | -65.0 | -5.9 |
| Financing | 13.9 | 65.0 | 5.9 |
| IMF | 57.5 | 4.8 | -9.1 |
| Arrears | - | 18.3 | -20.3 |
| Others | -43.6 | 41.9 | 35.3 |
| Memorandum item: | | | |
| Current account deficit/GDP (in percent) | -11.6 | -11.2 | -6.9 |
| Exchange rate: US$/SDR | 1.0504 | 0.9914 | 1.0961 |

Source: Ministry of Economy and Finance, Projections Department, 4/30/86. Converted from SDRs according to rates in IMF, International Financial Statistics.

1/ Interpolated by USAID/Senegal from IMF, Senegal: Recent Economic Developments, March 13, 1985, Tables 23, p. 61.

Table 5. Senegal: Imports 1981 - 1985
(value in CFAF billions, volume in '000 Mt, prices in CFAF/kg)

| Commodity | 1981 | 1982 | 1983 | 1984 | Preliminary 1985 |
|---|---|---|---|---|---|
| Petroleum products | 80.8 | 82.6 | 77.4 | 105.0 | 93.9 |
| Crude petroleum | | | | | |
| Value | 47.1 | 44.3 | 27.0 | 36.5 | 13.4 |
| Volume | 604.2 | 473.7 | 288.3 | 328.5 | 133.5 |
| Price | 78.0 | 93.5 | 93.7 | 111.1 | 100.5 |
| Finished products | | | | | |
| Value | 33.7 | 38.3 | 50.4 | 68.6 | 80.5 |
| Volume | 386.2 | 391.5 | 546.0 | 623.2 | 757.5 |
| Price | 87.3 | 97.8 | 92.3 | 110.0 | 106.2 |
| Food products | 69.1 | 67.3 | 63.6 | 59.2 | 35.8 |
| Rice | | | | | |
| Value | 27.0 | 27.3 | 33.9 | 31.1 | 26.0 |
| Volume | 339.8 | 329.4 | 380.0 | 336.6 | 350.6 |
| Price | 79.5 | 83.0 | 89.1 | 92.3 | 74.0 |
| Wheat | | | | | |
| Value | 5.5 | 6.0 | 6.6 | 8.0 | 7.5 |
| Volume | 100.5 | 99.2 | 116.5 | 107.1 | 100.0 |
| Price | 54.5 | 60.5 | 56.7 | 74.8 | 74.6 |
| Sugar | | | | | |
| Value | 7.0 | 3.7 | 2.7 | 2.0 | 1.4 |
| Volume | 51.7 | 37.7 | 25.6 | 25.2 | 20.0 |
| Price | 135.4 | 98.1 | 105.5 | 79.4 | 69.1 |
| Other food products | 29.6 | 30.3 | 20.4 | 18.1 | 21.0 |
| Beverages and tobacco | 4.2 | 5.1 | 5.8 | 6.1 | 7.0 |
| Other consumption goods | 36.9 | 50.7 | 54.2 | 57.2 | 61.0 |
| Equipment goods | 32.5 | 45.0 | 62.6 | 55.58 | 60.5 |
| Intermediate goods | 68.8 | 82.1 | 93.8 | 91.8 | 99.0 |
| Subtotal: Special commerce, c.i.f. | 292.3 | 332.8 | 357.4 | 374.8 | 377.2 |
| Entrepots and adjustments | 19.3 | 22.0 | 23.6 | 24.8 | 25.2 |
| Subtotal: General commerce, c.i.f. | 311.6 | 354.8 | 381.0 | 399.6 | 402.4 |
| Freight and insurance 1/ | 37.4 | 42.6 | 45.7 | 48.1 | 48.8 |
| General commerce, f.o.b. | 274.2 | 312.2 | 335.3 | 351.5 | 353.6 |

Source: Direction de la Prévision.
1/ 12 percent of general commerce, c.i.f.

Table 6. Senegal: Exports, 1981-1985
(values in billions of CFAF, volumes in '000 MT, prices in CFAF/kg)

| Commodity | 1981 | 1982 | 1983 | 1984 | Preliminary 1985 |
|---|---|---|---|---|---|
| Peanut products (value) | 9.1 | 44.3 | 59,5 | 53.4 | 31.8 |
| Unrefined oil | | | | | |
| Value | 6.2 | 33.9 | 38.9 | 38.2 | 25.8 |
| Volume | 21.6 | 162.9 | 168.1 | 83.1 | 49.0 |
| Price | 287.0 | 208.1 | 231.7 | 460.0 | 526.5 |
| Refined oil | | | | | |
| Value | 0.1 | 0.2 | 1.5 | 4.3 | 1.4 |
| Volume | 0.4 | 0.7 | 5.8 | 8.9 | 2.6 |
| Price | 250.0 | 323.0 | 266.6 | 482.5 | 556.9 |
| Oilcake | | | | | |
| Value | 1.9 | 9.5 | 14.3 | 7.3 | 4.4 |
| Volume | 31.9 | 190.0 | 226.1 | 89.3 | 67.2 |
| Price | 59.6 | 49.8 | 63.1 | 81.6 | 65.2 |
| Peanuts | | | | | |
| Value | 0.9 | 0.7 | 4.7 | 3.6 | 0.2 |
| Volume | 2.9 | 4.7 | 29.5 | 14.5 | 0.7 |
| Price | 310.3 | 149.8 | 159.3 | 250.2 | 242.4 |
| Phosphates | | | | | |
| Value | 19.9 | 21.6 | 22.7 | 28.6 | 26.6 |
| Volume | 1333.4 | 1478.5 | 1545.6 | 1670.4 | 1712.2 |
| Price | 14.9 | 14.6 | 14.7 | 17.1 | 15.5 |
| Fish (value) | 27.9 | 37.6 | 41.7 | 48.0 | 55.2 |
| Fresh fish | | | | | |
| Value | 17.3 | 24.2 | 24.6 | 27.4 | 31.7 |
| Volume | 53.9 | 60.4 | 58.6 | 60.4 | 66.5 |
| Price | 320.9 | 400.7 | 419.8 | 453.4 | 476.7 |
| Canned fish | | | | | |
| Value | 10.6 | 13.4 | 17.1 | 20.6 | 23.5 |
| Volume | 15.2 | 16.3 | 20.1 | 23.1 | 25.0 |
| Price | 697.4 | 821.2 | 850.8 | 891.8 | 940.0 |
| Fertilizer | | | | | |
| Value | 2.6 | 2.0 | 3.9 | - | - |
| Volume | 130.4 | 135.4 | 171.2 | - | - |
| Price | 20.0 | 14.8 | 22.8 | - | - |
| Industries Chimiques Sénégalaises | | | | | |
| Value | - | - | - | 12.2 | 24.6 |
| Volume | - | - | - | | |
| Price | - | - | - | | |
| Cotton | | | | | |
| Value | 2.0 | 4.8 | 8.1 | 6.0 | 7.3 |
| Volume | 4.2 | 10.1 | 13.6 | 8.2 | 10.0 |
| Price | 476.2 | 475.2 | 595.6 | 731.7 | 730.0 |
| Salt | | | | | |
| Value | 2.3 | 2.9 | 3.1 | 5.4 | 5.9 |
| Volume | 147.7 | 155.8 | 152.2 | 147.1 | 151.2 |
| Price | 15.6 | 18.6 | 20.4 | 36.7 | 39.0 |
| Petroleum products | | | | | |
| Value | 38.3 | 45.8 | 40.8 | 45.7 | 47.0 |
| Volume | 347.8 | 391.5 | 323.4 | | |
| Prix | 110.1 | 117.0 | 126.2 | | |
| Other (value) | 33.8 | 30.4 | 32.0 | 34.7 | 40.0 |
| Special commerce, f.o.b. | 135.9 | 189.4 | 211.8 | 234.0 | 238.3 |
| Entrepot trade & adjust. | 3.1 | 4.4 | 4.9 | 5.5 | 5.4 |
| General commerce, f.o.b. | 139.0 | 193.8 | 216.7 | 239.5 | 243.7 |

Source: Projections Department, December 1985.

The overall deficit before debt rescheduling declined from $143 million in 1984/85 to $83 million in 1985/86. After debt rescheduling, the overall deficit was reduced to $6 million in 1985/86. The balance of payments prospects for 1986/87 are mixed. There should be an initial surge of imports that have been postponed pending announcement in July 1986 of lower tariff rates that have been under intense discussion with the World Bank for the last year. Furthermore, reduced import duties are likely to stimulate a higher normal level of imports. An offsetting factor is that world prices are relatively low for two major import products, petroleum and rice. Wheat prices are uncertain because of the Chernobyl nuclear power plant disaster in the grain-producing heart of the Ukraine.

Exports of peanut products should increase because peanut production during the 1986/87 campaign should be higher than last year's, during which farmers replenished their stocks of millet. However, there are a number of uncertainties, among them the availability of seed and the possibility of a grasshopper invasion. There are recent indications that vegetable oil prices are strenthening in the world market, which should favorably affect the export price of peanuts and peanut products.

3. Fiscal Position

It was a budget crisis that led the GOS to undertake the economic reforms of the 1980s. In 1980/81, the current budget deficit jumped sharply from 1979/80, as current expenditure increased by 4.4 percent but tax receipts fell by 14.9 percent (see table 7). However, the deficit fell off during the next two years, rose again in 1983/84 and in 1984/85, and declined somewhat in 1985/86.

The GOS has held back increases in current expenditure by putting a freeze on the number of government personnel and by curtailing purchases of materials and supplies. Interest on government debt is growing rapidly: in 1985/86, it was 3.5 times its 1980/81 level.

Tax receipts declined steadily as a percentage of GDP from 21.6 percent in 1979/80 to 17.2 percent in 1984/85 because of poor tax administration, legal exonerations, and increasing evasion. Tax buyoancy with respect to GDP (the rate of growth of tax revenue divided by the rate of growth of GDP) declined from 1.4 during the period 1971/72-1978/79 to only 0.6 during the period 1979/80-1984/85. For 1985/86, tax receipts are estimated at 16 percent of GDP.

The negative effects of declining tax buoyancy on government expenditure are serious. The shortfall in receipts hampers current government purchases of goods and services, ranging from office stationery to motor vehicle fuel, that support the activities of personnel who absorb most of the government expenditure budget. There is no current budget surplus to devote to investment expenditure, so that the GOS is entirely dependent on foreign assistance for all of its investment expenditures. One of the aims of the set of tax reforms that this AEPRP is designed to support is a reversal cf the downward trend in tax buoyancy through the creation of a more rational set of tax instruments and better tax administration.

Table 7. Government of Senegal: Current Expenditure and Tax Receipts

| Year | Current expenditure (Billions of CFAF) | Tax receipts (Billions of CFAF) | Current expenditure less tax receipts (Billions of CFAF) | Ratio of tax receipts to current expenditure |
|---|---|---|---|---|
| 1979/80 | 144.9 | 139.4 | 5.5 | 0.962 |
| 1980/81 | 151.3 | 118.6 | 32.7 | 0.784 |
| 1981/82 | 165.4 | 140.1 | 25.3 | 0.847 |
| 1982/83 | 186.6 | 164.8 | 21.8 | 0.883 |
| 1983/84 | 205.3 | 178.1 | 27.2 | 0.868 |
| 1984/85 | 217.1 | 189.1 | 28.0 | 0.871 |
| 1985/86 | 216.3 | 190.1 | 26.2 | 0.879 |

Source:

Current expenditure: IMF, Senegal-Recent Economic Developments, March 13, 1986, Tables 17, XV and XVI, pp. 41, 103 and 104: and Ministry of Finance, Projections Department, Tableau des opérations financières (TOF), April 1986.

Tax receipts: Ministry of Finance, Projections Department (Direction de la Prévision et de la Conjoncture), 4/27/86.

The donor community now provides resources to Senegal not only to finance the GOS investment budget through grants and loans but also to cover government current expenditure requirements. Tax reform and improved tax administration should reduce future dependence on financial assistance from the donors.

B. Policy Framework

The GOS is undertaking a set of major reforms of the Senegalese tax system in the framework of its Medium and Long Term Adjustment Program as a sub-set of the structural adjustment measures urged and supported by the World Bank, the IMF, the French and ourselves.

The Medium and Long Term Adjustment Program was announced in December 1984. It incorporated the New Agricultural Policy issued in April 1984 and it has been amplified by the May 1985 statement of the Minister of Finance on Economic and Financial Adjustment Policy, the February 1986 Industry Policy statement, and a June 1986 Cereals Policy statement. Parts of the intended package of tax reforms are explicitly included in the larger set of structural adjustment measures as elements of the new industrial policy: (a) reform of the system of taxes on foreign trade (lowering of customs duties on imports, step-by-step removal of quantitative restrictions on imports, and revision of the Customs Code); and (b) revision of the Investment Code and the exonerations from import duties and from internal taxation granted under the Investment Code.

Reform of the direct tax component of Senegal's tax system has been outside the direct thrust of the structural adjustment program as such, but it has been a focus of GOS discussions with the IMF (rather than with the World Bank) since the mid-1970s and with USAID/Senegal for the last two years. At the request of the GOS, USAID/Senegal fielded a survey mission from the U.S. Internal Revenue Service in June 1985. This is being followed up by a further exchange of visits by GOS Ministry of Finance tax administrators and IRS experts scheduled for the summer or early autumn of 1986. We have also called in a distinguished tax specialist from the Harvard Law School, the Director of Harvard's International Tax program, Professor Oliver Oldman, whose views are incorporated into this PAAD (see Annex F).

In the policy dialogue on tax reform in Senegal, our closest interlocutor is the Minister of Finance who is deeply concerned with three fundamental effects of changing the tax system: reversing the tendency to lose tax revenues; increasing the economic efficiency of Senegalese producers by removing disincentives to production, savings and productive investments; and increasing equity of tax incidence within Senegal. Our concern with reform of the direct tax system of Senegal has been sharpened by continuing requests for assistance from the Minister of Finance. Our own agenda includes, in addition to the Minister's explicit aims, increasing the availability of resources for productive investment and providing incentives for the growth of a vital and competitive private sector.

## C. Other Donor Assistance

Other donors concerned directly with the tax reform are the World Bank, the IMF and to a limited extent France. The World Bank included reform of the Customs Code, the import tariff structure and the Investment Code in its structural adjustment measures for the SAC-II. For all three of these the World Bank has been providing technical assistance. The IMF has sent several missions from their Fiscal Department to study the Senegalese tax system and to make proposals for tax reform. In June 1986, at our urging, the IMF sent a tax expert from their Legal Department to work with the GOS Tax Department on reducing the direct tax components of the General Tax Code. The French have been discussing with the GOS Customs Department the possibility of providing assistance for computerization of the customs operations, which would be useful, among other purposes, for keeping track of arrears owed by private and public sector importers.

## D. The Senegalese Tax System

Except for the customs tariff, the tax system is set out in the General Tax Code last published in 1982. A tax reform commission has been working on a revision of the General Tax Code over the last two years and published a draft revision in April 1986.

Senegal inherited a rather complex taxation system from the French colonial administration and added to its complexity after independence. It is time to reverse the process by introducing some simplifications into the system. Simplification should improve administration by facilitating tax assessment and collection. It should also make it possible to give clearer positive signals for stimulating productive investment and for encouraging efficient production. Before entering on a general description of the system, it is useful to cite two relevant exemples of simplifications that would generate desirable signals for productive enterprises. One would be elimination of the 3 to 5 percent payroll tax on employers (which is additional to income taxes withheld on wage and salary income of employees). The direct signal would be lowering the cost of labor, which should encourage greater use of labor. Similarly, the business license levy (patente) is a nuisance tax, additional to the tax on business profits, that simply adds to the cost of operating a business and as such discourages enterprise activity. Like the head tax, it exists because the tax collector is able to identify a potential taxpayer. The patente would be superfluous and could be eliminated if the tax on business profits were better administered.

The Senegalese tax system consists of six broad groups:

- income taxes, consisting of a binary system of 5 separate schedules by subcategory of income and an additional progressive general income tax;

- payroll tax on employers;

- property taxes, with 5 subcategories;

- taxes on goods and services, including the TVA and 6 other subcategories of specific taxes;

- taxes on foreign trade, including 4 subcategories of import duties and a selective export duty;

- other taxes: a head tax earmarked to local authorities; and a stamp tax.

The bulk of Senegal's tax receipts are levied as indirect taxes on goods and services and on foreign trade. Income and property taxes accounted for only 25 percent of total tax receipts in 1985/86, as indicated below:

| | Billion CFAF | Million dollars equivalent | Percent |
|---|---|---|---|
| Income taxes, payroll tax, and property taxes | 46.6 | 133 | 25 |
| Taxes on goods and services | 61.0 | 174 | 32 |
| Taxes on foreign trade | 73.0 | 209 | 38 |
| Other | 9.5 | 27 | 5 |
| Total tax receipts | 190.1 | 543 | 100 |

A more detailed breakdown of tax receipts is presented in Table 8.

1. Income Taxes

The system of taxes on income in the Senegalese tax code is a binary system inherited from the French colonial legislation but abandoned in France in 1959. The first part of the binary system is a set of taxes that vary the levy according to the category of income defined by source of income (*impôts cédulaires*).

These taxes by income category include:

- tax on industrial, commercial and agricultural profits (BIC);

- minimum lump sum company tax (IMFS);

- tax on profits of non-commercial professions (BNC);

- tax on property income (IRF);

- tax on wage and salary income (ITS);

- tax on income from financial assets (IRCM).

Table 8. Government of Senegal: Tax Receipts, Detailed Table, 1979/80 - 1986/87
(Amounts in Billions of CFAF)

| Tax Category | 1979/80 | 1980/81 | 1981/82 | 1982/83 | 1983/84 | 1984/85 | 1985/86 | 1986/87 |
|---|---|---|---|---|---|---|---|---|
| 1. Taxes on income and profits | 31.3 | 29.8 | 32.4 | 37.0 | 41.0 | 44.3 | 46.6 | 51.1 |
| a. Corporate profit tax and tax on professional income | 11.2 | 10.3 | 8.9 | 9.8 | 10.6 | 13.2 | 13.0 | 14.0 |
| b. Tax on wages and salaries | 8.8 | 8.4 | 12.6 | 11.9 | 12.3 | 13.0 | 14.0 | 15.1 |
| c. Tax on capital income | 2.7 | 2.8 | 2.1 | 2.6 | 3.2 | 3.6 | 4.7 | 5.1 |
| d. Tax on rental income | 0.2 | 0.4 | 0.4 | 0.3 | 1.1 | 0.7 | 0.7 | 1.0 |
| e. Tax on real estate capital gains | 0.2 | 0.1 | 0.1 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |
| f. General income tax | 8.2 | 7.8 | 8.3 | 12.2 | 13.6 | 13.6 | 14.0 | 15.7 |
| 2. Employers' payroll tax | 2.1 | 2.1 | 1.6 | 3.8 | 4.3 | 4.5 | 4.8 | 5.1 |
| 3. Taxes on property | 3.3 | 3.9 | 3.4 | 2.8 | 2.8 | 2.8 | 2.9 | 3.[illegible] |
| a. Real estate taxes | 1.3 | 1.4 | 1.3 | 0.5 | 0.2 | 0.3 | - | - |
| b. Registration duties | 1.9 | 2.1 | 1.9 | 2.2 | 2.5 | 2.4 | 2.8 | 3.0 |
| c. Mortgage duties | 0.1 | 0.4 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| 4. Taxes on goods and services | 40.1 | 36.6 | 41.0 | 48.8 | 54.2 | 58.2 | 61.0 | 67.8 |
| a. Value added and services | 21.5 | 20.7 | 25.9 | 32.9 | 43.6 | 48.0 | 50.0 | 55.9 |
| b. Specific tax 1/ on petroleum products | 9.3 | 7.8 | 7.1 | 6.2 | - | - | - | - |
| c. Other excises | 4.5 | 3.9 | 3.7 | 4.2 | 5.1 | 4.3 | 4.0 | 4.3 |
| d. Tax on insurance contracts | 1.0 | 0.8 | 0.9 | 1.3 | 1.2 | 1.4 | 1.5 | 1.6 |
| e. Tax on vehicles | 1.1 | 1.2 | 1.1 | 1.2 | 1.2 | 1.6 | 2.0 | 2.1 |
| f. Business license fees | 0.1 | 0.1 | - | - | - | - | - | - |
| g. Taxes on alcohol and cement | 2.6 | 2.1 | 2.3 | 3.0 | 3.1 | 2.9 | 3.5 | 3.9 |
| 5. Taxes on foreign trade | 52.6 | 44.6 | 60.6 | 71.2 | 74.2 | 77.6 | 73.0 | 82.2 |
| a. Import duties | 49.8 | 43.1 | 59.3 | 69.8 | 73.2 | 77.6 | 72.0 | 81.2 |
| b. Export duties | 2.8 | 1.5 | 1.3 | 1.4 | 1.0 | 0.0 | 1.0 | 1.0 |
| 6. Other taxes 2/ | 1.6 | 1.6 | 1.1 | 1.2 | 1.6 | 1.7 | 1.8 | 1.9 |
| 7. Total tax revenue | 131.0 | 118.6 | 140.1 | 164.8 | 178.1 | 189.1 | 190.1 | 211.3 |

Source: Projections Department, Ministry of Finance, April 1986.
1/ The specific tax on petroleum products was replaced by a value-added tax in 1983/84.
2/ Including stamp duties.

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The second part of the binary system is an additional progressive general income tax (IGR) that is applied to individual income recipients on their combined incomes from all sources after deduction of the category taxes (impôts cédulaires) already paid.

a. BIC: Tax on Industrial, Commercial and Agricultural Profits

The tax on industrial, commercial and agricultural profits (impôt cédulaire sur les bénéfices industriels, commerciaux et agricoles) is levied on net profits of enterprises in these fields. Assessments are made on the basis of actual net profits in the case of corporations and of individuals with an annual turnover of over CFAF 50 million. Other individuals may opt for an assessment based on a negotiated arbitrary estimate of income (régime du forfait). Normal business charges are allowed as deductions. Rates on net business profits under the existing code for individual enterprises are zero for the first CFAF 240,000, 16 percent for the next CFAF 240,000, and 28 percent beyond CFAF 480,000. Under the proposed revision, the zero and 16 percent brackets are eliminated and a single rate of 25 percent is applied throughout (reduced by half in the case of household enterprises). Net profits of corporations are taxed at 33.33 percent with a minimum tax of CFAF 400,000 (raised to CFAF 500,000 in the proposed revision).

b. IMFS: Minimum Lump Sum Company Tax

The minimum lump sum company tax (impôt minimum forfaitaire sur les sociétés), is fixed at an annual amount of CFAF 400,000 in the present code. The proposed revision raises the minimum levy to CFAF 500,000 for enterprises with a turnover of up to CFAF 50 million and establishes a progressive scale at 5 rates with a maximum of CFAF 2.5 million for enterprises with a turnover of more than CFAF 1.0 billion:

| Turnover (million CFAF) | Levy (FCFA) |
|---|---|
| Under 50 | 500,000 |
| 50-100 | 1,000,000 |
| 100-500 | 1,500,000 |
| 500-1,000 | 2,000,000 |
| 1,000 + | 2,500,000 |

The minimum levy is applied to all enterprises subject to the BIC (see above) and to all companies and legal entities (personnes morales) with taxable profits under CFAF 1.5 million.

c. BNC: Tax on Non-Commercial Professional Incomes

The tax on professional incomes (impôt cédulaire sur les bénéfices des professions non-commerciales) is levied on income from professional services either on the basis of book earnings (régime de la déclaration contrôlée) or on a presumptive or forfeitary basis (régime de l'évaluation administrative). The rates are the same as for the BIC in the existing code. The proposed revision applies a single rate of 25 percent. The déclaration contrôlée is applied to professionals whose total receipts exceed CFAF 50 million (CFAF 20 million under the proposed revision) or any other taxpayer who can provide a balance sheet and profit-and-loss statement to support his net profits statement. The évaluation administrative is applicable to taxpayers whose annual receipts do not exceed CFAF 20 million. The evaluation of taxable income is made by the tax official on the basis of information available to him; the taxpayer has 20 days to contest the evaluation before a complaints commission. The decision of the commission is final unless the taxpayer can provide evidence that his net profit was lower than the forfeitary figure.

d. IRF: Tax on Incomes from Real Property

The tax on incomes from real property (impôt cédulaire sur les revenus fonciers) is levied on incomes of individuals from rental of built-up and non-built-up property. For companies whose activity is managing rental real estate, each partner in the company is taxed on his personal share, but there is no provision for tax withholding by the company. The tax rate is 20 percent. Rental income from buildings owned by commercial and industrial enterprises or by non-commercial professional enterprises are taxed under those categories and not under the real property category; the effective tax is lower under the enterprise profit tax because of more advantageous business deductions. Imputed rents of owner-occupied dwellings are exempt from the tax on real property income.

The tax base for the tax on incomes from real property could be considerably widened by better tax administration, and above all by completion of the fiscal cadaster recently begun on a pilot basis in six districts of Dakar and its Cap Vert suburbs.

e. ITS: Tax on Wage and Salary Income

The tax on wage and salary income (impôt cédulaire sur les traitements et salaires) is imposed on payments in cash and in kind excluding family allocations and the 7.5 percent withheld for obligatory payment to pension funds. The tax is withheld for payment to the Treasury by employers resident in Senegal. Wage and salary earners working for non-resident employers are required to pay their tax directly to the Treasury.

The present and proposed tax schedules are as follows:

| Tax bracket ('000 CFAF) | | |
|---|---|---|
| Present code | Proposed revised code | Rate (percent) |
| 0-360 | 0-480 | 0 |
| 361-480 | 480-600 | 5 |
| 480+ | 600 + | 10 |

The upward adjustment in the ranges of the three income brackets is considerably smaller than the intervening rise in the general price level, so that the effective tax burden on the middle ranges of salary incomes is still much greater than a decade ago.

f. IRCM: Tax on Income from Financial Assets

The tax on income from financial assets (impôt sur le revenu des capitaux mobiliers) includes two categories: the tax on income from securities; and the tax on income from loans and deposits.

The tax on income from securities (impôt sur le revenu des valeurs mobilières) is levied on interest, dividends, distributed profits and other income from stocks, bonds, and shares as well as payments to administrators and board members of companies as compensation for participation in shareholder meetings. Four different rates are applied, two of which are modified in the proposed revision of the code:

| Income category | Rate (in percent) Present code | Proposed revised code |
|---|---|---|
| Shares paid to creditors and bond holders | 25 | 25 |
| Interest on bonds | 10 | 18 |
| Dividends and other incomes | 16 | 14 |
| Profits of foreign companies | 16 | 16 |

The inversion of the hierarchy of rates on income from bonds and income from stocks is intended as an incentive to risk capital.

The tax on income from loans and deposits (impôts sur le revenu des créances, dépôts et cautionnements) is applied to interest, warrants and all other proceeds of mortgages, deposits, guarantees, current accounts, and cash vouchers. Proceeds of such transactions between industrial, commercial, agricultural, or mining enterprises are exempt as are interest and other proceeds of a number of State or quasi-State financial instruments. The rates applied under the present code and under the proposed revision are as follows:

| Category | Rate (in percent) Present code | Proposed revised code |
|---|---|---|
| Ordinary rate | 16 | 10 |
| Rate applied to interest and other income by banks, exchange agents, Caisse des Dépôts, and State Treasury | 8 | 5 |
| Nominal and bearer cash vouchers | 20 | 15 |

g. IGR: General Income Tax

The general income tax (impôt général sur le revenu) is the second major component of the binary system. Its major characteristics are that (a) it is progressive, with a maximum marginal tax rate of 65 percent for incomes over CFAF 16.0 million (lowered to 60 percent for incomes over CFAF 16.5 million in the April 1986 proposed revision of the General Tax Code), and (b) the tax base is adjusted for family size on the basis of family shares or "splits" explained below.

The rate schedules in the present code and in the proposed revision are as follows:

| Rate (in %) | Income bracket (in CFAF '000) Present Code | Proposed revised code |
|---|---|---|
| 0 | under 320 | under 330 |
| 10 | xx | 330- 380 |
| 12 | 320- 440 | 380- 480 |
| 15 | 440- 560 | 480- 600 |
| 18 | 560- 750 | 600- 900 |
| 22 | 750- 1,050 | 900- 1,100 |
| 25 | 1,050- 1,260 | 1,100- 2,300 |
| 30 | 1,260- 2,750 | 2,300- 4,400 |
| 35 | 2,750- 5,500 | 4,400- 6,300 |
| 40 | 5,500- 7,500 | 6,300-10,000 |
| 45 | 7,500-11,000 | 10,000-12,500 |
| 50 | 11,000-13,000 | 12,000-14,000 |
| 55 | 13,000-14,000 | 14,000-16,500 |
| 60 | 14,000-16,000 | 16,500 and over |
| 65 | 16,000 and over | xx |

The proposed revision eliminates the top marginal tax rate of 65 percent and adjusts the bracket limits upward to provide partial compensation for the intervening rise in the general price level since the existing schedule was fixed. The loss in revenue that would have occurred if the new schedule had been applied in 1983/84 is estimated at CFAF 125 million ($357,000), if there were no adjustment for family size. Eliminating the 60 percent bracket would have resulted in a further loss of only CFAF 2 million.

The method for adjusting the tax base for family size requires a bit of explanation. In contrast with the U.S. system of a fixed deduction for each dependent, the Senegalese tax code adjusts taxable income for number of dependents by dividing family taxable income into parts or shares ("splits") depending on the number of dependents. A man and his wife are each alloted one share, each dependent child a half share. If a polygamous tax payer declares incomes for several wives, each wife is alloted a full share. The maximum total number of full shares that a taxpayer can cumulate is 5 in the present tax code and 6 in the draft revised code. Each share is then taxed on a progressive basis according to the published schedule of rates. Since the family shares system divides total taxable incomes by the number of shares, the tax benefit is proportionately much higher for the higher income groups than for the lower. If all the taxpayers in the top three brackets in 1983/84 had large enough families to qualify for an additional family share, the proposal to increase the maximum number of family shares from 5 to 6 would have resulted by itself in an actual revenue loss to the Treasury of CFAF 12 million.

It is USAID/Senegal's view that the revised code should make a clearer move toward creating an income incentive to effort and efficiency by eliminating not only the 65 percent bracket but the 60 percent bracket (and perhaps the 55 percent bracket) as well. On the other hand, we oppose the proposed increase in the maximum number of family shares from 5 to 6 since it gives the wrong signal for family planning.

One of the more controversial innovations in the proposed revised code is a new provision for filing separate tax declarations for working spouses, an option that can be exercised by the husband whether or not his spouse is in agreement. Senegalese women consider payment of taxes to be a male prerogative. An extreme consequence is the case of a civil servant with three income earning wives whose combined tax liabilities (which the ladies decline to recognize) amount to 80 percent of the husband's total annual income. The women's organizations are up in arms about the proposed article in the draft revised code. USAID/Senegal has no intention of getting involved in the controversy.

There is also a provision under the General Income Tax for assessment of taxable income on the basis of outward signs of life style: unless justified to the contrary by the taxpayer, taxable income cannot be less than a lump sum assessment linked to certain elements of living style such as housing (without or with swimming pool), automobiles, servants, yachts, private airplanes. The proposed revised code raises the rates and adds race horses and orchards to the list of taxable elements of living style.

2. Payroll Tax

A lump sum payroll tax (*contribution forfaitaire à la charge des employeurs*) is levied on all enterprises and organizations paying wages and salaries. The rates imposed are higher for foreign workers than for Senegalese workers. State and local government entities as well as foreign and international public or para-public organizations are exempted from the payroll tax. The rates have been raised by 1 percentage point in the proposed revision of the code:

| | Rate (in percent) | |
|---|---|---|
| Nationality of employee | Present code | Proposed revised code |
| Senegalese | 2 | 3 |
| Foreign | 4 | 5 |

3. Other Direct Taxes

Other direct taxes include the following:

- fiscal minimum personal tax (IMF and TRIMF);
- business license levy (patente);
- license fees;
- firearms tax.

The discussion below deals with the first two.

a. Fiscal Minimum Personal Tax: IMF and TRIMF

The fiscal minimum personal tax (impôt du minimum fiscal) is imposed on all residents of Senegal over 14 years of age other than employees. The proceeds are passed on to the local authorities. The tax is minimal, ranging from an annual lump sum of CFAF 600 to an annual lump sum of CFAF 4,000 in the current tax code (CFAF 600 to CFAF 12,000 in the proposed revision). The tax exempts indigent persons, military personnel in service, school children, war victims, work accident victims, blind persons and others.

The tax on employees in lieu of the fiscal minimum tax (taxe représentative de l'impôt du minimum fiscal) is witheld at the source for wage and salary earners. The proceeds are passed on to the local authorities. The tax is imposed as a lump sum ranging from CFAF 900 to CFAF 6,000 in the present code (CFAF 900 to CFAF 12,000 in the proposed revision).

b. Business License Levy: Patente

The patente is a business license levy whose proceeds are transferred to the local communities. For some trades, it consists of a fixed tax (droit fixe) ranging from CFAF 3,000 to CFAF 60,000 in the present code, and a proportional tax (droit proportionnel) of 0, 5, 7.5 or 10 percent. For others, it consists of a base tax (taxe déterminée) between CFAF 12,000 and CFAF 60,000 and a variable tax (taxe variable) on the number of (a) workers or (b) material inputs or horsepower. For importers and exporters, a patente ranging from CFAF 30,000 to CFAF 350,000 in the existing code is levied on the basis of global amount of customs value of imports or exporters. The patente for whosalers of petroleum products ranges from CFAF 30,000 to CFAF 350,000 in the existing code.

4. Property Taxes

Property taxes include:

- tax on built-up property;
- tax on non-built-up property;
- registry tax;
- tax on mortgages.

The discussion below focuses on the first two.

a. Built-Up Property Tax

The tax on built-up property (contribution foncière des propriétés bâties) is collected on behalf of the local authorities. Built-up property includes all buildings as well as uncultivated land used for commercial or industrial purposes and fixed equipment of industrial establishments. Permanent exemptions include public buildings, ports, public water and electricity distribution systems, buildings used for religious, medical, social assistance and educational purposes, farm buildings, and straw huts without foundations. Temporary exemptions include new constructions: 5 years for buildings used for purposes other than manufacturing or housing; 10 years for factories in the Cap Vert and for housing; 15 years for factories outside the Cap Vert, for moderate rental housing, and for renovation of buildings in St-Louis, Gorée and certain other localities.

The tax is levied on the basis of rental value of the property less imputed costs agreed to for housing and 50 percent for factories. For small property owners not covered by the profits tax or the general income tax, an additional amount of rental value is exonerated from the property tax: in Dakar, Pikine and Rufisque, CFAF 72,000; in other localities, CFAF 60,000 in the existing code (CFAF 144,000 and CFAF 120,000 in the proposed revision). The rates are as follows (in percent):

| Category of property | Present code | Proposed revised code |
|---|---|---|
| Standard | 30 | 25 |
| Buildings subject to tax on property income or included in the balance sheet assets of an enterprise | 15 | 10 |
| Dwellings occupied by the owner as principal residence | 30 | 5 |

b. Non-Built-Up Property Tax

The tax on non-built-up property (contribution foncière des propriétés non-bâties) is levied on the market value of the property. There are a number of exemptions. The rate is 5 percent in the present code (6 percent in the proposed revision). A surtax on non-built-up or insufficiently-built-up property is levied in the communes of Dakar, Kaolack, Ziguinchor, St-Louis, Thiès and Diourbel, with rates of 0.75, 1.75, and 2.75 percent applying to different schedules of market value for (a) Dakar, (b) Kaolack and Thiès, and (c) St.Louis, Diourbel and Ziguinchor. The amounts collectible from the surtax are smaller than the cost of collection.

5. Taxes on Goods and Services

a. Turnover Taxes: Tax on Value Added and Tax on Services Rendered

The tax on value added and the tax on services rendered apply to all industrial, commercial, artisanal and non-commercial activities except agriculture and salaried activities as defined in the Labor Code. Transformation of agricultural and fishery products are included in the scope of the value added tax even if the activities are carried out by farmers, fishermen, or their cooperatives. Deliveries for own consumption or processing are also covered, as are imports into Senegal. Services include all service activities except selling.

Activities exonerated from the value added tax and the tax on services include, among others:

- exports, including sales and repairs related to non-Senegalese ocean-going ships and river ships operating on international rivers;

- resale of goods that have already paid the value added tax, if no further transformation is performed;

- insurance transactions;

- printing and sale of newspapers and periodicals, and purchase of raw materials for production of books and newspapers in Senegal;

- equipment and services related to petroleum and gas prospecting;

- imports and sales of products and merchandise delivered to the State, communes and public establishments to the extent that these are already exempted from import duties.

The amount of taxable activity is arbitrarily fixed for a period of two years on the basis of turnover estimates submitted for the tax on industrial and commercial profits. The taxpayer has 20 days to accept or protest the assessment.

The proposed revised code reduces turnover tax rates:

| Category | Rate (in percent) Present code | Rate (in percent) Proposed revised code |
|---|---|---|
| Value added tax: | | |
| Normal rate | 20 | 18 |
| Reduced rate applied to sugar imports and internal deliveries, and appended list(s) of other products | 7 | 3 and 5 |

| Category | Rate (in percent) Present code | Proposed revised code |
|---|---|---|
| Intermediate rate | xx | 34 |
| Increased rate applied to a second list of products | 50 | 40 |
| Tax on services rendered: | | |
| Normal rate | 17 | 15 |
| Reduced rate applied to rental of furnished rooms outside the Cap Vert | 7 | 5 |
| Reduced rate applied to sports, films, theatrical representations, banking commissions, medical fees | 7 | 3 |
| Intermediate rate applied to furnished rooms rented by hotels, pensions and others | 12.5 | 10 |
| Increased rate applied to operations of transfering funds abroad not engendered by services or sales | 50 | xx |

b. Other Taxes on Goods and Services

Other taxes on goods and services in the present code include a set of specific commodity taxes of different unit amounts on alcoholic beverages, soft drinks, coffee, tea, edible fats and oils, tobacco products, kola nuts, petroleum products and cement. The revised code eliminates the specific tax on petroleum products and adds a 3 percent tax on hotel rooms allocated to a national fund for the promotion of tourism.

6. Foreign Trade Taxes

Taxes on imports include a customs duty, a fiscal duty, and a value added tax. There is an export tax on the books for phosphates and peanut products but it is suspended for the time being. The customs duty and the fiscal duty are charged on all imports except those from member states of the West African Economic Community (CEAO). Imports of goods originating in the CEAO are subject to a different tariff schedule (the *tarif d'usage*). Under Law 83-44 of February 18, 1983, the basic customs duty (*droit de douane*) is 15 percent of c.i.f. value with the following exceptions:

- A list of products considered as essential to the maintenance of public health and the national economy are exempt. In general, these include primary goods, raw materials and pharmaceuticals.

- Products entering from CEAO member countries are exempt.

- Products entering from member states of the Economic Community of West African States (ECOWAS) are subject to a customs duty of 5 percent.

- Products imported by industrial enterprises located in Senegal that are designated as priority enterprises under the Investment Code are exempt.

Under Law 80-39 of August 25, 1980, the fiscal duty (droit fiscal) is applied to c.i.f value, except for products whose valuation for customs is established annually in a list of applicable market values (valeurs mercuriales applicables) to avoid under-invoicing. The basic rate of fiscal duty is 40 percent. A reduced rate of 10 percent is applied to a list of products that includes some but not all foodstuffs, certain paper products, veterinary supplies and insecticides. A increased rate of 50 percent is applied to another list of products that includes paper products and packing materials. A special rate of 75 percent is applied to a group of products that includes luxury foodstuffs, jewelry and watches. Exempt from the fiscal duty is a group of products that includes such articles as medecines, insecticides, pharmaceuticals and bottled gas.

The value added tax is imposed on c.i.f. value plus both customs and fiscal duties. Three levels of rates are applied depending on the category of goods: 20 percent, 5 percent, and 50 percent. With a number of exceptions, the groups are similar to those under the fiscal tax.

The protection role of import taxes is reinforced by quantitative restrictions that include (a) prior authorization (autorisation préalable) to protect local industrial enterprises, (b) prior approval (visa préalable) for reasons of public health or security, (c) quotas, and (d) absolute bans.

This system of protection, in force through June 1986, has rendered the Senegalese economy increasingly uncompetitive. Nominal tariffs through June 1986 have been high, especially for finished goods, but their protective effect is offset in many cases by extensive tariff waivers and exemptions. At the same time, domestic producers have also been granted quantitative restrictions on imports of a number of products that came to over 160 at the peak to reinforce protection. In some cases, the local producer is also the sole permitted importer. The average level of protection in the domestic market is therefore high, around 50 percent, but the pattern of protection is uneven and the effects are not evident. A study of effective protection 1/ for selected commodities carried out by the Projections Department of the Ministry of Finance in 1985 showed a wide range of effective protection rates (see Table 9). Protection was negative for soap and oil pressing. Protection was also negative before subsidy for biscuits, confectionery and sweetened condensed milk primarily because of the high price of sugar sold through the Compagnie Sucrière Sénégalaise which has complete monopoly of the market for locally produced and imported sugar. Protection was heavily positive on tuna

1/ Effective protection measures the combined effect of tariff protection on output and tariff protection on inputs used to produce that output.

Table 9. Senegal: Estimated Effective Protection Rates 1/ by Sector, 1984

| Sector | | Domestic market | Exports CEAO | Exports Other | Exports Total |
|---|---|---|---|---|---|
| Tuna Canning: | with subsidy | 1.00 | - | 0.35 | 0.36 |
| | without subsidy | 1.00 | - | -0.27 | -0.25 |
| Frozen Fish: | with subsidy | - | - | 0.36 | 0.36 |
| | without subsidy | - | - | -0.09 | -0.09 |
| Biscuits: | with subsidy | 0.07 | 0.25 | - | 0.12 |
| | without subsidy | -0.30 | -0.25 | - | -0.28 |
| Confectionery: | with subsidy | -0.36 | -0.31 | - | -0.36 |
| | without subsidy | -0.58 | -0.29 | - | -0.55 |
| Milk processing: | | | | | |
| -Natural milk and yoghourts | | 2.44 | - | - | 2.44 |
| -Condensed milk, sweetened | | -0.01 | - | -0.67 | -0.03 |
| -Condensed milk, unsweetened | | 0.94 | - | - | 0.94 |
| Floor milling | | 4.26 | - | - | 4.26 |
| Vegetable canning | | 1.05 | - | - | 1.05 |
| Oil pressing | | -0.05 | - | -0.16 | -0.13 |
| Textiles: | with subsidy | 0.10 | 0.27 | 0.03 | 0.08 |
| | without subsidy | 0.69 | 0.27 | 0.03 | 0.40 |
| -Spinning: | with subsidy | 0.20 | 0.37 | 0.01 | 0.07 |
| | without subsidy | 0.18 | 0.37 | 0.00 | 0.11 |
| -Weaving & printing: | with subsidy | 0.05 | 0.27 | 0.36 | 0.09 |
| | without subsidy | 1.16 | 0.26 | 0.35 | 0.94 |
| -Knitting: | with subsidy | 0.97 | 7.10 | 6.84 | 1.10 |
| | without subsidy | 5.12 | 7.46 | 7.11 | 5.04 |
| Shoes (with subsidy) | | 1.02 | 0.19 | 0.08 | 0.64 |
| Soap | | -0.71 | - | -0.17 | -0.69 |
| Paints | | 3.88 | - | -0.23 | 3.67 |
| Cosmetics | | 0.73 | - | -0.03 | -0.52 |
| Matches | | 2.29 | -0.25 | -0.25 | 1.65 |
| Paper products | | 0.70 | 0.28 | -0.17 | 0.48 |
| Cardboard packaging | | - | - | 0.44 | 0.00 |
| Construction materials: | with subsidy | 0.55 | - | -0.19 | -0.52 |
| | without subsidy | -0.32 | - | -0.11 | -0.32 |
| Vehicle assembly | | 2.77 | - | - | 8.25 |
| Metal packaging | | 0.80 | - | 0.07 | 0.25 |

Source: Direction de la Prévision

1/ The effective protection coefficient is derived as domestic value added divided by value added in international prices. The effective protection rate is the effective protection coefficient minus 1.0.

canning (effective protection rate of 1.00), milk and yoghourts (2.44), flour milling (4.26), knitted goods before subsidy (5.12), paints (3.88), matches (2.29), and vehicle assembly (2.77).

7. Investment Code

A major factor affecting the tax system is the exemptions and exonerations granted under the Investment Code for priority industries. Eligibility for exemptions under the Investment Code is determined by the Ministry of Plan, usually without reference to the Tax Department. Although the exemptions are granted for a fixed time period, usually 5 years, they are in fact often extended far beyond the initial period. The Investment Code is currently being revised, with technical assistance from the World Bank and under heavy pressure from the IMF.

The advantages granted under the 1981 Imvestment Code are summarized as follows:

Ordinary regime:

- For 25 percent of investment out of own funds: exemption from the TVA on rents.
- Outside the Cap-Vert region, interest rate subsidies on credit provided through SOFISEDIT (Société Financière Sénégalaise pour le Développement de l'Industrie et du Tourisme).

Priority regime:

- For investments of CFAF 200 million before taxes realisable in 3 years and creating a minimum of 50 jobs in 2 years, or creating a minimum of 100 permanent jobs for Senegalese staff and workers: a 3-year exemption from import taxes and TVA on necessary materials not produced in Senegal and on utility vehicles, but not on vehicle spare parts; a 3-year exemption from turnover taxes (taxes sur le chiffre d'affaires); a 5-year exemption from import taxes and TVA on spare parts for imported machinery up to 10 percent of the cost of the machinery; exemption from transfer taxes; exemption from company establishment taxes (droits de constitution des sociétés); a value added premium during 9 years; 15-year exemption from property tax.
- For agriculture, animal husbandry, and forestry: 8-year exemption from customs duty and fiscal duty on imported inputs; exemption from TVA on local inputs; annual exemption on fuel and lubricants.
- For investments in the Cap-Vert region: 5-year exemption from patente.
- For investments outside the Cap-Vert region: 8-year exemption from patente.
- For the tourist industry, 8-year exemption from licenses and taxes on

Derogation:

- For extensions and renewals to existing facilities included in the Plan and located outside the Cap-Vert region, of a minimum of CFAF 200 million: same exemptions as for new investments of CFAF 200 million under the priority regime noted above.

Special agreements (conventions):

- For investments of CFAF 2 billion in 3 years, for enterprises of a particularly important economic or social interest with respect to the objectives of the Development Plan, and for minerals exploration, extraction and transformation: extension up to 10 years of the tax exemptions under the ordinary and priority regimes. A request for further extension of this stabilization of the tax regime for an additional period of 10 years (and not renewable) may be submitted to the Interministerial Committee on Investments.

The ministry in charge of drafting and administering the Investment Code (by authorizing tax exemptions) is the Ministry of Planning and Cooperation. In general, the Planning Ministry's views do not coincide with those of the Ministry of Finance which has no say in deciding on what exemptions to grant; indeed, the Tax Department often is informed only by an enterprise from which it tries to collect taxes that an exemption has been granted.

## III. Project Description

### A. The Problem

#### 1. Weaknesses of Senegal's Tax System

Senegal's tax system contributes to several of the major ills besetting the country's economy : a shortage of financial resources; distorted economic incentives; and social inequities. The tax system is badly in need of overhaul: the multiplicity of taxes makes the system overly complex; direct taxes are predatory with respect to incomes in the modern sector that are easy to identify; customs tariff rates have been raised so high that total receipts fall off because of the profitability of smuggling; the system is mined by exonerations and exemptions; taxable property is poorly identified and property taxes are under assessed; and tax administration is grossly inefficient. In addition,, the tax system is an active disincentive to productive investment and benefits non-productive investment in real estate. The effects are an inequitable incidence of taxes, widespread tax evasion, economic distortions, sagging tax collections, and public finance crises that are palliated by increasing injections of foreign aid.

Reform of the direct tax system is needed to encourage productive effort, to achieve greater equity, and to facilitate improvement of tax administration. Revision of the customs tariff is needed to make the economy more competitive as well as, eventually, to increase customs receipts. A new Investment Code is needed to reduce and rationalize tax exemptions. Existing special exonerations need to be renegotiated. Carrying out a fiscal cadaster in the Dakar-Cap Vert region, which will require at least 2 or 3 years of work on the ground, and in the secondary urban centers is essential to effective administration of taxes on property and on income from property.

As described on the section II.D. on the Senegalese tax system, direct taxes include income taxes and a payroll tax on employers. Income taxes are structured in a binary system consisting of (a) half a dozen schedular taxes on different categories of income, on which is superimposed (b) a progressive general income tax. The general income tax is characterized by high marginal rates and a peculiar system of splitting incomes by family size. The schedular system is inherited from the French colonial administration but was abolished in France itself in 1959. Collection of the schedular taxes is inefficient and open to evasion. The payroll tax on employees is additional to the schedular tax on wages and salaries, creating still another economic bias against employment of labor in the modern sector.

Taxes on goods and services include a "modern" element, the value added tax, and a series of specific taxes on petroleum products, cement, electricity, alcoholic and non alcoholic beverages, coffee, tea, edible oils, tobacco and kola nuts.

Taxes on foreign trade include an import customs duty and a fiscal duty to which is added the value added tax. There is an export tax on the books but it has been suspended. The current structure of import tariff rates is not economically rational. Furthermore, under pressure from the IMF in the early 1980s, customs tariff rates were increased to the point that evasion became a highly profitable activity. Receipts of foreign trade taxes have been further diminished by extensive exonerations, some permitted under the Investment Code and other negotiated as special agreements between individual enterprises and the GOS. The IMF estimated that actual import tax collections in 1983/84 represented only about one-third of the amount that would have resulted if all import goods had been subjected to normal rates without preferential schemes and exonerations.

Ineffective assessment and collection of taxes on rental incomes, particularly in the Greater Dakar area, create gross inequities in tax incidence and distort investment incentives away from production of goods and services. Property taxes on built-up and non-built-up real estate are minimal. Part of the ineffectiveness of the taxes on rental income and real estate is due to lack of a fiscal cadaster.

## 2. Need for Tax Reforms

Senegal needs an effective and equitable tax system in order to:

- eliminate disincentives to economic growth and private investment built into the present tax system;

- spread the tax burden more equitably.

Eliminating disincentives to growth and investment requires reform of the import tariff structure and of the present system of protection and legally-enforced quasi-monopoly positions of established producers. It also requires collection of property and income taxes on real estate, particularly in the Greater Dakar area, to increase the relative attractiveness of investment in production of goods and services other than luxury housing. Spreading the tax burden requires identification and effective taxation of income sources other than wages and salaries of government and other modern sector employees.

## B. Project Purpose and Content

### 1. Purpose

This AEPRP is designed to support a package of tax reforms being undertaken by the GOS as part of the process of structural reform to which the GOS and the major international donors are committed.

### 2. Content: The Tax Reform Package

The GOS is undertaking a major reform of the tax system in the framework of structural adjustment measures urged and supported by the World Bank, the IMF, the French and ourselves. The Ministry of Finance has been working on a proposed revision of the General Tax Code for the last two years and has now issued a draft revision for discussion by the concerned interest groups ("the social partners") and the donors. The World Bank has been assisting the GOS in formulating a major reform of the customs tariff code designed to lower rates and to harmonize them among commodities, and to carry out a progressive removal of quantitative restrictions on imports. The World Bank also has been providing support to the Ministry of Plan on a revision of the investment code aimed at reducing the extent of legal tax exonerations permitted under the code and to the Ministry of Finance in carrying out a pilot fiscal cadaster in six tax precincts of Greater Dakar. The IMF has carried out two major studies on the Senegalese tax system since 1975, will be providing a tax expert from their Fiscal Department to work with the Ministry of Finance, and (at our request) has sent out a tax expert from their Legal Department to look at the direct tax component of the proposed revision of the General tax Code. USAID/Senegal has funded an analysis of the proposed revision of the direct tax volume by a team of French experts from the University of Clermont-Ferrand (see Annex B for a translation of the executive summary of their report) as well as a study of the Senegalese tax system by the U.S. Internal Revenue Service. We have also funded a short mission by an international tax expert from the Harvard Law School to examine the proposed revision of the direct tax code (see Annex F).

The proposed tax reforms will have both positive and negative effects on major vested economic interests in Senegal: the modern sector industrial establishments in the Cap-Vert environs of Dakar; the labor unions; the traders doing a brisk business in legal and smuggled imports; anonymous wealthy Senegalese investing their funds in real estate in Greater Dakar. All of these have close political ties to the GOS, and they will complain when they are affected negatively. Defining and implementing reforms in the tax system require tough decisions by the GOS that take account of the political ramifications of reform. The funds made available by this AEPRP grant will help the GOS cover the short-run shortfall in receipts resulting from reduction in tax rates and will bolster the political determination of the GOS to carry through on the proposed reforms.

The proposed reforms focus essentially on simplification of the tax system, reductions in tax rates, and elimination of wide-spread tax exonerations. This conception reverses the direction of actions urged on the GOS by the IMF between 1980 and 1985, namely to increase tax rates in order to increase tax receipts. The consensus of opinion now is that the policy of increased tax rates had a perverse effect on tax receipts and intensified distortions in the economy by increasing the incentives for tax evasion and for investment in real estate as opposed to investment in the production of goods and services. The elasticity of tax revenue with respect to gross domestic product (GDP) fell from 1.4 during the period 1971/72-1978/79 to 0.6 during the period 1979/80-1983/84. Tax revenue as a percentage of GDP fell from 21.7 in 1979/80 to 15.5 in 1985/86.

The tax reform package includes (a) a revamping of the customs tariff code and schedules, (b) a parallel reform of the Investment Code, and (c) a reform of the direct tax system including property taxes.

The revision of the customs tariff schedule consists of a major reduction and "harmonization" of rates intended (a) to reduce the level of protection and (b) to reduce internal incoherencies that respond to the conflicting interests of different categories of domestic producers (e.g. farmers versus producers of agricultural equipment). The details are being worked out by the GOS with technical assistance from the World Bank in the context of its second structural adjustment credit to Senegal (SAC-II).

The reform of the Investment Code will eliminate most of the exonerations from indirect and direct taxes that it currently permits. It will bring the remaining exonerations together into a generally applicable system and eliminate the practice of special regimes. The reformed code will apply to new investments. Renegotiating existing contracts established under the present code will be a delicate and long drawn out process.

A number of reforms of the direct tax system are contained in a proposed revision of the General tax Code that was published in April 1986 for discussion by business organizations, labor unions and the accounting profession as well as the aid donors. It is our general feeling that the proposed revision has moved the direct tax system in the right direction but does not go far enough. We are making some immediate suggestions for modifying the proposed revision in the current round of discussions, but we also intend to work closely with the GOS over the next 18-24 months to develop a more far-reaching reform than is now envisaged. We want, in particular, to move the Senegalese direct tax system much further along the transition to a global or unitary income tax.

a. Customs Tariff

Reform of the customs code and customs tariff rates are intended as part of a revised system of protection based on reduced and harmonized tariff protection. The intention of the reductions is two-fold: (a) to reduce the incentive to fraud and smuggling and (b) to force Senegalese producers to become more efficient. Harmonization is designed to encourage domestic production of raw materials and intermediate goods rather than only final consumer goods. Reform of the tariff structure is to be accompanied by removal of a number of quantitative restrictions through: reduction of absolute and relative prohibitions; gradual elimination of the system of prior authorizations; and freezing of the number of products subject to quotas, gradual increases in the quota levels, and subsequent abolition of the quotas.

The new tariff code drafted by the Ministry of Finance presents the principles of the tariff reform, a proposed schedule of tariff rates, and a proposed allocation of commodities to the proposed rates. Present rates will be adjusted step by step starting in July 1986, with the new rates to be fully applicable by July 1988. Draft legislation is being submitted to parliament in July 1986. An action plan and timetable for eliminating quantitative restrictions was issued by the Ministry of Industry on July 1, 1986. Quantitative restrictions on some commodities not produced in Senegal were lifted earlier in 1986. Prior authorization for a number of other commodities will be lifted in July 1986: announcement in June 1986 that prior authorization on metal products would be among first to be eliminated caused a major uproar among the affected industrialists. The time table for further elimination of quantitative restrictions to January 1988 is as folows:

| Date | Industry branch and product group |
|---|---|
| **1986** | |
| July 1 | Mechanical metal working products |
| October 1 | Paper and cardboard packaging materials |
| **1987** | |
| January 1 | Building materials<br>Shoe parts: uppers, etc. |
| March 1 | Food processing<br>Office articles and stationery supplies |
| July 1 | Chemical products (except batteries, household soaps, PVC tubes and pipes) |
| **1988** | |
| January 1 | Batteries, household soaps, PVC tubes and pipes<br>Textiles and shoes<br>School stationery supplies |

On September 1, 1986, the Ministry of Industry with UNIDO technical assistance will start monitoring the impact of the program.

The import tariff reform is intended as part of the reform of industrial incentives under the New Industrial Policy. The tariff schedule will be divided into 7 broad economic categories, to each of which a different rate will be applied. During a two-fiscal year transitional period starting on July 1, 1986, the rates will be decreased at the beginning of the fiscal year to a considerably lower level than the rates being replaced. The aims are to harmonize effective protection in the domestic market and to reduce the attractiveness of fraud. The rates set for on July 1, 1986 (FY 1986/87) and July 1, 1988 (FY 1988/89) are the following (in percent):

| | 1986/87 | | 1988/89 | |
|---|---|---|---|---|
| | Customs duty (on c.i.f. value) | Fiscal duty (on c.i.f. value) | Customs duty (on c.i.f. value) | Fiscal duty (on c.i.f. value) |
| 1. Social and assimilated goods | 0 | 0 | 0 | 0 |
| 2. Strategic goods | 15 | 0 | 10 | 0 |
| 3. Equipment goods and raw materials | 15 | 10 | 10 | 10 |
| 4. Semi-finished goods | 15 | 10 | 10 | 20 |
| 5. Revenue goods | 15 | 25 | 10 | 30 |
| 6. Other finished goods | 15 | 35 | 10 | 30 |
| 7. Luxury goods | 15 | 10 to 60 | 10 | 10 to 50 |

Social and assimilated goods are so defined because of their social, cultural or educational character. They include pharmaceuticals, books, brochures, scientific documents, major agricultural inputs (fertilizers, pesticides, seeds), and domestic gas.

Strategic goods include products receiving support from the State because of their impact on the national economy: crude or refined vegetable oil; cereals such as wheat, rice and millet; potatoes; animals for reproduction; day-old chicks; and petroleum products.

Equipment goods include all machinery and equipment necessary for productive units as defined in the tariff code. Given the low level of tax on these goods, the view of the Ministry of Finance (and the World Bank) is that equipment goods should not be granted further exonerations under the Investment Code.

Raw materials include vegetable, animal and mineral primary products before transformation, to be incorporated or transformed in the process of manufacture. Semi-finished goods include goods to be used, incorporated or transformed in a production process.

Revenue goods include all current consumption goods not fabricated or produced locally. Other finished goods correspond mostly to consumption goods produced locally.

Luxury goods include the minority of goods consumed by high income households.

We intend to tie release of the three tranchesof the AEPRP cash transfer to the agreed timetable for three-stage adoption of reduced tariff rates and for progressive elimination of quantitative restrictions. We will be following closely the results of the Ministry of Industry/UNIDO impact studies. Of the $1.0 million reserved for studies and technical assistance, part will go for ex-post evaluation of the impact on the economy of the tariff reductions and elimination of quantitative restrictions.

b, Investment Code and Special Agreements

A summary of proposed revisions of the Investment Code designed to reduce or eliminate special exonerations from customs tariffs and direct taxes for new investments will be available for discussion in June 1986. A final version is scheduled for December 1986. The general principles guiding the proposed revision of the investment code are the following:

- The objective is to stimulate private investment without hindering the international competitivity of production units being established in Senegal.

- The advantages granted will be as neutral as possible in relation to the price system; i.e, they will be fairly generalized so as to avoid relative price distortions.

- They will be degressive and limited in time.

- They will have a fairly automatic and transparent character.

So far, the suggestions made by the working group on revision the Investment Code concerning the objectives and directions of a new Investment Code are pretty tentative:

- Neither the criteria (e.g. level of value added, level of technicity) nor the activities to which the code should apply have been defined.

- Additional advantages are considered to be needed to encourage decentralization (e.g. accelerated depreciation allowances, subsidies for the acquisition of factory sites or prepreparation of such sites by the State).

- Special advantages may be needed for infant industries, "but without creating conditions of unfair price competition".

- With respect to employment, stronger conditions could be included to encourage employers to hire and train Senegalese office and plant level management staff.

- Additional advantages could be included to encourage use of local raw materials.

- Instituting a financial reserve for investment might encourage reinvestment.

- Economic return to the proposed investment (presumably in international prices) in addition to financial return could be a criterion for eligibility under the code.

- The minimum of investment giving eligibility to benefits from the investment code favors capital intensivity and creates a built-in bias against labor-intensive activities and against small and medium scale enterprises (SMEs), which are usually more labor intensive than larger enterprises.

- The new investment code should not grant special reductions in tariffs beyond those defined in the new import tariff.

- Interest rate subsidies for investments outside the Cap Vert region might be limited to SMEs.

- The special agreements (conventions spéciales) should be suppressed.

Drafting a revised Investment Code applicable to new investments is an intellectual exercise that can be completed according to schedule without much strain. A more difficult nut to crack will be renegotiating existing special agreements (conventions spéciales) between the GOS and individual cmpanies that have been granted tax exonerations. The World Bank will be financing a study to define the terms of eventual renegotiation. The study will be carried out by an international consulting group, possibly in association with a local Senegalese consulting firm. The study is to be initiated in September 1986 and hopefully will present conclusions in December 1986.

We intend to include completion of revision of the Investment Code as a condition precedent to the third tranche of the AEPRP grant and progress on renegotiation of the special agreements as a covenant to the third tranche.

c. Direct Taxes

As a described in section II.D above, the Senegalese direct tax system contains different schedules for different sources of income with different rates of tax applied to each schedule:

- industrial and commercial income and agricultural income,

- non-commercial professional income,

- property income,

- witholding tax on wages and salary income.

The incomes distributed to individuals after the scheduled taxes are then submitted to the progressive general income tax which now contains 15 marginal tax brackets, the last 9 increasing the marginal rate by 5 percentage points with the top bracket taxed at 65 percent.

The draft revision of the Senegalese tax code prepared by the Ministry of Finance and published in April 1986 is now being distributed to business organizations, labor unions, women's organizations, accountants, bankers and international donors for their review. Comments by the "social partners" (and the donors) will be taken into account in preparing a final draft for submission to the national commission on tax reform. We have submitted some suggestions to the Tax Department for inclusion in this round. However, the process of revision is a continuing one and further amendments to the code will be issued from time to time. During the course of the AEPRP, we will work with the Ministry of Finance to bring about more fundamental changes in the structure of the direct tax system than are now planned by the GOS.

The operative principle of the direct tax reform proposed so far is to revise the regulations and to lower rates in order to rationalize the system, but without losing revenues. In this framework, the Ministry of Finance wants to carry out a step-by-step reduction in the maximum marginal rate of the general income tax to provide increased incentives to productive effort and then to see what happens to tax collections. The basic assumption is that better tax administration to expand the tax base will compensate for the reduction in tax revenues from people who are already paying taxes at the maximum marginal rate. However, this compensating effect will be far from immediate. The draft revision published in April 1986 introduces a new scale of taxable income and eliminates the 65 percent bracket, reducing the maximum marginal rate to 60 percent on incomes of 16.5 million CFAF ($47,000) and above. These changes would result in a revenue loss of CFAF 125 million ($357,000) if there were no adjustment of deductions for family size. Our view is that the maximum marginal rate should be reduced further and faster. The immediate result of reducing the maximum marginal rate to 55 percent would be a small further loss in revenue of some CFAF 2 million.

Unification of the several direct tax categories into a single schedule for taxation of physical persons (impôt sur le revenu des personnes physiques) is not included in the April 1986 proposed revision. Nor is it likely to be accepted within the present deadline (October 1986) for discussion and legislation of this round of revisions. However, changes in the tax code are legislated continuously; in fact the printed code is sold to the public in a 3-ring loose leaf binder to accommodate for subsequent changes. Introducing a major structural change of this sort has a number of implications for tax administration as well as tax incidence that need to be worked out carefully.

Our approach will be to propose maintaining in existence the GOS Tax Department's working group on tax reform and creation of a new tax reform commission whose mandate will be to examine the implications of transition to a global or unitary income tax and to come up with a new framework for the tax system. The objectives would be those of the present efforts of tax reform in the U.S.: simplification; equity; and a rationalization of the incentive system to achieve greater economic efficiency and growth. The process of a schedular to a global system has to be examined carefully. An initial degree of simplification can be achieved by pulling the rate structure together to get it on a common basis.

We will include further work by the Tax Department on a basic revision of the direct tax system as covenants for second and third tranche conditionality of the AEPRP cash transfer. We will reserve $1 million of the AEPRP for further studies and technical assistance, part of which will go for analysis of the impact of reforms we propose and for technical assistance on redrafting the code. We would like, by 1988, to get the working group on tax reform of the GOS Tax Department to prepare a preliminary draft of a further reform of the direct tax system embodying a major move toward a global income tax.

d. Fiscal cadaster

A fiscal cadaster is being carried out on a pilot basis in 6 of the better-off districts of Greater Dakar with assistance from the World Bank. If resources are available, the cadaster can be extended to all of Greater Dakar (Dakar and its Cap Vert suburbs) in two or three years. Despite legal ambiguities concerning property rights in the Cap Vert suburbs, the cadaster can also serve as an effective instrument for checking on otherwise unreported incomes of anonymous property owners. The World Bank is considering funding of the complete cadaster as part of its next Senegal urban projects loan. We will include evidence of progress on the cadaster in our third tranche conditionality.

C. Impact of Proposed Tax Reforms

The reform of the tariff code is intended in the first place to give the system greater internal consistency by reducing or eliminating situations of negative protection caused by higher protection on inputs than on outputs. By a general lowering of rates it is intended (a) to increase pressure on domestic firms to operate with greater efficiency and (b) to reduce the incentive for fraud and smuggling of imported goods.

The larger objective of the reform of the system of protection is to increase the flexibility of Senegalese industry and to encourage its progressive adaptation to the international and African regional economic environment. The immediate impact is likely to be a weeding out of some of the more inefficient lines of industrial activity and a closing down of parts of existing plant. Since the reduction in tariff protection is to be phased over two more years beyond July 1, 1986, industrialists will have some time to make needed changes; but the shock will still be severe.

The effect on capacity can be looked at in two ways: closing down of production lines implies either a reduction in capacity or a freeing-up of capacity for other uses. The New Industrial Policy package includes a proposal for making available credits for restructuring existing plants. Since the GOS does not have the resources for this purpose, it will presumably be funded out of a future World Bank industrial development loan now under discussion between the GOS and the World Bank.

The initial effect of lowering and harmonizing customs tariff rates and removing quantitative restrictions is likely to be a decrease in total customs receipts by the GOS. In the medium term, customs receipts should rise: as the incentive to smuggling and bribery are reduced, it will become cheaper to be honest than fraudulent. Reduced protection should also lead to greater efficiency of operation of the Senegalese economy as foreign competition forces local producers to become more efficient in their use of manpower, raw materials and equipment. However, reduced protection, particularly the removal of quantitative restrictions, is also likely (a) to force some existing modern sector enterprises into bankruptcy or greater efficiency, and (b) to benefit some informal sector enterprises that will be able to obtain their inputs more cheaply than now.

The revised investment code will be applicable only to new investments and to proposed renewals of exonerations whose initial time has expired. Renegotiating existing exonerations, which are contracts between individual firms and the State, is likely to be a painful and time consuming process.

The revisions of the direct tax code that we would like to see would (a) simplify tax administration, (b) lower tax rates to increase incentive to effort, (c) reduce the scope for evasion and bribery and thereby increase the tax base, and (d) increase equity in the imposition of taxes. The fiscal cadaster should facilitate identification of income earners now avoiding the tax net; it should also provide a firm base for property valuation that now does not exist. Our presumption is that there will be a short term fall in direct tax receipts which will be offset in the medium term by increased revenues resulting from reduced incentives to evade taxes and from improved tax administration. Also in the medium term, reducing tax rates should encourage formal sector economic activity which in turn should generate increased tax collections. It is also clear, however, that effective tax administration is a matter of political will as well as of administrative discipline. Our AEPRP is intended to bolster both of these.

D. Budget Support and Balance of Payments Implications

The $14 million cash transfer (CFAF 4.9 billion) of the $15 million AEPRP will at the same time provide direct support to the GOS budget and some relief to pressures on Senegal's balance of payments, particularly in view of the osmosis between Government budget transactions and balance of payments transactions in a member country of the (French) West African monetary union.

$10 million of this AEPRP grant are likely to be disbursed as a cash transfer during FY 87 if the conditions for release of the first two tranches are met. The third tranche of $4 million will carry over at least to FY 88. The GOS budget showed a global deficit on current operations and capital expenditures of CFAF 17.4 billion in 1985/86. The CFAF 3.5 billion equivalent of $10 million would help reduce the 1986/87 budget deficit. The AEPRP cash transfer will help cover GOS performance targets in the IMF's financial operations table (TOF) when disbursements are made, but we will not be linking releases to the IMF's timetable.

As indicated in Section II.A.2 above, Senegal's balance of payments, although still heavily in deficit, showed continued improvement in 1985/86. The prospects for 1986/87 are somewhat optimistic but the deficit will remain heavy. Release of $5 or 10 million of our AEPRP in 1986/87 would help reduce the burden.

## E. Implementation and Management Procedure

### 1. Financial Mechanisms

The AEPRP program provides $14.0 million for budgetary support in three tranches and $1.0 million to support implementation of the tax reform program. Following PAAD approval and signature of the Grant Agreement, and in anticipation of the fulfilment of conditions precedent, a Program Assistance Agreement Abstract will be prepared by the Africa Bureau and forwarded to FM/PAD (the accounting station) for entry into the Agency's records. This Abstract will serve as the obligating document until confirmed copies of the Agreement are received by FM/PAD. The Mission will prepare a Financing Request for a Cash Transfer signed by both the Mission Director and a representative of the Ministry of Finance. FM/PAD will schedule the payments through the Federal Reserve Electronic Funds Transfer System to the Central Bank (BCEAO) Account No. 001,174.5460 in the Chase-Manhattan Bank (CMB) in New York or such other account as designated by the GOS.

Once the deposits are made the BCEAO will, upon GOS request, create sums equivalent to the transferred $14.0 million in CFAF in the "depot du tresor auprès de la BCEAO/Senegal" at the Central Bank in Dakar. A written letter from the Director of USAID/Senegal to the Treasurer and the Central Bank will constitute Mission concurrence in the use of the funds and permit their release from this Special Account.

The $1.0 million fund will be retained by USAID/Senegal to finance direct contract study and technical assistance services. The funds will be available immediately following obligation and their use will be discussed with the GOS prior to subobligation. It is anticipated that the final disbursement date for use of these funds will be two years following the obligation date.

### 2. Local Currency Uses

Senegal has employed local currency budget support provided by A.I.D. in the period 1983-1986 primarily to meet its performamce criteria under the IMF Standby Agreement. These are inscribed in the Ministry of Finance's tableau d'operations financières (TOF) and the GOS and USAID jointly select from the TOF specific line items to be financed by local currency. The principal criteria for selection are that the local currency must both reduce Senegal's arrears and contribute to productivity and job creation. FY 1986 ESF funds were used, for example, to reduce GOS debt to the Senegalese private sector. These repayments also provided needed capital injections to companies, enabling them to continue or expand their business activity. USAID/Senegal expects to apply this same formula to determine use of the $14.0 million equivalent in local currency to be available under the AEPRP. In so doing the

AEPRP funds will help meet GOS budget shortfalls.

3. Audit Considerations

The Central Bank will provide its guarantee that AEPRP funds will be utilized only upon mutual agreement between AID and the GOS as to their use. Following release of funds from the Special Account, USAID will receive a copy of the transfer order showing to whom transfers were made.

Such books and records as are related to this activity will be audited regularly, in accordance with generally accepted auditing standards, and maintained for three years.

4. Implementation Schedule

| | Implementation Schedule | Timing | Action |
|---|---|---|---|
| 1. | AID/Washington authorizes PAAD. | August 86 | AID/W |
| 2. | Letter sent to Central Bank asking them to block account pending USAID/DIR letter authorizing release of funds. | August 86 | ECU |
| 3. | Grant Program Assistance Agreement (GPAA) finalized in French and English. | August 86 | PRM |
| 4. | GPAA signed by USG and GOS. | Aug-Sept 86 | PRM |
| 5. | Financing request prepared (PRM) and signed by GOS (ECU). | September 86 | PRM/ECU |
| 6. | All CP's are satisfied for first (and subsequent) disbursements. | Sept-Oct 86 | ECU |
| 7. | Financing request countersigned by USAID/DIR. | Oct 86 | PRM |
| 8. | Telephone AFR/PD/SWAP to advise that all documents are signed. | Oct 86 | PRM |
| 9. | Financing request cabled to AID/W. | Oct 86 | PRM |
| 10. | Funds transferred from U.S. Treasury to BCEAO Account at Chase Manhattan. | Oct 86 | AID/W(FM) |
| 11. | Telephone confirmation of transfer (AID/W and BCEAO). | Oct 86 | ECU |
| 12. | Mission Director authorizes Central Bank by letter to release funds from blocked account. | Oct 86 | ECU |
| 13. | USAID receives copy of transfer order to confirm that funds were allocated as agreed. | Oct 86 | ECU |

Steps 5 through 13 will be repeated for the second and third tranches.

| | | | |
|---|---|---|---|
| 14. | Limited Scope Grant Agreement (LSGA) finalized in French and English. | August 86 | PRM |
| 15. | LSGA signed by USG and GOS. | August 86 | PRM |
| 16. | Technical assistance negotiated by USAID. | Oct-Nov 86 | PRM |

5. Mission Management

The direction and implementation of this program are the responsibility of the Program Office and its Economic Unit.

6. Waivers

It is conceivable that the needed expertise, experience and relevant French language facility may not be available in the U.S. If needed, the Mission will seek a nationality waiver for supply of services.

F. Conditionality

In addition to the standard conditions precedent (legal opinion, specimen of signatures, and designation of authorized representatives), the following conditions precedent and covenants will in substance be included in the Program Grant Agreement. The covenants to the third tranche will be the basis for formulation of conditions precedent to an eventual follow-on AEPRP grant.

1. First Tranche Conditionality: Conditions Precedent

Prior to release of the first tranche of $5 million, the GOS will provide evidence of:

(i) the announcement by the GOS of the first round of reduced customs tariff rates scheduled for July 1, 1986 (garbled details were published in Le Soleil of July 4, 1986);

(ii) adoption by the National Assembly of the new customs tariff code scheduled for July 1986;

(iii) publication of regulations implementing removal of quantitative restrictions on the importation of selected products scheduled for July 1, 1986 and October 1, 1986.

2. Second Tranche Conditionality

a. Conditions Precedent

Prior to release of the second tranche of $5 million, the GOS will provide evidence of:

(i) the announcement by the GOS of the second round of reduced customs tariff rates scheduled for July 1, 1987;

(ii) the implementation of previously announced regulations removing quantitative restrictions on the importation of selected products and publication of regulations implementing removal of quantitative restrictions on additional products scheduled for January 1, March 1, and July 1, 1987;

(iii) that the GOS Tax Department's working group on tax reform remains in existence after adoption of the revised General Tax Code by the National Assembly and has a plan for studies on further possible reforms of the direct tax system, including especially transition to a global or unitary income tax and further reduction in the maximum marginal rate.

3. Third Tranche Conditionality

a. Conditions Precedent

Prior to release of the third tranche of $4 million, the GOS will provide evidence of:

(i) the announcement by the GOS of the third round of reduced rates scheduled for July 1, 1988;

(ii) the implementation of previously announced regulations removing quantitative restrictions on the importation of selected products and publication of regulations implementing removal of quantitative restrictions on additional products scheduled for January 1, 1988;

(iii) publication of a new Investment Code compatible with the announced and planned reductions in customs tariff rates; and

(iv) that the working group on tax reform of the GOS Tax Department will prepare a preliminary draft, acceptable to A.I.D., of a further reform of the direct tax system embodying a transition to a global income tax, reduction in the maximum marginal rate or rates, and simplification of the system.

b. Covenants

(i) The GOS will report on progress in renegotiation of special agreements (conventions spéciales) granted under the present Investment Code.

(ii) The GOS will provide to USAID/Senegal evidence of progress in carrying out the fiscal cadaster for the Dakar-Cap Vert region, evidence that the cadaster is being used to improve collection of property taxes on real estate and of income taxes on property income from real estate, and evidence that a more realistic rate schedule is being applied.

G. Feasibility of Timing

Import tariff reform and removal of quantitative restrictions are areas of intersecting interest to ourselves and the World Bank as a part of two broader programs: the industrial incentives component of the World Bank's Structural Adjustment Program (see section I.C. above); and our own concern with all the elements of tax reform. In that area of intersecting interest, our AEPRP conditionality will pick up where the World Bank's SAC-II conditionality stops.

The timetable for reform of the customs code and the customs tariff schedule was set in the World Bank's SAC-II development policy letter in 1985. The timetable for removal of quantitative restrictions was established in negotiations between the World Bank and the GOS and presented in the Action Plan for Industry issued by the Ministry of Industry on July 1, 1986. The timing for fulfilment of some of the conditions precedent to release of each of the three tranches of this AEPRP grant depends on these two timetables.

With respect to our covenants, reform of the Investment Code should be worked out by the GOS and the World Bank over the next 6-9 months, i.e. by March 1987 at the latest. A timetable for renegotiating existing special agreements will also emerge from the GOS-World Bank discussions. We expect to be able to formulate and to negotiate out a basic reform of the direct tax system with the GOS over the next 18-24 months, facilitated by technical assistance from U.S. and IMF tax experts.

## H. Technical Assistance and Evaluation

As noted several times above, the World Bank is already providing technical assistance on customs tariff reform, revision of the Investment Code, and the fiscal cadaster. The IMF will be providing technical assistance on tax administration, particularly in the direct tax field. USAID/Senegal will be funding a training program for the Tax Department to be implemented by the IRS under the Technology Transfer project.

Under the AEPRP grant, USAID/Senegal will earmark up to $1 million to finance studies and technical assistance on (a) a major revision of the direct tax component of the General Tax Code, and (b) evaluation of (i) the effects of tax reforms on tax administration and tax collections and (ii) the impact of the tariff reductions and elimination of quantitative restrictions on the economy.

### 1. Studies and Technical Assistance on Direct Tax Reform

The following are some of the detailed aspects of reform of the direct tax system that need to be examined before proposing a major re-draft of the tax code:

- transition from a schedular to a global income tax;

- international aspects of taxation of company incomes (e.g. transfer pricing; royalties);

- real estate property taxes, in conjunction with extension of the fiscal cadaster.

We propose to contract with a U.S. source of tax expertise (a) to carry out studies on these and other aspects of direct tax reform that we have not yet identified and (b) to provide technical assistance to the Tax Department (Direction Générale des Impôts et Domaines) on redrafting the General Tax Code. We may need a nationality waiver to find a tax expert with the requisite French language legal drafting skills. We intend to collaborate with the Legal Department of the IMF on this activity.

## 2. Monitoring and Evaluation Plan

This component of the program will (a) monitor program outputs (e.g. of the working group on tax reform) and (b) monitor and evaluate impacts of the tax reforms. The substantive aim of the impact monitoring and evaluation component of this AEPRP grant is to identify and assess the fiscal and economic effects of the several components of the tax reform program, and particularly the package related to reduction in protection through lowering customs tariffs, removing quantitative restrictions, revising the investment code and renegotiating the special agreements. In addition, we will be monitoring implementation of the regulations related to direct tax reform and progress on the fiscal cadaster.

An initial set of evaluation indicators to be tracked includes: (a) changes in levels and composition of government revenues; (b) changes in the composition of imports, (c) changes in types of imported or locally produced inputs in Senegalese production, and (d) changes in the levels and composition of value added, employment, and investment in manufacturing.

Evaluation of the long-run effects of the tax reform program will extend beyond the lifetime of this AEPRP grant. The time frame for the monitoring and evaluation program internal to the program is the following:

- Early in FY 1988, before disbursement of the third tranche, a mid-term in-house routine evaluation will be made to assess progress made toward achievement of program objectives, to identify problems and to make recommendations for solving these problems. Initial examination will be made of data on tax collections, import taxes as a percentage of the value of recorded imports, and tax buoyancy in relation to changes in GDP.

- In FY 1989, approximately six months prior to the end of the program, an interim lessons-learned evaluation will be conducted by outside evaluators, focusing on assessment of (a) progress in, and the effects of, reducing protection against imports, and (b) progress on direct tax reform and the fiscal cadaster. The evaluation will develop specific recommendations for a follow-on policy reform program if that seems warranted.

Data for the evaluations will be obtained from:

- the GOS follow-up commission (comité de suivi) on the Medium and Long Term Development Program;

- the unit in the Ministry of Industry and Handicrafts that will be following up aspects of the new industrial policy, including changes in customs tariffs, quantitative restrictions and the Investment Code;

- the Tax Department of the Ministry of Finance;

- the standard sources of statistical data.

The Program Office of USAID/Senegal and its Economic Unit will be responsible for monitoring and evaluation. We intend to contract through IQCs early in the program for an evaluation specialist to design the evaluation program and for an economist to identify, with the Ministry of Industry, the impact indicators, base line data and the data to be collected for monitoring the effects of the customs tariff reforms, as well as the methods to be used for collection and analysis.

By December 1986, the Program Office and the Economic Unit will have sufficient staff (a U.S. direct hire economist, a U.S. contract economist, and two Senegalese economists) to deal with the routine monitoring of the tax program and its quantitative effects on a current (e.g. quarterly) basis.

3. Indicative Budget for Technical Assistance and Evaluation

We propose the following as an indicative budget for the technical assistance and evaluation components of the program:

| | $ '000 |
|---|---|
| Studies on special aspects of direct tax reform | 250 |
| Technical assistance to Tax Department on redrafting General Tax Code | 300 |
| Establishment of analytical and statistical basis for evaluation of economic impact of import tariff reductions and removal of quantitative restrictions | 100 |
| Evaluations | 200 |
| Other | 150 |
| TOTAL | 1,000 |

It is reasonable to expect that the economic impacts will take some time beyond the life-of-project of this AEPRP to work themselves out. Provision should be made in future Mission and AID/W evaluation plans for funding an ex-post economic impact evaluation in FY 1991.

## Annex A. Senegal's Fiscal Performance 1/

### 1. General Characteristics of Fiscal Performance

There has been a marked deterioration in Senegal's fiscal performance from the 1970s to the 1980s. As shown in Table A.1, the value of the marginal propensity to tax from income declined substantially from 0.235 for 1968-1978 to 0.160 for 1979-1983. The marginal propensities declined for both direct and indirect taxes but the proportionate decline is greater for direct taxes. The marginal propensity for direct taxes is one-third to one-fifth for indirect taxes reflecting the preponderant share of indirect taxes in total tax revenue.

Income elasticity calculations, which indicate the sensitivity of tax revenue to changes in income, reveal a dramatic decline for direct and indirect taxes between 1968-1978 and 1979-1983. For both periods, the income elasticity of direct taxes is lower than the income elasticity of indirect taxes. The usual expectation is that there will be increasing reliance on direct taxes as an economy develops and allows governments to tap the additional revenue potential generated by rising incomes. The lower income elasticity of direct taxes in Senegal's case is explained by (a) administrative difficulties experienced in the process of collecting income and property taxes and (b) the relatively regressive incidence of income tax which is collected primarily from lower income, salaried workers (e.g. civil servants and workers in the modern sector). Taxation on professional income, capital income and real estate capital gains is extremely sparse. The above tendency appears to have been accentuated since 1979 as indicated by a sharp decline in the income elasticity of direct taxes from 1.036 in 1968-1978 to 0.446 in 1979-1983. A similar but more modest decline in the income elasticity of indirect taxes was also registered over these two periods.

Additional detail on the specific behavior of certain categories of taxes is presented in Table A.2. Direct taxes as a percentage of GDP have declined steadily from a high of 6.0 percent in 1979/80 to a low of 4.6 percent in 1984/85. A similar pattern can be discerned for indirect taxes but there have been both declines and subsequent increases in the indirect tax ratio, and different categories of indirect taxes have experienced radically different trends. Export duties as a percentage of total exports have declined markedly between 1979/80 and 1984/85 reflecting the Government's decision to suspend export duties on groundnut products in 1982 and the relative stagnation or decline in the share of phosphates in total exports which is the only export that continues to be subject to a duty. Similarly, excise taxes as a percent of GDP have declined steadily over the period. The decline may be explained partially by the fact that the Government is progressively shifting from excise taxes in favor of ad valorem taxes and by the perverse impact of rate increases for kola nuts and alcoholic beverages. Import duties, on the other hand, with the exception of the extremely favourable results registered in 1979/80, have remained about the same percentage of the value of total imports

1/ Excerpted and edited from a paper by Jacqueline Damon, Fiscal Policy in Senegal, May 1, 1986.

TABLE A.1

## SENEGAL: PARAMETERS WITH RESPECT TO TAX REVENUE

| | 1968-1983 | 1968-1978 | 1979-1983 |
|---|---|---|---|
| 1. Marginal Propensity to tax from income a/ | | | |
| - Total tax revenue | 0.222 | 0.235 | 0.160 |
| - Direct taxes | 0.048 | 0.046 | 0.024 |
| - Indirect taxes | 0.151 | 0.167 | 0.123 |
| 2. Income elasticity of tax revenue b/ | | | |
| - Total tax revenue | 1.163 | 1.228 | 0.756 |
| - Direct taxes | 1.088 | 1.036 | 0.446 |
| - Indirect taxes | 1.162 | 1.262 | 0.877 |

a/ Increase in tax divided by increase in income.
b/ Rate of increase in tax divided by rate of increase in income.

TABLE A.2

## SENEGAL: PUBLIC FINANCE INDICATORS
(In Percent)

| | 1979/80 | 1980/81 | 1981/82 | 1982/83 | 1983/84 | 1984/85 |
|---|---|---|---|---|---|---|
| 1. Tax revenue as percent of total expenditure | 74.6 | 57.2 | 64.2 | 64.7 | 70.2 | 74.3 |
| 2. Import duties as percent of total imports | 27.5 | 21.0 | 21.6 | 22.4 | 22.2 | 21.3 |
| 3. Export duties as percent of total exports | 2.6 | 1.2 | 0.8 | 0.6 | 0.3 | 0.2 |
| 4. Excise taxes as percent of GDP | 2.6 | 2.1 | 1.7 | 1.5 | 0.8 | 0.6 |
| 5. Direct taxes as percent of GDP | 6.0 | 5.4 | 4.9 | 4.8 | 4.8 | 4.6 |
| 6. Indirect taxes as percent of GDP | 15.6 | 12.8 | 13.5 | 13.6 | 13.2 | 12.4 |

varying only between 21.0 percent and 22.4 percent. This relative stagnation should be viewed in the context of considerable increases in rates over the same period.

The detailed structure of Senegal's tax revenue and its evolution over the past six years is set out in Table A.3, which highlights the continued reliance on indirect taxes for government revenue throughout the period under examination. On average indirect taxes accounted for 73 percent of total tax revenue while direct taxes accounted for only 27 percent. The single most important category of taxes is taxes on foreign trade followed by taxes on the consumption of goods and services. In third place are taxes on income and profits which represented approximately 24 percent of total tax revenue and 85 percent of revenue from direct taxes.

As shown in Table A.3, tax revenue (excluding non-fiscal receipts) as a percentage of GDP declined abruptly between 1979/80 and 1980/81, increased marginally in 1981/82 and declined over the two fiscal years 1983/84 and 1984/85. The decline has been most pronounced for taxes on income and profits and for taxes on goods and services; however, taxes on foreign trade have also declined as a percentage of GDP. The share of the employer's payroll tax and taxes on rental income increased marginally but neither tax is a significant revenue generator. The tax on rental income, which was introduced in 1981, is only now bringing in modest receipts but the yield continues to remain substantially below the potential offered by Dakar's thriving rental market.

2. Taxation on Consumption and Foreign Trade

Senegal has three types of taxes on consumption: (1) a value-added tax on goods (TVA) and on the provision of services (TPS); (2) excise taxes; and (3) a stamp tax required on all receipts for sales of goods and provision of services. The value-added tax on goods has four separate rates which are levied on the value added in manufacturing, crafts and other productive activities with the exception of agricultural production and salaried activities. Wholesale and retail trade are excluded. The tax is applied to domestic production and imports equally. 1/ As would be expected nominal rates are highest for luxury goods (50 percent) following by petroleum products other than crude oil imports and fuel oil (34 percent) and the normal rate on most goods is 20 percent. A special reduced rate of 7 percent is utilized for essential products such as basic consumer staples and fuel oils. Imports and sales of products for the Government are exempt as well as goods for export. Services are also taxed at different rates ranging from 50 percent for certain financial transactions to 7 percent for sports and cultural events and services of doctors and lawyers. Owing to the administrative difficulties inherent in the application of the TVA on retail sales to a large number of small traders and shops, Senegal's TVA is essentially a manufacturer-importer sales tax.

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1/ For specifics, see Annex entitled Summary of the Tax System in 1985, in IMF, Senegal - Recent Economic Developments, March 1986.

Government policy with respect to the TVA and TPS since 1980 has been characterized by a general extension of the coverage of such taxes and some increases in rates. Movement in this direction appears adviseable as domestic value-added by industries and commercial enterprises takes on greater importance. According to a recent IMF publication on Taxation in Sub-Saharan Africa, the value added tax is the "best option for promoting neutrality and uniformity of the tax burden while providing incentives for increased productivity and industrialization." 1/ Also, greater reliance on the TVA should, in principle, increase the elasticity of revenue as compared to the use of specific rates as in the context of excise taxes.

In spite of the advantages of using value-added taxes to generate revenue without creating distortions the use of excise taxes may be a more efficient means of promoting equity if they are concentrated on specific luxury items. Excise taxes are levied on all raw or processed tobacco products, alcoholic beverages, edible oils, soft drinks, kola nuts, tea, coffee and cement. Judging from the products subject to excise tax these taxes are likely to be regressive in nature because of the heavy emphasis on the taxation of mass consumption goods such as edible oils, soft drinks, kola nuts, tea, coffee and cement. Nevertheless, in view of the relative simplicity of administration of excise taxes in comparison to the value added-tax, which requires a certain degree of sophistication since valuation is essential, continued but limited use of excise taxes for revenue generation can be justified. At any rate, revenue from excise taxes, particularly since the tax on petroleum products has been converted into a value added-tax, is only a very modest share of revenue generated from the taxation of consumption. The elasticity of revenue from consumption taxes with respect to private consumption is relatively high (1.53) suggesting that the Government policy of shifting emphasis to the value added-tax, at least from a revenue prespective, is an appropriate one.

Taxes on foreign trade are the single largest source of revenue for the Government and have been utilized to achieve two objectives which are not necessarily always mutually compatible: (1) protection of domestically produced goods and (2) revenue generation. Excessively high rates, which may be motivated by a desire to protect domestic industry, not only create distortions in domestic resource allocation but also lead to an erosion of the tax base by increasing the incentive for tax evasion. Senegal has a three-tier taxation system on imports comprised of a customs duty, a fiscal duty, and the value-added tax described above. Government policy has been to increase tax rates as a means of discouraging imports, and there have been five rate increases in the past seven years. Customs duties are levied on the c.i.f. value or the standard value of imports. A minimum tariff of 15 percent is applicable to goods originating in countries enjoying most-favored-nation status while a general tariff of 45 percent is applied to other countries. As Senegal is a member of the West African Economic Community (WAEC) and the Economic Community of West African States (ECOWAS) it also has lower, special tariffs for goods originating from other countries participating in these regional organizations.

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1/ IMF Staff, Taxation in Sub-Saharan Africa, Occasional Paper 8, October 1981, p. 17.

There are four different ad valorem rates for the fiscal duty depending on the type of import. Raw materials and capital goods are taxed at 10 percent of their c.i.f. value, semi-finished products and noncompeting finished products at 40 percent, luxury products at 50 percent and competing finished products at 75 percent. Essential foodstuffs, medical supplies, boats and airplanes are exempt; however, the number of exemptions is considerably lower than for the customs duty. Recent increases in the rates applied for customs and fiscal duties have considerably accentuated the problems traditionally associated with the administration of foreign trade taxes.

The fact that the percentage of import taxes to the value of total imports has remained constant despite considerable increases in rates can only be explained by an erosion of the tax base. One means by which importers have dealt with increased rates is by consistently undervaluing imports which is facilitated by the fact that customs declarations are not computerized and that officials tend to rely on arbitrarily assigned price lists to value imports. Furthermore the customs administration is complicated by the proliferation of duties and taxes and is handicapped by the problem of inadequately trained personnel, insufficient incentives to personnel and inadequate physical plant such as warehousing. The tax base has been legally eroded as a result of legal exemptions or tax incentives provided under the investment code. Goods imported under Government contracts, aid-financed imports and food aid are also exempt. Thus for FY 1983/84 alone it is estimated that the Government granted exonerations and exemptions which led to a loss of CFAF 109 billion in revenue or 148 percent of duties actually collected for that year. Temptation has also been great to use ad hoc tax exonerations as a means of providing implicit subsidies to inefficient parastatals such as the oil millers (SONACOS, SEIB), ONCAD and more recently the CPSP on rice imports. In acknowledgement of the recent problems experienced with foreign trade taxes the Government has decided to reduce tax rates substantially (by as much as 100 percent) and to take steps to strengthen customs administration including the computerization of customs declarations.

3. Taxation on the Agricultural and Modern Sectors

The level of the tax burden on agriculture has become negligeable since the groundnut sector has moved into deficit and the Government has (1) ceased taxing the sector through the CPSP; (2) suspended export duties on groundnuts; and (3) eliminated withholding on marketing proceeds from groundnuts. Normally agricultural profits are subject to a general profits tax; however, it is no longer applied. Although Senegal has property taxes they do not apply to rural land. While agriculture per se contributes little tax revenue there are a number of taxes whose incidence falls particularly heavily on the rural population; these are: (1) the poll tax on all individuals over 14 years of age who are non-salaried workers; (2) excise taxes on mass consumer items; and (3) business license fees paid by small traders operating in rural markets. Collection of the poll tax and the license fees is primarily the responsibility of local government.

The major focus of taxes on property and income has been the modern sector which is affected by an impressive range of different taxes. A general problem with this category of tax has been the substantial discrepancies between legal and actual tax bases. Salaried workers and civil servants in particular appear to be most seriously affected while professional income has proved difficult to identify and tax. Equity may also be jeopardized as a result of the use of a relatively large number of schedular income taxes which apply different marginal rates to various sources of income. There are six schedular income taxes on: (1) businesses' and individuals' net income or profits on industrial commercial and agricultural activities (maximum rate 28 percent); (2) professional income (maximum rate 28 percent); (3) wages and salaries (maximum rate 10 percent); (4) capital income (maximum rate 25 percent); (5) rental income (maximum rate for residents 20 percent) and (6) real estate capital gains (15 percent). 1/ In addition to the schedular taxes there is a general income tax with a maximum marginal rate of 65 percent. Although there are no exemptions, deductions are allowed for interest on loans and debts, schedular taxes paid, contributions to a retirement fund, life insurance premiums and 10 percent of reinvested profits.

Taxes on income are characterized by a number of problems which may explain the comparatively low yield on these taxes with respect to their potential. First, the large number of schedular taxes is complex to administer and causes difficulties in monitoring of tax payers as there is no consolidated tax form which must be submitted annually. Second, problems in identifying tax payers other than salaried employees and the practice of withholding on wages and salaries create a de facto tax bias against employees. Third, the traditional African family structure and division of financial responsibilities within the extended family make it difficult to define the tax paying unit. Polygamy is a particular source of confusion and conflict with respect to tax liability and more importantly the number of tax deductions that can be claimed. Deductions are based on the French system of the family quotient or income shares. Taxable income is divided into a number of shares based on family size, with one share for each adult and one-half share for each child up to a maximum of five shares. Each share is taxed separately so that the system significantly reduces effective tax rates on large families with incomes falling in higher brackets. 2/

The Government is currently in the process of proposing some reforms in direct taxes both in order to increase the income elasticity of the tax, currently estimated to be 0.60, and to improve the equity of the system. One proposed reform which has been under discussion is the possibility of progressively replacing the relatively large number of schedular taxes with one general progressive income tax. Other reforms currently under consideration are: (1) the need to revise business licensing which in fact taxes businesses up front before they have begun operations and the minimum business tax on small businesses which applies a flat rate of CFAF 400,000 payable in advance and deductible from any additional liability under the profits tax but which is not refundable if no profits taxes are paid; (2) the

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1/ IMF, Senegal Recent Economic Developments, March 1986.

2/ IMF Staff. Taxation in Sub-Saharan Africa, op. cit., p. 29.

need to redefine the concept of the tax household and to review the current practice of income splits; (3) the advisability of reassessing the rates at which fringe benefits are evaluated for tax purposes to reflect their real value more fully; and (4) the necessity for a general revision of tax brackets and rates to correspond more accurately to the structure of income distribution in Senegal.

In the continental tradition revenue from property taxes is derived primarily from duties paid in order to register land and/or to transfer land rather than from real estate taxes. Thus Table A.3 shows an increasing tendency to rely on registration duties to generate revenue in this category. There are three different types of real estate tax in addition to registration duties and death duties but all of them relate exclusively to urban land. The first is a tax on buildings which is levied on the rental value of all built-up land including factories. There are, however, extensive exemptions. These include government property and property used for religious worship and/or educational purposes. New buildings (irrespective of type) are exempted for the first ten years. Furthermore there is an allowable deduction of 40 percent for houses and 50 percent for factories from the rental value of the property in lieu of maintenance expenses. For owner-occupied properties the rate is 30 percent on the presumptive rental value as determined by the tax authorities; and for properties subject to the schedular rental income tax or properties owned by businesses the rate is 15 percent. The 10-year exemption on new buildings seriously erodes the potential base and partially explains why property taxes yield very little revenue despite a thriving construction industry.

There are two other property taxes, one on unimproved property and one on unimproved or insufficiently improved urban land. Deductions and exemptions for the tax on unimproved property are the same as for the tax on buildings; however, the rate is set at 5 percent of the presumptive market value of the property. The rate on unimproved urban land, levied annually, varies progressively from 0.75 percent to 2.75 percent of the presumptive market value of the property. Deductions and exemptions allowable on unimproved urban property erode the potential tax base while the relatively low rates on unimproved land can encourage land speculation.

Property taxes warrant the detailed attention of tax specialists. Potential yields are considerable and property taxation is probably the most effective means of taxing income that now escapes taxation as a result of the difficulty involved in identifying non-salaried income. Furthermore, considerable capital generated from the informal sector is invested in real estate. Current exemptions for owner-occupied dwellings or recently constructed buildings promote inequity and the misallocation of resources as higher-income individuals who invest in real estate pay virtually no tax. Administrative difficulties are complicated by a 1976 law which authorizes only the Government to own land which it provides to individuals on a long-term lease basis (and leasing fees are rarely paid). The lack of land titles makes it difficult to establish a fiscal cadaster and to monitor changes in ownership of buildings. A recent IMF study suggests that considerable revenue could be generated and that administration of property taxes could be facilitated if the Government agreed to auction land titles to

TABLE A.3

SENEGAL: STRUCTURE OF TAX REVENUE FY 1979/80 - FY 1984/85
(Amounts in Billions of CFAF)

| | 1979/80 | | 1980/81 | | 1981/82 | | 1982/83 | | 1983/84 | | 1984/85 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Amount | Percent of GPD | Amount | Percent of GDP | Amount | Percent of GDP | Amount | Percent of GDP | Amount | Percent of GDP | Amount | Percent of GDP |
| 1. Taxes on Income and Profits | 31.1 | 5.1 | 29.4 | 4.5 | 32.0 | 4.2 | 36.7 | 4.1 | 40.[illegible] | 4.1 | 43.9 | 3.9 |
| a. Corporate profit tax and tax on professional income | 11.2 | 1.9 | 10.3 | 1.6 | 8.9 | 1.2 | 9.8 | 1.1 | 10.6 | 1.1 | 13.2 | 1.2 |
| b. Tax on wages and salaries | 8.8 | 1.4 | 8.4 | 1.3 | 12.6 | 1.7 | 11.9 | 1.3 | 12.3 | 1.25 | 13.0 | 1.2 |
| c. Tax on capital income | 2.7 | 0.4 | 2.8 | 0.38 | 2.1 | 0.29 | 2.6 | 0.29 | 3.2 | 0.33 | 3.6 | 0.3 |
| d. Tax on rental income | - | - | - | - | - | - | - | - | 0.2 | 0.02 | 0.3 | 0.03 |
| e. Tax on real estate capital gains | 0.2 | 0.03 | 0.1 | 0.02 | 0.1 | 0.01 | 0.2 | 0.01 | 0.2 | 0.02 | 0.2 | 0.02 |
| f. General income tax | 8.2 | 1.37 | 7.8 | 1.2 | 8.3 | 1.0 | 12.2 | 1.4 | 13.6 | 1.38 | 13.6 | 1.15 |
| 2. Employers' payroll tax | 2.1 | 0.35 | 2.1 | 0.3 | 1.6 | 0.25 | 3.8 | 0.4 | 4.3 | 0.4 | 4.5 | 0.4 |
| 3. Taxes on property | 3.3 | 0.55 | 3.9 | 0.6 | 3.4 | 0.45 | 2.8 | 0.3 | 2.8 | 0.3 | 2.8 | 0.25 |
| a. Real estate taxes | 1.3 | 0.21 | 1.4 | 0.2 | 1.3 | 0.17 | 0.5 | 0.04 | 0.2 | 0.03 | 0.3 | 0.02 |
| b. Registration duties | 1.9 | 0.32 | 2.1 | 0.3 | 1.9 | 0.25 | 2.2 | 0.25 | 2.5 | 0.26 | 2.4 | 0.21 |
| c. Mortgage duties | 0.1 | 0.02 | 0.4 | 0.1 | 0.2 | 0.03 | 0.1 | 0.01 | 0.1 | 0.01 | 0.4 | 0.02 |
| 4. Taxes on goods and services | 40.1 | 6.6 | 36.6 | 5.6 | 41.0 | 5.4 | 48.8 | 5.5 | 54.2 | 5.5 | 58.2 | 5.2 |
| a. Value added and services | 21.5 | 3.6 | 20.7 | 3.2 | 25.9 | 3.4 | 32.9 | 3.7 | 43.6 | 4.45 | 48.0 | 4.3 |
| b. Specific tax (1) on petroleum pdts | 9.3 | 1.5 | 7.8 | 1.2 | 7.1 | 0.94 | 6.2 | 0.7 | - | - | - | - |
| c. Other excises | 4.5 | 0.7 | 3.9 | 0.6 | 3.7 | 0.49 | 4.2 | 0.47 | 5.1 | 0.52 | 4.3 | 0.38 |
| d. Tax on insurance contracts | 1.0 | 0.17 | 0.8 | 0.1 | 0.9 | 0.12 | 1.3 | 0.16 | 1.2 | 0.11 | 1.4 | 0.13 |
| e. Tax on vehicles | 1.1 | 0.18 | 1.2 | 0.18 | 1.1 | 0.15 | 1.2 | 0.13 | 1.2 | 0.11 | 1.6 | 0.14 |
| f. Business license fees | 0.1 | 0.02 | 0.1 | 0.02 | - | - | - | - | - | - | - | - |
| g. Tax on arms | - | - | - | - | - | - | - | - | - | - | - | - |
| h. Taxes on alcohol and cement | 2.6 | 0.43 | 2.1 | 0.3 | 2.3 | 0.30 | 3.0 | 0.34 | 3.1 | 0.31 | 2.9 | 0.25 |
| 5. Taxes on foreign trade | 52.6 | 8.7 | 44.6 | 6.9 | 60.6 | 8.0 | 71.2 | 8.0 | 74.2 | 7.6 | 79.0 | 7.1 |
| a. Import duties | 49.8 | 8.2 | 43.1 | 6.6 | 59.3 | 7.8 | 70.1(2) | 7.85 | 73.5(2) | 7.5 | 78.5(2) | 7.06 |
| b. Customs duty | 3.3 | 0.5 | 7.9 | 1.2 | 15.5 | 2.01 | | | | | | |
| c. Fiscal duty | 19.6 | 3.2 | 18.7 | 2.9 | 22.6 | 3.0 | | | | | | |
| d. Value added tax | 23.9 | 4.0 | 14.3 | 2.2 | 18.8 | 2.5 | | | | | | |
| e. Regional coop. tax | 0.1 | 0.02 | 0.3 | 0.04 | 0.2 | 0.03 | | | | | | |
| f. Other | 2.9 | 0.48 | 1.9 | 0.26 | 2.2 | 0.26 | | | | | | |
| g. Export duties | 2.8 | 0.5 | 1.5 | 0.3 | 1.3 | 0.2 | 1.1 | 0.15 | 0.7 | 0.1 | 0.5 | 0.04 |
| 6. Other taxes (3) | 1.6 | 0.3 | 1.6 | 0.3 | 1.1 | 0.1 | 1.2 | 0.1 | 1.4 | 0.1 | 1.7 | 0.15 |
| 7. Total Tax Revenue | 130.8 | 21.6 | 118.2 | 18.2 | 139.7 | 18.4 | 164.5 | 18.4 | 177.2 | 18.0 | 190.1 | 17.0 |

Source: Projections Department, Ministry of Finance.
(1) The specific tax on petroleum products was replaced by a value-added tax in 1983/84.
(2) Breakdown is not available
(3) Including stamp duties.

property owners. 1/ Other recommendations include the establishment of a fiscal cadaster and modification of the exemption system.

1/ IMF, Sénégal - Aide Mémoire portant sur l'amélioration de l'assiette, du contrôle et du recouvrement des impôts et des droits et taxes de douane, July 1985, p. 6.

## Annex B

### Note on the Proposed Reform of the Senegalese Direct Tax system in Senegal (1986) (*)

This paper will first present our major observations on the draft reform, then our recommendations and proposals.

## 1 - EVALUATION OF THE PROPOSED REFORM

The reform proposals can be characterized both by what they do not include and what they do include.

### 1.1 The lack of a major reform of the income tax

The team does not feel that the lack of a major income tax reform is likely to hinder the attainment of the objectives that the GOS wants to achieve by adjusting the present tax system.

Indeed, an immediate reform towards a unitary and global income tax would have, for the time being, more disadvantages than advantages (see infra, conclusions and proposals). Such a reform should be the culmination of a process (which can be set into motion quickly) rather than a starting point or a prerequisite to any change.

The maintenance of a schedular tax system is thus quite defendable, which does in no way mean that this system cannot be improved (cf. infra, proposals).

### 1.2 - Proposed adjustments of the existing system

The draft text was evaluated both for form and substance (technical feasibility and eventual consequences of the proposed arrangements in the social and economic field).

(*) This note summarizes the major observations contained in the report prepared at USAID request by the University of Clermont Ferrand I, Centre d'Etudes et de Recherches sur le Développement International (CERDI) team on the Senegal direct taxation reform (volume I of the draft revised tax code, text available as of 4/7/86). The team consisted of MM Jean Aulagnier, Dean of the Faculty of Economics of Clermont Ferrand University, Gérard Chambas, Research Fellow at CNRS, Jean-Francois Petavy, Professor at the Ecole Nationale des Impôts and Jean-Marie Serre, Associate Professor, Team Leader. The views are those of the team, and do not coincide with those of USAID/Senegal.

1.2.1 - Observations on form

Several sections seem ambiguous or incomplete. It seems also that some sections of the current General Tax Code have been transferred into the draft reform without due consideration of the new context resulting from the reform (these various items are addressed in chapter 2 of the report).

1.2.2 - Comments on substance

These focus on the technical "feasibility" of the proposed arrangements, notably on their budgetary, economic and social impact.

A - Technical "feasibility"

As the reform is limited in scope, it will not a priori be faced with problems that cannot be resolved. However, some of the measures contemplated are relevant only if they are concurrent with an increase or a redistribution of the resources of the agency; on the other hand, some of the proposed arrangements can complicate or even burden the functions of the services without necessarily increasing tax efficiency.

a - Measures likely to require an increase or redeployment of the resources of the services

* For the tax on non commmercial professional income above CFAF 20 million, the transition from the system of administrative evaluation or "the lump sum tax" (forfait) to the controlled tax return or "the real tax" will result in gains for the State only if an effective control system is established. Experience elsewhere shows that if this condition is not met, the change in the system can result paradoxically in tax losses.

* Some decreases in the tax rates proposed by the Tax Reform Commission will result in the intended stimulative or selective effect only if the relevant tax receipts exceed a given critical threshold (otherwise the operation will result in tax losses, without subsequent economic advantage).

We have especially in mind here the real estate taxes whose rates will be smoothly scaled down remaining at a significant level on the average. However, the extremely low collection rate of these taxes leads from now on to effective tax rates lower or equal to the legal rates proposed by the commission. For the measure to have a significant impact (notably on the use of the savings), it is first of all necessary to intensify the collection effort.

b - Measures that may complicate or burden the operations of the services

We cite the following examples:

* The establishment of the separate General Income Tax return and its various effects (distribution of joint obligations, distribution of the children among the spouses...)

* The splitting into two parts of the tax on wage and salary income which would from now on discriminate between nationals and expatriates.

B - The budgetary impact

* The budgetary impacts of some of these reform proposals are not quantifiable, either because no statistical documentation is available to put them into figures, or because it is not possible to predict the choices that will be made by the taxpayers when the text presents them with options 1/. However, in most cases where quantification is not possible, the reform would probably result in tax gains rather than in tax losses (cf report, chapter 4, and note 1 below), so that the amounts shown below represent the maximum tax losses that could be expected for the arrangements proposed by the reform commission.

* It could be considered that the net overall losses would represent around 2.4 percent of the direct revenues from fiscal year 1984/85 taken as base year (or CFAF 1,150 million collected).

- Tax gains would accrue to the State from the tax on individuals under the industrial, commercial and agricultural profits tax reform, the reform of the tax on income from real property and (marginally) from that of the tax on non-built-up real property.

- Losses would accrue to the State from the reform of the General Income Tax (55 percent of the gross losses), of the tax on wage and salary income and of the tax on non-built-up real property.

It is important to mention that a simulation showed (cf. chapter 4 of the report) that a decrease in the top marginal rate to 55 percent or even 50 percent in the General Income Tax (and maintaining at 6 the number of family shares pertaining to the calculation of the tax) would not increase substantially the eventual losses to this tax - unless the income levels of the brackets assigned to the tax schedule were also radically changed at the same time.

1/ Quantification is not possible for: the tax on non commercial professional income (possible gain for the State); the business licence levies (probable gain); the minimum lump sum company tax and the fiscal minimum personal tax (assured gain); the tax on income from financial assets (net effect eventually low); the effect of the separate return for the General Income Tax (net effect eventually low). The establishment of a minimum lump sum company tax for individuals will provide non quantifiable additional revenues.

C - Economic and social repercussions

The dual concern of promoting economic efficiency and reinforcing the equity of the tax system is evident in the proposals of the Commission. However, some proposals seem to go counter to these objectives. In addition, some measures a priori useful to their implementation are not contained in these proposals.

a - Major economic repercussions

These deal with consumption, savings and investment.

* Since the reform results in direct tax relief (subject to the above qualifications with regard to its non quantifiable results), it is likely to increase the income on hand and thus both consumption and savings, even though only moderately. In this respect, the marked reduction of the General Income Tax (8 percent on the average, over 10 percent for the classes whose taxable income exceeds CFAF 13,000,000, the higher brackets of the schedule) and the tax on wage and salary income (around 5 percent on the average) can be especially favorable. However, it should be recalled that the taxpayer population ranges between 5 and 6 percent of the total population of the country which restricts the scope of these measures.

Likewise, the proposed reduction of the tax pressure on the high tax on industrial, commercial and agricultural profits and the tax on non commercial professional income is, from this point of view, a timely measure.

* However, concerning especially savings, they should not only increase but also be used locally and in the most efficient manner. Some of the proposed measures can help achieve this objective; others seem to run counter to these objectives.

i - The reform of the income tax on movable assets tends to encourage risk savings (those placed into shares) and especially short term liquid savings, which is thoroughly realistic. However, it seems that the levy rates on the incomes from long term investments remain excessive overall. In addition, the reform of the income tax on stocks and shares (IRVM) would allow a loophole at the expense of foreign firms. This loophole aimed undoubtedly at promoting the Senegalisation of the companies could in fact result in making Senegalisation more difficult by penalizing the Senegalese minority shareholders.

ii - More importantly, the existing loophole for the use of savings in real property at the expense of productive investment is increased rather than reduced in the proposals of the Commission (cf. the reform of the tax on built-up real property in particular).

iii - There are no major changes in the amortization system. An extended accelerated amortization process able to stimulate some investment classes (cf. infra, our proposals) could be envisaged.

iv - No selective criteria to promote priority investments have generally been noted; however, all investments could not be taken as priority ones in a scarce capital resource situation.

b - Major social repercussions

The Reform Commission's proposals would result generally in a balancing in the distribution of the tax burden among the various classes of taxpayers as well as in a redistribution of this burden within these classes.

* Balancing is clear in two aspects:

i - Wage earners and self employed

The most substantial reductions pertain to taxes essentially or exclusively paid by wage earners: tax on wage and salary income and General Income Tax. On the other hand, the tax on profits of unincorporated industrial, commercial and agricultural enterprises would (on the average) be heavier than under the existing system. This would also be the case for the tax on industrial, commercial and agricultural profits if the extension of the controlled return was accompanied by an increased efficiency of the control - which cannot be predicted at this stage.

ii - Civil servants and private sector employees

The extension to the government service of the CFAF 120,000 reduction of the tax on wage and salary income was proposed by the commission. This would correct partially the steady increase over the past few years as the result of the slump in the purchasing power of the public sector employees. Thus, for those in the D grade, the tax on wage and salary income would be reduced by 45 percent on the average, hence an average increase of 1.6 percent in disposable income.

iii - On the other hand, there is an opposite measure, which would include in the wage and salary taxable income, only for expatriates, the entire family allowances (subject to international agreements).

* The redistribution of the fiscal burden would particularly affect individuals and unincorporated enterprises:

i - The tax on wage and salary income reform would be especially profitable to public sector employees in the C, D and E grades.

ii - The reform of the General Income tax would be especially profitable to the small taxpayers (henceforth taxed at 10 percent) and to the taxpayers subject to a marginal rate of taxation over or equalling 30 percent.

iii - The reform of both the tax on industrial, commercial and agricultural profits and on non-commercial professional income would be solely profitable to taxpayers whose tax on industrial, commercial and agricultural profits is above CFAF 2,960 million (2 times the average of the tax on industrial, commercial and agricultural profits) and to those whose tax on non commercial professional income is over CFAF 3,840 million (38 percent of those officially liable for taxes). Applying the tax from the first franc (flat rate of 25 percent) would result in a significant taxation of small profits. The team foresees the risk that some of the small entreprises affected by such a measure will move into the informal sector.

In short, it seems that the implementation of the proposals of the Commission would ensure the partial achievement of the economic and social objectives which were set for the reform (search for an improved efficiency of the tax system, stimulation of the economy, improved distribution of the tax burden); hence the following conclusions and proposals.

## 2 - CONCLUSIONS AND PROPOSALS

### 2.1 - A necessary reform

Our evaluation report of the direct taxation reform shows two prominent aspects.

* There has been a sharp decline in the performance of the direct taxation system over the past few years; this is partially due to the decrease in the efficiency of the tax system but also to the steady worsening of the real income of a significant portion of the taxpayers.

* Direct taxation made various economic and social loopholes possible. Thus, real tax pressure (at constant real income) worsened significantly while a large number of potential taxpayers succeeded in evading taxation partially or fully; such problems distort competition and do not allow a fair distribution of the tax burden.

A reform of the Senegalese direct taxation system is thus necessary. It seemed necessary before making different proposals to assess the major constraints and review the principal choices inherent to such a reform.

### 2.2 - A difficult reform: constraints and alternatives

#### 2.2.1 - Constraints

Because of the importance of public finance equilibrum for the GOS ,a tax reform must surely help prevent substantial and sustained tax revenue losses.

Requirements of the adjustment policy make it difficult or even impossible to mobilize additional resources for the tax administration.

#### 2.2.2 - Possible choices

Two directions were contemplated a priori:

* The establishment of a global and consolidated income tax.

* The maintenance of the existing system based on the schedular tax.

The reform committee decided on the maintenance of the existing system. Various points seem to warrant this basic choice (cf. the conclusion of chapter 1 of our report). First of all, the schedular tax system has the basic advantage of being suited to Senegalese conditions.

* The flat rate character of the tax assessment (for a given tax ) ensures conditions favorable to its sound management and understanding by the taxpayers.

* A schedular tax system is favorable to the implementation of an efficient tax witholding system, which does not require any return by the eventual income beneficiaries.

* Past adjustments, even minor ones, have always resulted in revenue losses during the periods of implementation.

In addition, a tax system based on schedular taxes does involve in theory more economic or social distorsions than a global tax system. Thus, through an arrangement existing in Senegal as the General Income Tax, it is possible to initiate progressive increase in taxation; because of the limited number of the taxpayers involved, the management of such a tax does not constitute an excessive burden.

Finally, the transition , under present conditions, to a global tax system involves the risk of significant revenue losses.

* The tax administration faces difficulties in the discharge of its day to day operations; without additional means, the tax administration could implement a reform of such a magnitude with difficulty, even if the administration of such a regular global income tax was to prove easier. 2/

Various Senegalese taxpayers would face problems in adjusting to a system based on the global income return.

If the choice for the maintenance of the schedule tax seems justified, the evaluation of the proposed reform does not allow us to believe that the major objectives set could be achieved, owing to the constraints above. However, various proposals could improve the efficiency of the tax system.

## 2.3 - Proposals

Two types of proposals are made:

* Some are designed to strengthen the efficiency of the existing system.

* The others seem to be the requisite to a reform of the tax system.

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2/ This point is not demonstrated, notably because instituting a global tax requires identifying and locating all the taxpayers concerned, and being able to communicate with them.

2.3.1 - Measures designed to strengthen the efficiency of the existing system.

A - It seems essential to strengthen the consistency of the tax provisions in order to clear up the confusion that might exist 3/ but also to improve the consistency of the tax system by building on the advantages of the schedular system. Indeed, the reform commission has proposed important measures towards the unification of the rates of the tax on industrial, commercial and agricultural profits and the tax on non commercial professional income. 4/

As a matter of fact, it would be possible to increase the efficiency of the tax system by generalizing the tax withholding system: thus, the establishment of a deduction at source of a tax on property income paid to the State would avoid significant tax losses 5/ while simplifying the administrative procedure.

B - The cross-checking of the various existing documentations (IPRES social insurance files against the withholding tax files),the reform of some procedures in order to clarify the responsibilities of various agencies and to facilitate the circulation of the relevant information 6/ would certainly ensure the improvement of the efficiency of the tax system. It would also be essential to streamline and reassign the resources of the Tax Department towards more useful tasks.

C - We show (chapter 4) that it is possible to decrease the maximum marginal rate of the General Income Tax to 50 percent without losing more tax revenues than by giving an additional family share for the assessment of the income of households. With a loss of equivalent tax revenue such a measure would probably provide a greater incentive than an increase of the number of family shares because it affects all those who earn high incomes; of course, it would reduce the relative advantage given to large households.

D - Extension (not planned by the reform commission) of the accelerated amortization system to second hand goods could be a useful economic incentive especially for small and medium scale enterprises (such an extension would be favorable to a reduction of imports while facilitating the purchase of equipment most suited to the situation of the enterprises.)

However, although it is possible to achieve outstanding tax revenue performance through such measures, it does not seem possible to initiate changes consistent with the initial objectives of the tax reform. As a matter of fact, the direct tax burden rests on a relatively low number of taxpayers in relation to the global population and the proposed reform does not seem to

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3/ Many proposals of this sort are made in our report.
4/ N.B. In our report we underscore the inconveniences, notably social, of eliminating reductions.
5/ These losses amount to about CFAF 500 million.
6/ Cf. the proposals in our main report on the procedure for collecting withholdings under the tax on wages and salary incomes.

enlarge the tax base significantly; under these conditions, as it is essential to avoid tax revenue losses, the scope of any reform is necessarily limited.

For this reason, measures should be identified to broaden the direct tax base; these constitute indeed the prerequisite to any reform.

3.2 - Measures for broadening the tax base

It is first of all essential to note that the scope of the General Income Code is broad enough, but that the tax administration does not for various reasons succeed in assessing the entire tax base. It faces various problems: the informal sector whose expansion has been significant over the past few years seems extremely difficult to asses for taxation and any effort towards these objectives would require a significant amount of time.

Indeed, with the available means, it seems that the preparation of a cadastral survey is a condition precedent to any significant reform of direct taxation and one of the most efficient ways of promoting this reform.

* The cadastral survey is the basis for an efficient tax system because it makes it possible to locate taxpayers exactly, to identify them better, and to make cross-checks favorable to the enlargement of the overall direct tax base.

* The size of the real property base would yield substantial tax revenues through moderate taxation rates of land taxes and land income taxes, independently from the economic situation. These revenues, added to those resulting from the broadening of the base of all the direct taxes, would then ensure major readjustments of the tax system (relief of real tax pressure, reduction of anti-incentive or low-yielding taxes, new distribution of the tax burden).

As it was possible to verify based on the conduct of the tests being held in Dakar, the preparation of a cadastral survey, even though burdensome and costly, is likely to be achieved within relatively short time limit.

## ANNEX C

## INITIAL ENVIRONMENTAL EXAMINATION

Country: Republic of Senegal

Project Title: Senegal Africa Economic Policy Reform Program (AEPRP)

Funding: Life of Project Funding $15.0 million

Period of Project: FY 1986-FY 1988

Activity Description: The purposes of the AEPRP grant are to (1) provide budgetary support to the Government of Senegal and (2) gain policy change in the key tax and fiscal management sector aimed at removing disincentives to savings and productive investment, increasing equity in the tax system and reducing Senegal's dependence on donors for budget support.

Environmental Action Recommended: Categorical Exclusion in accordance with Reg. 16, Section 216.2 (c) (1) (i): the action does not have an effect on the natural or physical environment, and Section 216.2(c)(2)(vi) Cash Transfer to a National Government; helping with the Balance of Payments.

IEE Prepared by: Joel E. Schlesinger, Chief Project Development Officer, USAID/Senegal.

Bureau Environmental Officer's Determination:

Approved: X

Disapproved:

Date: JUL 31 1986

AFR/TR/SDP: Bessie L. Boyd B Boyd

Clearances:

GC/RLA: EDragon

## **ANNEX D: AID/W Senegal AEPRP Guidance Cables**

- **STATE 134347**
- **STATE 166279**

PRM

ACTION: AID-2 INFO: DCM RIG

VZCZCTAA579ESC484
PP RUTADS
DE RUEHC #4347 1200559
ZNR UUUUU ZZH
P 300559Z APR 86
FM SECSTATE WASHDC
TO AMEMBASSY DAKAR PRIORITY 7574
BT
UNCLAS STATE 134347

LOC: 218 823
30 APR 86 0820
CN: 04695
CHRG: AID
DIST: AID

AIDAC

PRM

ACTION
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INFO
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PRM
ECU
RBDO
Reg Co
ENG
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ADO
STDO
FFP
HPNO
PDC
SMO
RIC
CHRON

E.O. 12356: N/A
TAGS:
SUBJECT: SENEGAL AEPRP

1. THE FOLLOWING MEMO DATED APRIL 23, 1986 FROM COUNSELOR OF THE AGENCY, MARSHALL BROWN TO AA/AFR MARK EDELMAN IS IN RESPONSE TO THE AEPRP PROPOSAL SUBMITTED BY THE MISSION. TEXT OF MEMO IS AS FOLLOWS:

QUOTE - THE PROPOSED REFORM PROGRAM SOUNDS ATTRACTIVE. IF I WERE IN THE MISSION, HOWEVER, I WOULD PAY PARTICULAR ATTENTION TO ASSURING THAT THE CONTENT OF THE PROGRAM WHICH IS ACTUALLY NEGOTIATED WITH THE GOVERNMENT IS FULLY RESPONSIVE TO AGENCY GUIDANCE ON INVOLVEMENT IN THE TAX AREA AND REFLECTS SUPPLY SIDE TAX PRINCIPLES.

AS YOU KNOW, A.I.D. INVOLVEMENT IN TAX QUESTIONS CAN BE AN EXTREMELY SENSITIVE ISSUE ON THE HILL -- TO THE POINT OF BEING ALMOST A THEOLOGICAL ISSUE. SINCE THEOLOGICAL QUESTIONS ARE NORMALLY NOT SUBJECT TO RATIONAL DEBATE, THE SENEGAL MISSION WOULD BE WELL ADVISED TO BE SURE ITS PROGRAM IS ON THE RIGHT SIDE OF THE ISSUE IN THE FIRST INSTANCE. END QUOTE.

2. PLEASE KEEP US FULLY INFORMED ON THE STATUS OF YOUR AEPRP PROGRAM DEVELOPMENT SINCE AFRICA BUREAU AND OTHER AID/W OFFICES ARE LOOKING AT THE PROGRAM WITH AVID INTEREST. WHITEHEAD
BT
#4347

NNNN

UNCLASSIFIED STATE 15627

ECF3

ACTION: AID-2 INFO: DCM RIG

VZCZCTAA684ESC943
PP RUTADS
DE RUEHC #6279 1480144
ZNR UUUUU ZZH
P 280145Z MAY 86
FM SECSTATE WASHDC
TO AMEMBASSY DAKAR PRIORITY 8033
BT
UNCLAS STATE 156279

LOC: 243 574
28 MAY 86 0827
CN: 08794
CHRG: AID
DIST: AID

AIDAC

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STDO
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HPNO
PDC
SMO
RIC
CHRON
Reading

E.O. 12356: N/A
TAGS:
SUBJECT: SENEGAL AEPRP

REFS: (A) STATE 26147 (B) DAKAR 02881

FOR THE MISSION'S GUIDANCE, TAX ADMINISTRATION IS CONSIDERED BY AID/W TO BE ACCEPTABLE, EVEN DESIRABLE, AS PART OF SENEGAL'S PROPOSED AEPRP ACTIVITY AS LONG AS 1) IT IS A PART OF AN OVERALL ECONOMIC REFORM PROGRAM AND, SPECIFICALLY, PART OF A SENEGALESE AND DONOR-ACCEPTED TAX REFORM PROGRAM, 2) THAT THE REFORM ENCOURAGES SAVINGS AND INVESTMENT AND DOES NOT ACT AS A DISINCENTIVE TO PRODUCTION, AND 3) THAT THE REFORM ENCOURAGES, OR AT THE VERY LEAST, DOES NOT DISCOURAGE PRIVATE ENTERPRISE ACTIVITY. THE AIM OF ANY TAX REFORM PROGRAM SHOULD BE TO ENCOURAGE THE SHARING OF A FAIR TAX BURDEN SPREAD EQUITABLY OVER THE POPULATION. AS LONG AS THE PROPOSED PROGRAM MEETS THESE CRITERIA, NEITHER AID NOR THE HILL IS LIKELY TO HAVE AN OBJECTION TO INCLUSION OF A TAX ADMINISTRATION COMPONENT. SHULTZ
BT
#6279

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UNCLASSIFIED STATE 156279

# ANNEX E

## Statutory Check List

PD-AAY-486

Senegal: AEPRP PAAD

3(A)2 NONPROJECT ASSISTANCE CHECKLIST

The criteria listed in Part A are applicable generally to FAA funds, and should be used irrespective of the program's funding source. In Part B a distinction is made between the criteria applicable to Economic Support Fund assistance and the criteria applicable to Development Assistance. Selection of the criteria will depend on the funding source for the program.

CROSS REFERENCES: IS COUNTRY CHECKLIST UP TO DATE? IDENTIFY. HAS STANDARD ITEM CHECKLIST BEEN REVIEWED?

GENERAL CRITERIA FOR NONPROJECT ASSISTANCE

1. FY 1985 Continuing Resolution Sec. 525; FAA Sec. 634A.

   Describe how authorizing and appropriations committees of Senate and House have been or will be notified concerning the project.

   The AEPRP Program Grant does not appear in the FY 1986 Congressional Presentation. A Congressional Notification is being submitted.

2. FAA Sec. 611(a)(2). If further legislative action is required within recipient country, what is basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purpose of the assistance?

   Conditionality includes approval of new Customs Code by the National Assembly of Senegal, expected for July 1986.

3. FAA Sec. 209 Is assistance more efficiently and effectively given through regional or multilateral organizations? If

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| so, why is assistance not so given? Information and conclusion whether assistance will encourage regional development programs. | No. Program will not encourage regional development programs. It is aimed at a Senegal-specific problem. |
| 4. <u>FAA Sec. 601(a)</u> Information and conclusions whether assistance will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture, and commerce; and (f) strengthen free labor unions. | Reforms aimed at encouraging greater private initiative, reduction in protection against imports and thereby improved enterprise productivity. |
| 5. <u>FAA Sec. 601(b)</u> Information and conclusions on how assistance will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise). | No direct effect. |
| 6. <u>FAA Sec. 612(b), 636(h); FY 1983 Continuing Resolution Sec. 507.</u> Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the U.S. are utilized in lieu of dollars. | N.A. |

7. FAA Sec. 612(d). Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?

8. FAA Sec. 601(e). Will the assistance utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise?

Yes, for studies and technical assistance.

9. FAA 121(d). If assistance is being furnished under the Sahel Development Program, has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of A.I.D. funds?

N.A. Funds are not provided by Sahel appropriation.

10. FY 1985 Continuing Resolution Sec. 533. Is disbursement of the assistance conditioned solely on the basis of the policies of any multilateral institution?

NO.

B. FUNDING CRITERIA FOR NONPROJECT ASSISTANCE

1. Nonproject Criteria for Economic Support Fund

YES.

a. FAA Sec. 531(a). Will this assistance promote economic and political stability? To the maximum extent feasible, is this assistance consistent with the policy directions, purposes, and programs of part I of the FAA?

b. FAA Sec. 531(c). Will assistance under this chapter be used for military, or paramilitary activities?

NO.

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| c. <u>FAA Sec. 531(d)</u>. Will ESF funds made available for commodity import programs or other program assistance be used to generate local currencies? If so, will such local currencies be available to support activities consistent with the objectives of FAA sections 103 through 106? | NO. |
| d. <u>ISDCA of 1985 Sec. 205</u>. Will ESF funds made available for commodity import programs be used for the purchase of agricultural commodities of United States-origin? If so, what percentage of the funds will be so used? | NO. |
| e. <u>ISDCA of 1985 Sec. 801</u>. If ESF funds will be used to finance imports by an African country (under a commodity import program or sector program), will the agreement require that those imports be used to meet long-term development needs in those countries in accordance with the following criteria? | N.A. |

(i) spare parts and other imports shall be allocated on the basis of evaluations, by A.I.D., of the ability of likely recipients to use such spare parts and imports in a maximally productive, employment generating, and cost effective way;

(ii) imports shall be coordinated with investments in accordance with the recipient country's plans for promoting economic development. A.I.D. shall assess such plans to determine whether they will effectively promote economic development;

(iii) emphasis shall be placed on imports for agricultural activities which will expand agricultural production, particularly activities which expand production for export or production to reduce reliance on imported agricultural products;

(iv) emphasis shall also be placed on a distribution of imports having a broad development impact in terms of economic sectors and geographic regions;

(v) in order to maximize the likelihood that the imports financed by the United States under the ESF chapter are in addition to imports which would otherwise occur, consideration shall be given to historical patterns of foreign exchange uses;

(vi)(A) seventy-five percent of the foreign currencies generated by the sale of such imports by the government of the country shall be deposited in a special account established by that government and, except as provided in subparagraph (B), shall be available only for use in accordance with the agreement for economic development activities which are consistent with the policy directions of section 102 of the FAA and which are the types of activities for which assistance may be provided under sections 103 through 106 of the FAA;

(B) the agreement shall require that the government of the country make available to the United States Government such portion of the amount deposited in the special account as may be determined by the President to be necessary for requirements of the United States Government.

f. ISDCA of 1985 Sec. 207. Will ESF funds be used to finance the construction of, or the operation or maintenance of, or the supplying of fuel for, a nuclear facility? If so, has the President certified that such country is a party to the Treaty on the Non-Proliferation of Nuclear Weapons or the Treaty for the Prohibition of Nuclear Weapons in Latin American (the "Treaty of Tlatelolco"), cooperates fully with the IAEA, and pursues nonproliferation policies consistent with those of the United States?

NO.

g. FAA Sec. 609. If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made?

N.A.

2. Nonproject Criteria for Development Assistance

a. FAA Sec. 102(a); 111; 113; 281(a). Extent to which activity will (a) effectively involve the poor in development, by extending access to economy at local level; increasing labor-intensive production and the use of appropriate technology, spreading investment out from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using the appropriate U.S. institutions; (b) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward better life, and otherwise encourage democratic private and local governmental institutions; (c) support the self-help efforts of developing countries; (d) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (e) utilize and encourage regional cooperation by developing countries?

N.A.

b. FAA Sec. 103, 103A, 104, 105, 106, 107. Is assistance being made available: (include only applicable paragraph which corresponds to source of funds used. If more than one fund source is used for assistance, include relevant paragraph for each fund source.)

N.A.

(1) [103] for agriculture, rural development or nutrition; if so (a) extent to which activity is specifically designed to increase productivity and income of rural poor; [103A] if for agricultural research, full account shall be taken of the needs of small farmers, and extensive use of field testing to adapt basic research to local conditions shall be made; (b) extent to which assistance is used in coordination with efforts carried out under Sec. 104 to help improve nutrition of the people of developing countries through encouragement of increased production of crops with greater nutritional value, improvement of planning, research, and education with respect to nutrition, particularly with reference to improvement and expanded use of indigenously produced foodstuffs; and the undertaking of pilot or demonstration of poor and vulnerable people; and (c) extent to which activity increases national food security by improving food policies and management and by strengthening national food reserves, with particular concern for the needs of the poor, through measures encouraging domestic production, building national food reserves, expanding available storage facilities, reducing post harvest food losses, and improving food distribution.

(2) [104] for population planning under sec. 104(b) or health under sec. 104(c); if so, extent to which activity emphasizes low-cost, integrated delivery systems for health, nutrition and family planning for the poorest people, with particular attention to the needs of mothers and young children, using paramedical and auxiliary medical personnel, clinics and health posts, commercial distribution systems and other modes of community research.

(3) [105] for education, public administration, or human resources development; if so, (a) extent to which activity strengthens nonformal education, makes formal education more relevant, especially for rural families and urban poor, or strengthens management capability of institutions enabling the poor to participate in development; and (b) extent to which assistance provides advanced education and training of people in developing countries in such disciplines as are required for planning and implementation of public and private development activities

(4) [106] for technical assistance, energy, research, reconstruction, and selected development problems; if so, extent activity is: (i)(a) concerned with data

collection and analysis, the training of skilled personnel, research on and development of suitable energy sources, and pilot projects to test new methods of energy production; and (b) facilitative of geological and geophysical survey work to locate potential oil, natural gas, and coal reserves and to encourage exploration for potential oil, natural gas, and coal reserves.

(ii) technical cooperation and development activities, especially with U.S. private and voluntary, or regional and international development, organizations;

(iii) research into, and evaluation of, economic development processes and techniques;

(iv) reconstruction after natural or manmade disaster;

(v) for special development problems, and to enable proper utilization of earlier U.S. infrastructure, etc., assistance;

(vi) for special development, especially small labor-intensive enterprises, marketing systems, and financial or other institu[illegible] help urban poor participate in economic and social development.

(5) [107] is appropriate effort placed on use of appropriate technology? (Relatively smaller, cost-saving, labor using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor.)

| | |
|---|---|
| c. <u>FAA 118(c) and (d)</u>. Does the assistance comply with the environmental procedures set forth in AID Regulation 16. Does the assistance take into consideration the problem of the destruction of tropical forests? | N.A. |
| d. <u>FAA Sec. 281(b)</u> Describe extent to which the activity recognizes the particular needs, desires, and capacities of the people of the country; utilizes the country's intellectual resources to encourage institutional development, and supports civic education and training in skills required for effective participation in governmental and political processes essential to self-government. | N.A. |
| e. <u>FAA Sec. 122(b)</u> Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self-sustaining economic growth? | N.A. |

5C(3) - STANDARD ITEM CHECKLIST

Listed below are the statutory items which normally will be covered routinely in those provisions of an assistance agreement dealing with its implementation, or covered in the agreement by imposing limits on certain uses of funds.

These items are arranged under the general headings of (A) Procurement, (B) Construction, and (C) Other Restrictions.

A. Procurement

| | | |
|---|---|---|
| 1. | FAA Sec. 602. Are there arrangements to permit U.S. small business to participate equitably in the furnishing of commodities and services financed? | N.A. |
| 2. | FAA Sec. 604(a). Will all procurement be from the U.S. except as otherwise determined by the President or under delegation from him?? | Yes. |
| 3. | FAA Sec. 604(d). If the cooperating country discriminates against marine insurance companies authorized to do business in the U.S., will commodities be insured in the United States against marine risk with such a company? | N.A. |
| 4. | FAA Sec. 604(e); ISDCA of 1980 Sec. 705(a). If offshore procurement of agricultural commodity or product is to be financed, is there provision against such procurement when the domestic price of such commodity is less than parity? (Exception where commodity financed could not reasonably be procured in U.S.) | N.A. |

5. FAA Sec. 604(g). Will construction or engineering services be procured from firms of countries which receive direct economic assistance under the FAA and which are otherwise eligible under Code 941, but which have attained a competitive capability in international markets in one of these areas? Do these countries permit United States firms to compete for construction or engineering services financed from assistance programs of these countries? — N.A.

6. FAA Sec. 603. Is the shipping excluded from compliance with requirement in section 901(b) of the Merchant Marine Act of 1936, as amended, that at least 50 per centum of the gross tonnage of commodities (computed separately for dry bulk carriers, dry cargo liners, and tankers) financed shall be transported on privately owned U.S. flag commercial vessels to the extent such vessels are available at fair and reasonable rates? — N.A.

7. FAA Sec. 621. If technical assistance is financed, will such assistance be furnished by private enterprise on a contract basis to the fullest extent practicable? If the facilities of other Federal agencies will be utilized, are they particularly suitable, not competitive with private enterprise, and made available without undue interference with domestic programs? — Yes.

8. International Air Transportation Fair Competitive Practices Act, 1974. If air transportation of persons or property is financed on grant basis, will U.S. carriers be used to the extent such service is available? — Yes.

FY 1985 Continuing Resolution Sec. 504. If the U.S. Government is a party to a contract for procurement, does the contract contain a provision authorizing termination of such contract for the convenience of the United States? — Yes.

B. Construction

1. FAA Sec. 601(d). If capital (e.g., construction) project, will U.S. engineering and professional services be used? — N.A.

2. FAA Sec. 611(c). If contracts for construction are to be financed, will they be let on a competitive basis to maximum extent practicable? — N.A.

3. FAA Sec. 620(k). If for construction of productive enterprise, will aggregate value of assistance to be furnished by the U.S. not exceed $100 million (except for productive enterprises in Egypt that were described in the CP)? — N.A.

## C. Other Restrictions

1. FAA Sec. 122(b). If development loan, is interest rate at least 2% per annum during grace period and at least 3% per annum thereafter? — N.A.

2. FAA Sec. 301(d). If fund is established solely by U.S. contributions and administered by an international organization, does Comptroller General have audit rights? — N.A.

3. FAA Sec. 620(h). Do arrangements exist to insure that United States foreign aid is not used in a manner which, contrary to the best interests of the United States, promotes or assists the foreign aid projects or activities of the Communist-bloc countries? — YES.

4. Will arrangements preclude use of financing:

   a. FAA Sec. 104(f); FY 1985 Continuing Resolution Sec. 527. (1) To pay for performance of abortions as a method of family planning or to motivate or coerce persons to practice abortions; (2) to pay for performance of involuntary sterilization as method of family planning, or to coerce or provide financial incentive to any person to undergo — N.A.

sterilization; (3) to pay for any biomedical research which relates, in whole or part, to methods or the performance of abortions or involuntary sterilizations as a means of family planning; (4) to lobby for abortion?

b. FAA Sec. 488. To reimburse persons, in the form of cash payments, whose illicit drug crops are eradicated? N.A.

c. FAA Sec. 620(g). To compensate owners for expropriated nationalized property? N.A.

d. FAA Sec. 660. To provide training or advice or provide any financial support for police, prisons, or other law enforcement forces, except for narcotics programs? N.A.

e. FAA Sec. 662. For CIA activities? N.A.

f. FAA Sec. 636(i). For purchase, sale, long-term lease, exchange or guaranty of the sale of motor vehicles manufactured outside U.S., unless a waiver is obtained? N.A.

g. FY 1985 Continuing Resolution, Sec. 503. To pay pensions, annuities, retirement pay, or adjusted service compensation for military personnel? N.A.

h. FY 1985 Continuing Resolution, Sec. 505. To pay U.N. assessments, arrearages or dues? N.A.

i. FY 1985 Continuing Resolution, Sec. 506. To carry out provisions of FAA section 209(d) (Transfer of FAA funds to multilateral organizations for lending)? N.A.

j. FY 1985 Continuing Resolution, Sec. 510. To finance the export of nuclear equipment, fuel, or technology or to train foreign nationals in nuclear fields? N.A.

k. FY 1985 Continuing Resolution. Sec. 511. Will assistance be provided for the purpose of aiding the efforts of the government of such country to repress the legitimate rights of the population of such country contrary to the Universal Declaration of Human Rights? N.A.

l. FY 1985 Continuing Resolution, Sec. 516. To be used for publicity or propaganda purposes within U.S. not authorized by Congress? N.A.

ANNEX F

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# PRELIMINARY REPORT OF A BRIEF SURVEY OF SENEGAL'S DIRECT TAXES

For USAID Senegal
By Oliver Oldman
June 30, 1986

(Subject to revision after receipt of comments by such interested organizations as Government of Senegal, USAID, and IMF)

Outline of Report




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Scope of Mission

(1) Examine direct tax modernization policy for Senegal with special emphasis on legal and administrative aspects of simplifying the structure while generating economic efficiency and growth along with fairness.

(2) Provide the perspective of Americans (and others beside the French) on the process of changing the direct tax system to fit medium and longer term changes in Senegal's economy and society while assuring the availability of tax tools to reflect shorter term needs when required.

Background--Materials and Support

(1) Two reports (1985 and 1976) of IMF Department of Fiscal Affairs, made available by USAID and Government of Senegal.

(2) Parallel mission of IMF Legal Department, which provided its staff member, Lotfi Maktouf, who is my former student and staff member of Harvard Law School International Tax Program and who is not only bilingual in French and English but also has a solid background in American tax law as well as French and Tunisian tax laws.

(3) Oral summary of some of the suggestions of a brief mission by the U.S. Internal Revenue Service Tax Administration Assistance Staff.

(4) <u>Doing Business in Senegal</u> (Price Waterhouse Information Guide, 1982).

(5) April 1986 preliminary draft of proposed legislative changes

in direct taxes, prepared as a result of the efforts of the National Tax Commission created in 1984.

(6) "The Transition to a Global Income Tax: A Comparative Analysis," by Oliver Oldman and Richard Bird, printed in Volume 3 of the Bulletin for International Fiscal Documentation at pp. 439- in 1977.

(7) Institutionalizing the Process of Tax Reform: A Comparative Analysis by Michael J. McIntyre and Oliver Oldman, a monograph published in 1975 jointly by the Harvard Law School International Tax Program and the International Bureau of Fiscal Documentation.

## Recommendations and Suggestions

Because of the brevity of the mission and its broad scope of direct taxes these recommendations and suggestions are to be taken as matters for consideration which require considerable further examination before adoption.

### A. General Points

1. At the outset, in the first official meeting in DAkar, it was agreed that the broad goals of new legislation constituting direct tax reform were revenue, efficiency (meaning simplicity and growth), and social justice.

2. The tax policy planning process in Senegal, at present quite ad hoc in nature, needs to be institutionalized in order to provide continuous adaptation of the tax system to changing

conditions. Basic needed data are not regularly gathered from tax returns and other sources to provide kinds of information policy makers and legislators need. For example, I was unable to get income tax revenue data broken down by industry sectors such as fishing, agriculture, financial services, transportation, etc.

3. The major direct tax issue in the coming years, an issue which requires comprehensive review of the taxation of business income, international income, personal income, and real estate income is the lowering of tax rates along with a broadening of the tax base by reducing exceptions and exemptions. This is to be done in the context of a realistic examination of the meaning of globalizing the income tax for Senegal and the problems of transition to the system desired. At the same time continuous attention is to be paid to the numerous valuable suggestions the 1985 IMF Report made on modernizing tax administration. An important part of improving administration consists of proposed training in the U.S. for selected tax officials of Senegal, whose instruction in Washington might well include training in developing, managing, and using tax data.

4. While indirect taxes were not covered by this mission and several major and immediate steps are soon to be taken in this field, longer range tax planning will want to pay continuous attention to these taxes and their interaction with direct taxes.

B. <u>Specific Points</u>

These points cover a lot of direct tax ground, but are nevertheless far from a complete listing. These are points which arose in discussions in Dakar with officials of the Government of Senegal, of USAID, and of the IMF or which occurred to me as I reflected on those discussions and the several reports. Unfortunately the proposed legislation deals with only a few of these points. At the heart of the omissions from the proposed legislation is the substantial part of the tax laws embodied in the Investment Code. While a high level group is now considering revision of that Code, it is unclear how closely it is being coordinated with revisions of the direct tax laws. This problem may be in the process of solution, however, because data are now being compiled on the costs of tax exonerations ("tax expenditures" in modern terminology).

1. <u>Taxation of business entities</u> (corporations)

The present system for taxing corporations appears on the surface to impose substantial burdens when the combination of the 33.33% corporate tax and the tax on individual shareholders of up to 65% is considered. Administrative shortcomings plus the elaborate network of special deductions, exceptions, exemptions, and incentives convert that appearance to the reality of a low effective tax on business income for most if not all taxpayers. Serious thought should be given to broadening the base while lowering the rate. In Indonesia, and perhaps soon in Jamaica, the approach is to assure current taxation of all business income at about 33%, to eliminate exceptions and incentives, and to limit severely if not eliminate taxation of dividends except those going to nonresidents. That approach implies, however, as already achieved in those countries, a maximum personal tax rate which is also on the order of 33%. That approach would also eliminate the problems that the use of bearer shares raises. Similarly, the numerous problems rising from liquidation of corporations, redemptions of stock, and corporate mergers and other reorganizations would be reduced or eliminated. Reduced taxation of capital gains could also be dispensed with.

In broadening the tax base special consideration ought to be given to government owned enterprises engaged in the same or similar activities as those of the private sector. Accounts and income taxes of these organizations, administered I understand by the Portfolio Division of The Ministry of Finance, should approximate those of private corporations.

2. **International aspects**

A review of the treatment of international business income in its many forms and of international investment income in its various forms is called for, though the proposed legislation does not appear to make any changes here. The income flowing from Senegal to foreigners and foreign corporations through their Senegalese corporations or branches or investments is a proper subject of taxation. The operation of present law on this income is unclear. For example, the dividends paid to foreign corporations not otherwise established in Senegal appear not to be taxed at all in contradistinction to the prevailing practice of other countries.

Receipts of income from foreign sources are not taxed to Senegalese corporations (the territorial system) but such income is taxable if received by Senegalese resident individuals. It is not clear to me whether or not foreign source income exempt in the hands of a corporation gets taxed when it is passed on as a dividend of any kind to the individual resident shareholder. Using the territorial system for corporations and the global or worldwide system for individuals is not very common but is nevertheless used not only by France but, for example, El Salvador as well.

Administrative aspects of international income, particularly the area of transfer pricing, raise some of the most complex issues of income tax administration. These aspects would have to be examined as part of a close look at Senegal's international income tax situation, present and prospective.

3. **Family issues**

The rise of the family quotient system of parts (one for each spouse and one-half for each child), adapted from the French system, needs especially careful examination to fit the Sengalese social reality, on the one hand, and Senegalese fiscal needs, on the other. I am one of a relative few among my American colleagues who has a healthy respect for the French system. It is in my view not so much the system as how it is applied in

Senegal that leads to what the IMF reports characterize as "random variations in the average tax rates of individuals." A significant part of the revenue loss impact of this system is caused by allowing the income tax on each part to be calculated with a "zero" bracket (or exempt amount) that is always the same for each part whether there are only 2 or as many as 12. Some curtailment of the availability of the zero bracket is needed, for example, by reducing its size to, say, one-third for the third part and to one-sixth for the fourth part.

Also, the existing limit of five parts per family should probably be cut to four parts while at the same time tapering down the fraction of a part to be allowed for each additional child. For example, while one part each would continue to be allowed for a husband and a wife, additional dependents would be allowed only one-third of a part for the first two, and one-sixth for each thereafter. Such a system recognizes the difference between French and Senegalese family sizes but greatly reduces the variation in effective tax rates. The IMF proposal to substitute a flat deduction for each dependent, one which might even decline as the number of dependents increases, accords with practice elsewhere. Without a closer examination of the social situation and a careful look at the precise changes in revenue and distribution of tax burdens, I cannot now go beyond urging a comprehensive review of taxing the family. In any event, to the extent that the top rate of tax is reduced form 65% to 50% and perhaps even lower later, the spread of tax burdens among families will be reduced.

4. <u>The transition to a global system</u>

The present system of schedular income taxes complemented with ~~with~~ a progressive tax on the total income from all the schedules, though once in force in a number of countries, is largely an anachronism. That would not be enough of a reason to change the system by itself. The difficulty of justifying different tax rates for each type of income plus the administrative disadvantages of what is in fact a complex rate structure exist in Senegal as elsewhere. Having said that (as other reports on Senegal have as well), I note that a number of features in the schedules are likely and wisely to be retained insofar as calculating net income goes. Examples are found in the Oldman-Bird article referred to earlier. Senegal can and should have a simpler and more easily understood system than it now has in this respect.

5. <u>Real estate</u>

Real estate ownership, property law, and real estate taxes need comprehensive study. In real estate taxes I include: an annual tax on current actual or imputed rent, and annual tax on capital value, and taxes on the transfer of real estate based on the transfer price (gross capital value) or on capital gain. Because so much of the land of Senegal is owned by the government with some of it leased or licensed for private use, the taxing context is different from that in the Americas and many other places. Land in Senegal may be viewed as a publicly owned natural resource the way mineral rights are in many countries. Ordinarily, countries with mineral resources exploit them in a manner to yield the government a return comparable to a market rate of return. This may be done by charging royalties or rents and by levying taxes. Senegal has not sought market rates of return for the land it leases or licenses for private use. Allocating land resources is not based, it seems, on market factors. What the factors are is unclear. To the extent that these factors, whatever they be, compel continuation of present practice, the question remains as to how taxation may be used to provide more public revenues from public land than at present is realized. The potential revenue may be relatively small now because the amount of government land now actually used privately is still not nearly as valuable as the land now privately owned (if I understood correctly what I heard). But as more and more government land is leased or licensed for private use, it will offer a revenue potential which could be substantially greater than that of privately owned land.

The real estate tax problem, aside from needed administrative improvements in the present taxes and the existence of room for rate increases in those taxes, is a longer range problem requiring a study of public land management along with real estate taxes.

5. Administration

Always more important than the tax laws themselves is how they are administered. Several aspects were noted during my visit and considerable attention to administrative issues was wisely given by the recent IMF mission. Plans are in progress to centralize collection activities further and to require withheld taxes to be paid over to the government monthly and in appropriate cases quarterly. Audit activities need to be increased along with a followup on other suggestions made in the IMF report. Sending a group of responsible officials to the U.S. Internal Revenue Service for a short-term exposure to a different system will pay handsome dividends in terms of providing those officials with new ways to look at their own old problems. Consideration should be given to looking at Canadian tax administration as well, particularly in the French-speaking parts of Canada.

Finally, as part of the process of review of government land mangement it is essential to go forward with plans for preparing a detailed land cadastre.

## Conclusion

It is at least partly if not wholly my own fault for not obtaining and digesting whatever other reports may exist on Senegal's fiscal past as well as on its current fiscal situation. No doubt this preliminary report could have been more solidly based. The World Bank certainly has a reservoir of information. Law and accounting offices have practical knowledge that needs to be gathered. Extensive on-the-scene discussions and observations in and outside Dakar are also needed. Hence, this brief report can do little more than suggest approaches that may lead to solutions to current and longer range concerns. Perhaps, however, I can offer a suggestion as to how the undone work can get done. Exploring this suggestion may in turn lead to a workable and sensible organized effort at tax reform in Senegal.

The suggestion is a joint venture or consortium of international and national organizations interested in and committed to assisting Senegal. For example, a small team jointly organized by the IMF and AID would be in a positon to give Senegal advice of the type it wishes and probably needs, that is, nonconflicting suggestions agreed on by two or more major providers of technical and financial assistance. Of course, one can at least consider the prospect of asking still others, for example, the World Bank, the French Government, and the European Community, to join in such an effort. If the idea of a consortium or joint venture is appealing to Senegal and AID, then perhaps a meeting of representives of interested organizations and governments could be held in Washington, Paris, Brussels, or Dakar. The first personnel problem such a consortium or joint venture would face is obtaining a public finance expert as a leader. The second is for an experienced international tax lawyer. The third need is for an experienced tax administrator. Ideally, all three would have multi-country knowledge and be able to work in the French language.

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