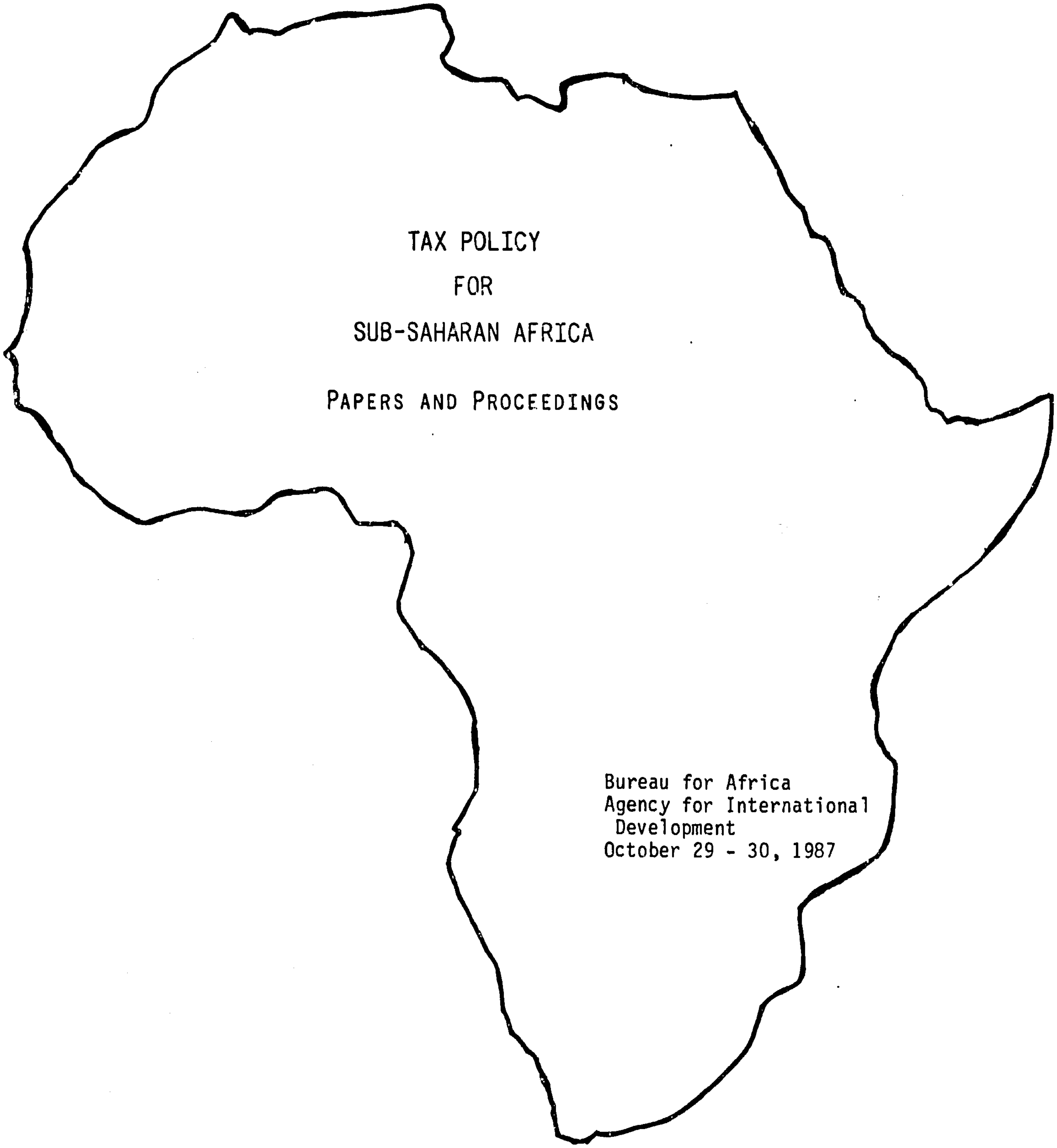


TAX POLICY FOR SUB-SAHARAN AFRICA

PAPERS AND PROCEEDINGS

Bureau for Africa
Agency for International Development
October 29 - 30, 1987

PREFACE

These papers and proceedings summarize the Tax Policy Seminar for Sub-Saharan Africa sponsored by the Africa Bureau of the U.S. Agency for International Development (USAID). The seminar was convened October 29-30, 1987 in the U.S. Department of State. USAID wishes to extend deep appreciation to all the participants without whose presence the seminar would not have been the outstanding success that it was. In this regard, we wish to single out for praise (a) Brookings Richard Goode -- past director of the IMF Fiscal Affairs Department, (b) Kevin O'Connor -- Chief of the IMF's Financial Institutions Division, (c) Professor John Due of the University of Illinois, (d) Pradeep Mitra who represented the World Bank's Public Economics Division, (e) IMF Senior Economist Leif Muten, (f) Counsellor for Taxation for the IMF Lotfi Maktouf, (g) USAID Economists Samuel Skogstad and Richard Greene, (h) Syracuse University's Roy Bahl, and (i) Jacqueline Damon -- Economist for the IMF's Northwest Africa Division. A great deal was learned from the sessions, all of which were well received. Considerable information was exchanged in the spirited and lively question and answer periods that followed the formal presentations.

USAID was extremely pleased with the number of people who showed up for the seminar. The primary audience for the seminar was to be the Africa Bureau's overseas Missions, and indeed most of the Missions were represented. However, also in attendance were (a) high level officials from the IMF and World Bank, (b) leading academics, and (c) individuals in non-profit organizations and the private sector. Moreover, a number of U.S. government agencies were represented in addition to USAID including the Overseas Private Investment Corporation, State, Treasury, and the Internal Revenue Service.

We wanted the seminar to be as much as possible "hands-on" in nature. Hence, the primary focus of the seminar was implementation of tax reform programs. Four sessions dealt directly with the issue while the remainder peripherally discussed the topic. Although the session on the Jamaican tax reform chaired by Messrs. Bahl and Skogstad at first glance appeared out of place in a seminar focusing on Sub-Saharan Africa, valuable lessons were learned from that session that could be extended to Sub Saharan Africa.

We also wish to apologize for some unevenness in the presentations that appear in these papers and proceedings. Some of the materials in our document are in the form of formal papers; these papers elaborate and expand on the subjects covered orally. All the other materials in these papers and proceeding are derived from edited transcripts of the oral presentations.

Don Harrison

TAX POLICY SEMINAR FOR SUB-SAHARAN AFRICA PROGRAM

<u>Thursday, October 29</u>

9:00 - 10:15	Implementing Tax Reform in Sub-Saharan Africa	Richard Goode, Brookings
10:15 - 10:45	COFFEE	
10:45 - 12:00	Sub-Saharan Francophone and Anglophone Economic Systems and Implications for Tax Policy and Administration	Kevin O'Connor IMF
12:00 - 2:00	LUNCH	
2:00 - 3:15	Problems in the Structure and Operations of Sales Taxes in Tropical Africa	John Due University of Ill
3:15 - 3:45	COFFEE	
3:45 - 5:00	Tariffs: Revenue Generation, Protection, and Other Selected Issues	Pradeep Mitra, IBRD

<u>Friday, October 30</u>

9:00 - 10:15	International Monetary Fund Activities in Tax Reform in Sub-Saharan Africa	Leif Muten, IMF Lotfi Maktouf, IMF
10:15 - 10:15	COFFEE	
10:45 - 12:00	USAID Tax Reform Initiatives: The Case of Jamaica	Roy Bahl, Syracuse University Sam Skogstad, USAID
12:00 - 2:00	LUNCH	
2:00 - 3:15	USAID Tax Reform Initiatives: The Case of Senegal	Jacqueline Damon, IMF Richard Greene, USAID

IMPLEMENTING TAX REFORM IN SUB-SAHARAN AFRICA

Richard Goode

Tax reform is needed in the countries of sub-Saharan Africa--and in other areas also--because of deficiencies of existing systems judged by the standards of revenue adequacy, economic efficiency, equity, and simplicity. None of these standards is absolute; all are subject to interpretation. And, properly, some of the standards are applied more rigorously as governments' ability to meet them improves. Without being patronizing, we may recognize that governments in sub-Saharan Africa cannot reasonably be expected to be so sensitive to tax equity as we urge (often unsuccessfully) our own government to be. Demands for revenue and the need for simplicity force some compromises of equity or fairness. Although a poor country can less afford economic inefficiency than can a rich one, it may be less able to forgo using taxes that economists consider inefficient.

This paper first comments on the objectives of tax reform, which are taken to be better performance with respect to revenue adequacy, economic efficiency, and simplicity. It then discusses four constraints on reform--insufficient knowledge, politics, weak administration, and poor compliance. Some suggestions for dealing with the first two constraints are followed by more detailed consideration of adapting to the administrative and compliance constraints and of relaxing them. The paper ends with a few concluding remarks.

GENERAL CONSIDERATIONS

Reform Objectives

Revenue adequacy is the most elementary of the standards that a tax system should meet. The prevalence of budget deficits in sub-Saharan Africa suggest that the tax systems are yielding too little revenue. Some will deny that and insist that the cause of the deficits is excessive spending, or temporarily adverse economic conditions. That may be true in a sense. If, however, large budget deficits persist for some time, we have to ask whether more revenue should not be an objective of tax reform. The answer should depend on the circumstances of each country. Surely, few, if any, countries in the region can afford to adopt reforms, however, desirable on other grounds, if they would result in substantial short-term revenue losses. My observation has been that it is hard to gain serious consideration for a revenue-neutral reform proposal. In Africa most ministers of finance regard revenue gain as the primary motive for tax reform.

With some exceptions, the budget deficits of sub-Saharan countries in relation to government expenditures and gross domestic product are not unusually large in comparison with those of other countries. But the African deficits are worrisome because, in the underdeveloped state of the region's financial systems, the deficits must be financed in ways that produce inflation, crowd out productive credit, prevent the accumulation of needed foreign exchange reserves, and build up foreign debt. Also, several countries--for example, Chad, Zaire, Mali, the Gambia, and Liberia--depend to a considerable extent on grants from foreign countries, which may be curtailed or eliminated by political changes at home or abroad or by budgetary stringency in donor countries.

No subtle arguments or refined analysis is necessary to show that greater economic efficiency is an appropriate objective of tax reform in sub-Saharan Africa. The heavy reliance on import duties in the majority of countries in the area has resulted in high levels of protection of domestic producers against foreign competition. Sometimes the condition reflects deliberate, though questionable, policy, but often it is the unintended consequence of depending on a traditional and expedient revenue source. Export duties in some cases have discouraged the production and marketing of commodities in which the taxing country enjoys a comparative advantage. Ill-considered special incentive provisions have sacrificed revenue and have encouraged enterprises that contribute little to modernization and growth. For some time to come, the countries of the region will have to look to taxes on imports for a substantial part of their revenue, but that need not inflict as much damage to economic efficiency as the present haphazard measures do. By rationalizing customs tariffs and substituting excises for revenue-motivated selective import duties, excessive and unintended protection can be avoided. Although good arguments can be made for eliminating export duties and special tax incentives, the more realistic goal is revision of the measures and moderation in their use.

The objective of improving equity or fairness has two dimensions. One is reducing differences in the amount of tax paid by similarly situated persons; the other is establishing a better relationship between the amounts paid by persons with differing abilities. The two aspects usually are called horizontal equity and vertical equity. As a minimum, horizontal equity requires legislation and administrative practices to ensure, so far as feasible, even-handed assessment and collection of taxes, avoiding omissions, bargaining, favoritism, and caprice. In a broad sense, horizontal equity is involved in the allocation of taxes between the rural and urban sectors. Vertical equity is usually interpreted as requiring some degree of progressivity, that is, a rising ratio of taxes to income as income increases. There are, of course, legitimate differences of opinion on the practicability and economic advisability of tax progressivity in countries at early stages of development. But there are no respectable arguments for tax regressivity, which causes the poor to pay a larger fraction of their income than the middle class and rich pay--a condition that appears to prevail in several sub-Saharan countries, although statistics to demonstrate it may be lacking.

Simplicity, always desirable, is especially important where tax administration and compliance are weak, as they are in Africa. There, as elsewhere, simplicity is endorsed but often subordinated to other priorities.

Constraints

The shortcomings of the tax systems of sub-Saharan Africa and the general objectives of reform are familiar. They have been documented in many offical reports and other studies. Why then has not progress been made in tax reform?

Trying to resist the human tendency to blame others for unsolved problems, I begin with my own profession, that of political economist specializing in public finance. The truth is that, owing to intellectual complexities, data shortages, and too little applied research, we have <u>insufficient knowledge</u> of existing taxes and possible reforms. Revenue estimates often are made on simplistic assumptions and are unreliable. The incidence and effects of taxes on agricultural production and marketing have been poorly understood, and some countries have blithely used them to excess with disastrous consequences for home consumption and the balance of payments. Other examples could be cited. Great uncertainties surround the appraisal of taxation on work effort, saving, and investment. Much room is left for differences of opinion, which frequently appear to be influenced by self-interest or ideology.

<u>Politics</u> are a second constraint on tax reform. As often noted, political leaders tend to have short time horizons. Not only in democratic systems with frequent elections but also in other regimes, benefits obtainable in the distant future are subject to a high rate of discount. Few politician are willing to invest effort and political capital in pushing through a reform if the benefits are likely to be realized largely during the tenure of their successors.

Tax reform always brings about a redistribution of burdens. Members of relatively narrow interest groups that would suffer from a proposed reform are easily made aware of their prospective losses and can be moblized to oppose the changes, whereas the more numerous beneficiaries generally are less informed, have less at stake individually, and are unlikely to offer active support. Especially in small countries, only one or a few firms may suffer from the withdrawal of a tax benefit, and they usually have allies in the political and bureaucratic elites. Although the activities of interest groups are best publicized in open, democratic systems, it would be a mistake to suppose that leaders of authoritarian governments, or even those regarded as dictators, are insensitive to the reactions of interest groups.

In Africa a notable feature of politics is the disposition of governments to favor the urban population at the expense of the rural population. In taxation this shows itself in export taxes on agricultural commodities (and in the operation of government or quasi governmental marketing boards), in protection for local producers of goods bought by farmers, and in low taxes on certain nonessentials, particularly durable goods, consumed by middle and upper-income urban residents.

Weaknesses in tax administration are a third important constraint on reform in Africa. They either make quite impracticable certain reforms that appeal on grounds of equity and efficiency or severely limit the speed and extent to which they can be introduced. Modern taxes such as sales or value added taxes and income taxes have to be assessed on the basis of books of account, whereas specific excises, specific import and export duties, traditional taxes on cattle, and poll taxes or hut taxes are assessed merely by counting units. Clearly, revenue officers need more general education and specific training to apply the modern taxes, and more information is required. A detailed but significant example may be drawn from income taxation. For reasons of equity it is evident that residents should be taxed on their world-wide income. If that is not done, two persons with equal incomes will be taxed in different amounts if one of them obtains a part of his income from a foreign bank account or other foreign source while the other obtains all of his income from domestic sources. Furthermore, failure to tax income from assets held abroad will offer an incentive to move capital abroad, which is harmful for local development. But the revenue authorities may lack the capacity to obtain the information necessary for even-handed assessment of world-wide income.

With weak administration, taxes and particular tax provisions that appear desirable may in practice bear little resemblance to the measures visualized by policymakers and their advisers.

Administrative weaknesses can be lessened by changes in organization, personnel policy, and procedures that I shall mention later. But low administrative capacity will remain a constraint on tax reforms that can sensibly be contemplated in Africa for some time to come.

Taxpayer compliance, which is the other side of administration, deserves separate mention. Taxpayers must be able and willing to keep at a minimum rudimentary accounts to allow the successful use of sales or value added taxes and income taxes. Complying with these taxes is more burdensome for small enterprises than for large ones, and it may be impossible for illiterate traders and artisans. There is no country where taxes are paid with alacrity, but the tradition of voluntary compliance--motivated no doubt by some mixture of civic virtue and fear of penalties--is stronger in most industrial countries than I judge it to be in Africa. The history of colonial subjugation, the feebleness of democracy, the centralization of government authority and administration, the perceived prevalence of corruption, and the scarcity of visible benefits from government spending may explain poor taxpayer compliance in the majority of countries in sub-Saharan Africa.

The Implementation Problem

Broadly stated, the strategic problem in implementing tax reform is how to obtain as much of the objectives as the constraints allow. This is partly a matter of circumventing the constraints and partly one of acting to relax them.

Regrettable as the inadequacies of knowledge are, national civil servants and outside advisers should not allow themselves to be paralyzed by contemplating the uncertainties. On many tax questions we can form plausible judgments of the right direction to move to advance toward reform objectives, though we may be less confident about precisely how far to go. And silence of the relatively disinterested parties will leave the way open for the self-interested and the ideologues.

While I will not try to lay out a program for filling gaps in knowledge of taxation, I have some modest suggestions. First, in my view, it is prudent to follow an incremental approach to reform, making a series of smallish changes over time and being skeptical of proposals for abrupt and sweeping reforms. The incremental approach is prudent because of incomplete knowledge and limitations on human rationality and decision-making capacity. It does have a conservative bias and sometimes may unduly delay or prevent desirable and feasible innovations. Second, efforts should be made to increase knowledge. Countries that have not done so can benefit by creating a small advisory staff in the ministry of finance, or possibly in the office of the prime minister or president, with continuing responsibility for studying tax problems and related issues. Only a few persons--in small countries no more than two or three--would be required to start the work. The function of the unit would be to prepare recommendations for the consideration of policy makers at opportune times. Systematic collection of relevant statistics can assist tax planning and day-to-day administration. In some countries worthwhile dividends can be gained at modest cost.

Improvements of the data base, I suggest, may well be a suitable object of technical assistance and financial aid. A traditional form of aid, financing for foreign travel and study, can also contribute.

Differences in political conditions among countries make it difficult to generalize usefully on ways of dealing with political constraints. A tactic that has gained limited acceptance in a range of countries is to sidestep popular opposition to taxation by applying user charges for certain services. User charges surely will not be welcomed, but the connection between the payment and a particular benefit is clear. For tax reform, incrementalism usually has political advantages as well as intellectual justification. Successful tacticians, however, will have to recognize that many politicians find taxation a dull or distasteful subject--or possibly a dangerous one--and may be reluctant to take it up frequently. The chances of acceptance of recommendations are greatly improved when they address a recognized problem or promise early revenue gains.

Sometimes action can be motivated by the prospect of bilateral or multilateral economic assistance. In my opinion, however, that kind of bargain is risky for the donors or lenders. Nominal acceptance of tax reform does not ensure its implementation.

CHARACTERISTICS OF THE AREA THAT AFFECT TAXATION

The social and economic characteristics of sub-Saharan African help account for the shortcomings of existing tax systems and condition the kind of reforms that can be successfully carried out. The characteristics that I shall mention might have been classified as constraints, but I find it more convenient to treat them separately. They are well-known to persons professionally concerned with Africa, but they are not always sufficiently taken into account in assessing the tax systems and possible reforms.

Most of the countries of the area are small in population and national income. Of the 41 countries for which recent estimates are readily available, 20 have populations of less than 5 million; only 10 have populations of more than 10 million. Only Nigeria has a gross national product larger than Hong Kong's. (Except as noted, the statistics cited in this section are from the World Bank's World Development Report 1987 or the International Monetary Fund's International Financial Statistics, various issues.) Small size limits the opportunity of using import duties and tax incentives to foster establishment of plants of efficient scale in many lines of activity. Small countries cannot support big overhead administrative structures and need to avoid duplication of effort and excessive specialization.

Average income is low. The majority of countries in the area have per capita income (GNP) below $400. Burkina Faso, Mali, Mozambique, Malawi, Zaire, and (no doubt) Chad had per capita GNP below $200 in 1985 and were among the dozen or so poorest countries in the world. Only Gabon, with a population of about one million and oil resources, had a high enough per capita income to place it a little above the median of the world array in 1985. In addition to limiting the size of the national market, poverty limits the ability of the population to pay taxes without harm to health and capacity to work.

Agriculture is a prominent part of the African economies. In the great majority of the countries for which data are readily available, 70 percent or more of the labor force is employed in agriculture. The lowest reported figure is 56 percent for Ghana, the highest, 93 percent for Burundi and Rwanda. To compare, the percentage in the United States is 4; for the industrial market economies as a group it is 7. Farmers are notoriously hard to tax; poor farmers are especially hard to reach, except for those who produce staple export crops. Subsistence agriculture, also prevalent in Africa, presents no convenient tax handle.

Small-scale enterprises are the norm in retail trade and much of what is classified as manufacturing (actually handicraft or artisan work). The absence or unreliablilty of accounting records precludes the assessment of an income tax on these enterprises by conventional means, and the application of a sales tax or value added tax is only a little easier.

Illiteracy is widespread in sub-Saharan Africa. For the area as a whole, it was estimated at more than 70 percent for adults in 1976 and at more than 90 percent in some countries. For low-income countries throughout the world, the estimate was about 50 percent (World Bank, Accelerated Development in Sub-Saharan Africa, An Agenda for Action, 1981). Illiterate people cannot be expected to fill out tax returns, and it is hard to communicate to them their responsibility for obtaining help in complying with new forms of taxation.

Enrollment in primary and seconday schools, though much higher than it had been two decades earlier, was still low in sub-Saharan Africa in 1984. This suggests that illiteracy will decline but will continue to impose limitations on taxation in the remaining years of this century. School children often are employed as a channel for communication with parents on tax matters, and skills in arithmetic taught by schools are essential for administration and compliance.

Inflation has occurred in sub-Saharan Africa, generally at faster rates than in Asia but at much slower rates than in Latin America. In Africa, the inflation "leaders" according to the latest available statistics are Sierra Leone, Gabon, Sudan, Zambia, Somalia, Tanzania, and the Gambia. In all these countries, a continuation of the recent rates would cause consumer prices to double in about three years or less. Inflation disrupts the tax system. Specific excises and customs duties are reduced in real value, income taxes are distorted, and taxpayers are given a great incentive to postpone tax payment as long as possible in order to pay in depreciated money.

The colonial heritage is the last characteristic that I wish to mention. There are marked differences between the tax systems of anglophone and francophone countries, traceable to the systems put in place by great Britain and by France and Belgium and to the continuing influence of contacts with the former colonial powers. The heritage also influences the organization and procedures for tax administration. In the former French colonies, French nationals are still to be found in advisory and executive positions in tax departments.

OVERCOMING ADMINISTRATIVE AND COMPLIANCE CONSTRAINTS

Improvement of tax administration and compliance is in itself a substantive part of tax reform. It is also a means of making feasible other desirable changes in the tax system.

Consolidation of Minor Taxes and Elimination of Unproductive Ones

In Africa, as in many less developed countries in other areas, administrative resources are inefficiently used and unnecessary compliance burdens are imposed in collecting multiple taxes on the same base, or worse on closely similar bases. This is especially common with respect to import and export duties, excises, and stamp taxes but also occurs in income and sales taxes. Multiple taxes may be merely historical artifacts, produced by successive tax increases, some of which were billed as temporary but which have become permanent. Others result from the imposition of earmarked taxes assigned to particular purposes or organizations. Consolidation of the taxes going into the general revenues would be a worthwhile simplification raising no significant controversies. Consolidation of the earmarked taxes would present no technical problems, and the beneficiaries of earmarking could be compensated by shares of the expenditures financed by the consolidated taxes. However, the beneficiaries probably would object, fearing that the sharing arrangement would be more vulnerable to change. Those of us who dislike earmarking, indeed, might consider that a side benefit of consolidation.

In most countries there are some taxes that yield so little that they simply cannot justified as revenue measures, considering the direct cost of collection and the indirect cost due to diverting limited administrative resources from more remunerative work, as well as the inconvenience to taxpayers. Some of these taxes have regulatory or sumptuary functions that may justify their continuance. Pragmatic administrators may ignore others, but surely it would be neater to repeal them. A government desperately short of revenue, however, may be reluctant to repeal any tax.

Structural Questions

Although there is no single model tax system that can be prescribed for all the countries of sub-Saharan Africa, the main elements that, in varying proportions, would make up a desirable system for the next generation can be identified. As I see it, they are:

-- A broad sales tax or value-added tax applying to imports and domestic goods and services, with no more than a few rates;
-- Excises designed to raise revenue from traditional sources, particularly alcoholic beverages, soft drinks, and tobacco, supplemented by excises on certain non-essentials, designed to

impart some progressivity to consumption taxes; these taxes would apply equally to imports and domestic production;

-- Import duties for protective purposes;

-- Individual and corporate (company) income taxes.

In addition some countries will find it expedient to apply export taxes to agricultural commodities and possibly to timber and minerals and some will wish to tax mining by royalities and possibly a resource rent tax. (See my book, Government Finance in Developing Countries, 1984, pp. 167-94.) Social security taxes can be expected to be a significant, though minor, component of revenue in the majority of francophone countries.

Since the organizers of the seminar have wisely commissioned papers on customs duties and sales taxes, I will not discuss the structural aspects of these major taxes. The broadening of sales taxes will place increased demands on revenue administration, requiring better trained staffs than are needed for specific import duties and other traditional taxes. The revenue excises on beverages and tobacco could be imposed at specific rates, thereby simplifying administration, though I think ad valorem rates would be preferable. Most of the excises intended primarily for a distributional function would have to be ad valorem taxes, which require somewhat more sophistication than specific taxes.

Among the major taxes, I am left with income taxes, on which I shall make some remarks. I may thus appear to be guilty, as authors of many other papers and reports have been, of giving attention to income taxes disproportionate to their present and prospective roles in less developed countries. I must confess that discussing income taxation is not uncongenial to me, considering the intellectual and practical complexities of the subject and my previous work on it. And I would not belittle incomes, even for sub-Saharan African countries. They already provide significant revenues in the area and can be expected to become more productive as modernization proceeds and tax administration and compliance improve. That does not imply that I advocate trying to make income taxes the mainstay of the revenue systems.

An income tax issue that is more important in Africa than in any other geographic area is the choice between a schedular and a global (or unitary) system. With the exception of Chad, Gabon, and the Congo, the francophone countries apply schedular or mixed (dualistic) systems inherited from France and Belgium, which have since abandoned them. In a pure schedular system, each of the principal income flows--salaries and wages, earnings from professional activities, business profits, dividends and interest, rent--is subject to a separate, flat-rate schedular tax, and rates differ among the schedules. Personal exemptions are not allowed. This system, or an approximation of it, is used in Zaire, Rwanda, Burundi, and Burkina Faso. Other francophone countries have mixed or dualistic systems, which add a global complementary tax to the schedular taxes and may "personalize" the schedular taxes by providing personal exemptions and graduated rates. The global or unitary system, which is most familiar to Americans, is used in anglophone countries. In a pure global system, income form all sources is aggregated and is subject to a single rate or set of rates, after allowance of personal exemptions and deductions. In practice, there are departures from the pure system, especially in the form of preferential effective rates for earned income and capital gains.

An advantage that has been claimed for schedular system is greater ease of administration and compliance, especially in collection at the source through withholding and dispensing with individual returns. These advantages would be clear in a very pure system, which included no personal exemptions or rate graduation. In that system, the final tax on salaries and wages, dividends, interest, pensions, and rent could be collected by withholding, and there would be no need for individuals to file returns showing income and family status. It would still be necessary to obtain returns from self-employed persons, and difficulties would arise in enforcing withholding requirements in the case of small enterprises. In dualistic systems the advantages become problematical. It can be argued, indeed, that the dualistic systems are more complex than unitary systems because doubtful items have to classified as belonging to one of the schedules. For instance, the income of a self-employed person would have to be broken down into earnings from professional activities, business activities, and income from capital.

Another practical advantage often claimed for a schedular or mixed system is that rate differentiation between schedules can roughly compensate for different degrees of underreporting or evasion. Thus rates on income from self employment may be higher than rates on salaries and wages because it is presumed that the former is less fully reported. Any equalization achieved in that way will be rough indeed. Rate differentiation on such grounds suggest acquiesence in cheating and offers taxpayers an excuse for underreporting. This is not conducive to an effective income tax.

Administration and compliance aside, a global tax clearly is superior on equity grounds. In order to obtain an index of a person's ability to pay taxes, it is necessary to take into account income from all sources.

Since all the European countries except Portugal and a number of developing countries that formerly had schedular taxes have abandoned them, Americans need not feel that they are being narrow-minded if they recommend a unitary tax to the francophone counties that have not followed the trend. Nevertheless, one should be cautious about doing so. There is a real danger that the conversion would lose revenue owing to the allowance of personal exemptions. Before a proposal is made, it will be important to assemble the statistics needed to appraise carefully the revenue and distributional consequences.

Withholding on salaries and wages is everywhere the backbone of the individual income tax. In the United States, withholding brings in more than two-thirds of the total tax. France is the only major industrial country that does not use withholding of income tax on salaries and wages, and--probably not coincidentally--France among OECD countries obtains the smallest fraction of its total tax revenue from the individual income tax.

The African countries generally withhold income tax on salaries and wages. Withholding could, with advantage, be extended to other recurrent income payments, including pensions, dividends, interest, rents, and royalties, although these flows are relatively smaller than in countries with more developed financial systems. As mentioned earlier, withholding cannot be expected to operate as well in Africa as in the industrial countries. At present withholding on salaries and wages applies mainly to employees of government and large enterprises.

When tax is withheld on some forms of income, there is a strong case in equity for requiring current payments of estimated tax on other income. Delayed tax payments are always advantageous to the taxpayer, especially so where credit is hard to obtain, real interest rates are high, or inflation is occurring. In Africa, it should be emphasized, only a small number of individuals, who receive substantial amounts of income not covered by withholding or who are subject to top tax rate, should be required to make estimates. Companies should also be placed on a current-payments basis. This is particularly important in countries that inherited from the United Kingdom an arrangement allowing unusually long delays in payment of company tax. As is usual in current-payments systems, taxpapers would be subject to penalty and interest if their estimated payments fell short of their liabilities by more than a reasonable margin.

The final point that I wish to make about the structure of the income tax is to suggest that African countries that have not done so consider adopting a minimum company or corporation tax. The simplest form of minimum tax is one based on turnover. It would be credited against the tax calculated in the regular way, and the company would pay any additional amount but would not receive a refund if the regular tax was smaller than the minimum tax. Ideally, the minimum tax in relation to turnover should vary among lines of activity, according to normal profit rates, but that may not be practical. The minimum tax admittedly is a crude device, but it is justifiable owing to the very limited capacity of the African revenue administrations to audit accounts, especially those of companies engaged in large transactions with foreign parents or affiliates.

A feature of African tax systems that is likely to strike the attention of Americans is the insignificant role of taxes on urban real estate, rural land, and other forms of wealth. Such taxes, when well administered, have fewer adverse effects on economic incentives than most other taxes, they can contribute to progressivity, and they serve as a means of paying for services that especially benefit property owners. Unforunately, taxes on wealth are not promising in Africa. Although I have not researched this carefully, I understand that land records and titles in the Western sense are nonexistent for rural land where tribal tenure prevails and often are unclear in other rural and urban areas. However that may be, effective and fair administration of real estate taxes would require a great prior investment in cadasters and valuation, an investment that the poor countries of sub-Saharan Africa cannot afford. Also, the political system of most countries in the region allows very limited scope for local taxation, which is the field in which property taxation is most likely to thrive. Direct taxes on personal wealth exist in several European countries, and in the abstract they are attractive. However, these taxes are poorly applied even in countries with strong administrations, and they are not important revenue sources anywhere. They cannot be recommended.

Another innovation that cannot be recommended is the introduction of a direct tax on personal consumption (usually called an expenditure tax). This would resemble an individual income tax with the vital difference that savings would be excluded from the base and borrowings would be included. The idea of replacing the income tax by an expenditure tax has attracted much attention and support from theoretically inclined economists during the past two decades. This is not the occasion for going into the arguments for and against the idea, though I should disclose that I belong to the minority of economists specializing in public finance who find the theoretical case for the superiority of the expenditure tax quite unpersuasive. An expenditure tax is not in effect anywhere. India and Sri Lanka, whose tax administrations appear to be superior to those in sub-Saharan Africa, experimented with the tax but found it unworkable and abandoned it. The African countries should not be asked to serve as a laboratory for further testing the stylish idea of an expenditure tax.

Administrative Organization

In countries following the British tradition, customs duties, excises, and sales taxes usually are administered by one agency, and income taxes are assigned to a separate department. In the francophone countries, the usual pattern also includes two departments, one of which administers customs duties while the other department administers internal taxes, including sales taxes, and excises, as well as income taxes. In both groups of countries, earmarked taxes are commonly administered by the departments or organizations that are the beneficiaries.

Especially in small countries, there are good arguments for consolidating the revenue agencies into a single revenue department. The separate administration of customs duties or of customs duties and excises and of income taxes has lost most of its former rationale with the trend to replace specific customs and excise duties with ad valorem rates and the adoption of sales taxes that are largely, though not solely, applied to imported goods. Except perhaps for motor vehicle registration taxes and a few other regulatory taxes, the administration of earmarked taxes should be turned over the revenue department. Specialized units within the revenue department would be needed, but the consolidation would facilitate the use of information obtained in connection with one tax in the assessment of other taxes. Especially helpful would be the routine use of customs and sales tax records in income tax assessment. Audits could cover all taxes at the same time.

Another organizational feature that, in my opinion, has outlived whatever justification it once may have had is the separation of tax assessment from tax collection. This practice, found mainly in the French-influenced countries, assign to the tax departments responsibility for determining tax liability and to the treasury the function of collecting the taxes. The separation is intended to prevent corruption by introducing crosschecks on the tax and treasury officials. These checks, however, are of doubtful efficacy. Since the treasury is the passive receiver of payments, lacking direct and continuous contact with taxpayers the system often permits large arrears in payments to accumulate. The revenue department should be responsible for tax collection as well as tax assessment.

Excessive centralization and failure to delegate authority are pervasive weaknesses of administrative organization in Africa. A study by staff members of the Fiscal Affairs Department of the IMF asserted, "The success of revenue departments in the sub-Saharan region in fighting excessive centralization is, in itself, a measure of their efficiency." Carlos A. Aguirre, Peter S. Griffith, and M. Zhutu Yucelik, "Tax Policy and Administration," in Taxation in Sub-Saharan Africa, Occasional Paper 8, IMF, 1981, p. 38). The authors recommended that, subject to the availability of staff, field offices be established to carry out the day-to-day work of assessment and collection, while the head office would be responsible for activities such as planning, budgeting, statistics, recruitment, training, legal and technical advice, appeals, and (in most cases) audit.

Personnel Policy

Whatever the organizational structure of the revenue department (or departments), its effectiveness will depend on the number, abilities, and motivation of the staff. In general, the urgent need in Africa is not for greater total numbers of staff--indeed, there are cases of overstaffing--but for better qualified and better motivated persons. As already emphasized, the operation of all the modern taxes requires staff with some understanding of bookkeeping. For field auditors, greater accounting skills and familiarity with tax law and regulations are needed. A modern tax department also needs lawyers, statisticians, computer specialists, writers and editors, and even engineers. The full complement of specialized staff is unlikely to be available in Africa. Perhaps the greatest recruitment difficulties are encountered in the least developed countries, where there are absolute shortages of such persons, and in the most prosperous countries, where alternatives to government employment are greatest.

Except possibly in the smallest countries, the tax department will be well advised to conduct formal training programs for both new recruits and veteran staff. To rely solely on learning on the job will yield spotty results and will tend to perpetuate poor practices. The training material should comprise some combination of general material on tax administration, management, and accounting and country-specific material. Tax departments may with to seek outside assistance in assembling the material and planning and organizing the training courses.

Senior officials, however, must be prepared for frustration caused by trained staff members' leaving the tax department for positions in state enterprises, the private sector, and sometimes other government departments. Training creates human capital, but that capital, unlike a piece of equipment, is not owned by the organization that paid for it. A philosophical tax official--and one may hope a central budget official--may be consoled by the thought that the national economy will benefit even if the tax department loses the trained people.

Recruitment,staff retention, and motivation are affected by the attractiveness of compensation. The pay of tax officers is much higher in relation to average national income in Africa than industrial countries, but it is generally inferior to pay in state enterprises and large private companies. It is tempting for a tax specialist to suggest that revenue officers should receive higher pay than other civil servants whose energy and probity do not affect revenues. Open application of such a practice would be politically unacceptable, but somewhat greater liberality in establishing civil service classifications for tax officers may be acceptable.

<u>Identification of Taxpayers</u>

Identification of potential taxpayers clearly is an important step in tax enforcement. It is especially difficult in countries where self-employment, small enterprises, and agriculture account for a large part of economic activity. The consolidated revenue department should establish and keep current master files for individuals and enterprises that are actually or potentially subject to the major taxes. This is easier in a consolidated department than when the responsibility is divided between two or more departments. Names for possible addition to the files can be obtained from records of business and professional licenses, import licenses, and other public records as well from unofficial sources. House-to-house canvassing and other dragnet operations, which are sometimes recommended, appear to me of questionable value because they may divert attention and staff time from more remunerative tasks.

Taxpayers should be assigned a unique identification number as an aid for controlling the master files, collating information, and cross-checking assessments and payments of different taxes.

A word of caution is advisable, however. Master files and taxpayer identification numbers are aids, not substitutes, for the examination of returns and field audits. Collecting too much material can result in information overload and harm.

Presumptive Assessments and Forfaits

Although reliable accounting records are the proper basis for assessing modern taxes, more rough-and-ready methods are needed to deal with small enterprises that keep no books, conceal their records, or submit patently false reports. Experienced tax officers make best-judgment or administrative assessments when the information supplied by taxpayers is believed to be incorrect of incomplete. Without formal guidelines, however, this practice can produce arbitrary and highly variable results and can degenerate into unstructured bargaining and corruption.

In the conditions found in sub-Saharan Africa, there is justification for establishing, as alternatives to conventional assessments, methods for determining estimated income or value added of certain classes of taxpayers who are not expected to provide reliable information from accounting records. The most elaborate methods are the Israeli tachshivim and the forfait systems of France and French-influenced countries, including some in Africa. Ideally, these methods are based on systematic economic studies that relate value added and income to selected indicators that are more easily ascertained. Again ideally, different indicators and different numerical values for them should be adopted for various industries and activities. Indicators may include gross sales or turnover, area cultivated and land classification, purchases of materials, number of workers, amount and quality of equipment, size and location of premises, imports, consumption of fuel and electricity, etc. In France, a fairly elaborate set of external indicators of the individual's consumption level, each indicator being assigned a numerical value, is employed in _forfaits_ for personal income tax. These include the rental value of the person's principal and secondary residences; ownership of cars, motorcycles, and boats; and employment of servants.

Although I am not confident of the utility in Africa of _forfaits_ for individual income tax, I believe that there is room for more systematic used of indirect evidence in assessing taxes on business enterprises and large-scale farmers in both anglophone and francophone countries.

Of course, reliance on _forfaits_ or guidelines is less satisfactory than direct assessment of income taxes and value added tax on the basis of reliable accounting records or similiar information. When rigidly applied, the alternative methods are converted into a tax on the indicators rather than tax on the normal base. The _de facto_ tax may have quite different economic effects from those normally attributed to an income tax or value added tax. But systematic _forfaits_ or guidelines are much preferable to undirected exercise of judgment by tax officials or bargaining between them and taxpayers and also are preferable to the large exemptions for smaller enterprises sometimes provided in value added tax laws. It is desirable to try to shape a _forfait_ system or set of guidelines so as to avoid making them more advantageous than regular assessments and thus discouraging taxpayers from improving their accounts.

Inflation

Inflation adversely affects the tax systems of African countries, and at a rapid rate it can be disastrous. The real value of specific excises and customs duties is automatically reduced. Even ad valorem duties and sales taxes on imports lose value if, as often is the case, the exchange rate used is not devalued in step with the rising domestic price level (more exactly, the excess of inflation in the home country over the rate in trading partners). Taxpayers have greater incentives to postpone paying as long as possible if penalties and interest charges for late payment are not increased to compensate for falling real value. The only offsetting factor is the increase in income tax liabilities owing to bracket creep and the overstatement of business profits and income from capital.

The remedy is (a) indexation of all specific tax rates, the personal exemptions and bracket limits for the individual income tax and (b) fixed-sum money penalties. Comprehensive indexing of the base of personal and company income taxes is impracticable, but consideration should be given to indexing depreciation allowances and the basis of capital assets where capital gains are taxed. Delayed tax payments should be adjusted upward to reflect the increase in the price index between the due date and the time of payment. The index applied should be a broad one; probably in most cases the consumer price index, though not ideal, is the best choice. The interest rate applied to overdue payments (and to refunds) that have been adjusted by the price index should be a moderate one rather than a high rate reflecting the expectation of continuing inflation, since the application of both indexing and exceptionally high interest rate would imply a double correction.

Although indexing would add a complication to tax administration and compliance, it would be a fairly small one. Indexing would be simpler than frequent changes in tax rates or the addition of supplementary taxes and surcharges. Governments, nevertheless, are reluctant to introduce indexing because they do not like to admit that inflation is likely to continue. Indexing of consumption taxes, moreover, will raise prices, exacerbate popular discontent, and stimulate wage demands. Politicians usually dislike the homeopathic remedy of raising prices to combat inflation.

It should be emphasized that inflation adjustments are no substitute for vigorous enforcement. In an inflationary environment, enforcement should be strengthened to prevent the treasury from being the last creditor to be paid. Unfortunately, government salaries usually lag behind prices, which is not conducive to the motivation of tax officers.

Combatting Evasion and Corruption

Suitable penalties are essential to deter tax evasion and encourage voluntary compliance. Although American often advocate imprisonment for flagrant tax evaders, governments of developing countries rarely accept that advice. I agree that monetary penalties are more suitable for an offense that usually generates little moral indignation. Prison sentences for fiscal fraud almost certainly will be imposed erratically and may be used against political opponents.

Some economist have suggested that (within wide limits) severe penalties for evasion can substitute for expenditures to enforce taxes. The reasoning is that the effective amount of a statutory penalty, as seen by a person contemplating tax evasion, is the product of the probability of application and the statutory amount. For example, a $100 penalty that is expected to be applied to 10 percent of the offenses has a probable or effective value of $10. A penalty of $1,000 that is expected to applied in only 1 percent of cases also has a probable value of $10. Since the probability of detecting evasion is closely related to the amount spent on enforcement, this immediately suggests that high penalties can make up for low enforcement expenditures. At one extreme, surely it is correct that there is a tradeoff between enforcement efforts and penalties. If penalties for noncompliance were abolished, a great deal of enforcement would be required to prevent revenue from plummeting. But at the other extreme, drastic penalties would be meaningless without aduiting and other means of discovering noncompliance. Between the extremes, the substitutability proposition is unhelpful because too little is known about how taxpayers will react to the risk of penalties. In practice, taxpayers would have no good way of ascertaining what the probability of detection of evasion is, since no intelligent administration will select audit cases solely on a random basis or will publicize the selection procedures. Moreover, people do not appear to be rational calculators of probabilities, as is evidenced by their purchase of lottery tickets and airline flight insurance. Severe penalties are a poor substitute for enforcement through withholding, systematic use of information, <u>forfaits</u> and guidelines, and field audits.

Faced with endemic corruption in public administration in less developed countries, many Americans and other observers from industrial countries tend, according to temperament, either to tactfully ignore it or to hotly condemn it. If the first attitude is patronizing, the latter is puritanical. While penalties have a role in checking corruption, other preventive measures are more effective. In the tax field, these include decent compensation for officials; internal audits in the tax department; and laws, regulations, and procedures that limit the scope for arbitrary and unreviewed actions by officials.

CONCLUDING REMARKS

In concluding, I wish to emphasize only a few points. The problem of implementing tax reform in sub-Saharan Africa, and elsewhere, is how to avoid, or relax, the constraints of insufficient knowledge, politics, weak administration, and poor compliance. Reform should be seen as comprising both improvement in the operation of existing taxes and changes in tax laws. Taxes and detailed tax provisions enacted without close attention to the constraints and other social and economic characteristics of the region may bear little resemblance in practice to the intentions of their proponents. In legislation, the prudent course, in my opinion, usually is an incremental approach rather than abrupt and sweeping changes. Care should be exercised to avoid unforeseen revenue losses, administrative overload, and a breakdown of compliance

Not surprisingly, modern taxes apply mainly to the modern sector. More study should be given to the question how best to tap the taxpaying ability of farmers, handicraft producers, and small traders without gross unfairness and damaging economic consequences.

Among the troubles faced by sub-Saharan African governments, deficiencies in their tax systems certainly are not the most urgent. A United Nations report issued two weeks ago spoke of rising debt, low commodity prices, declining food production, and cuts in aid. But the other troubles make tax reform more important, not less so. And the participants in this seminar have some chance of influencing it.

Francophone and Anglophone Sub-Saharan Africa: Economic Systems and their Implications for Tax Policy and Administration

Kevin O'Connor, International Monetary Fund

I would like to first of all thank A.I.D. for inviting me to talk on a topic that quite surprised me when I heard from Don Harrison, posing a question about Francophone versus Anglophone countries. These terms have been used by everybody that has worked on African countries, but I had never considered the topic at all systematically nor whether it had any operational value.

The study we wanted to undertake was to focus on three areas:

-- First, clarification of the terms as they are used and a meaningful classification of countries based on this;

-- Second, an analysis of broad macroeconomic indicators of these countries and country groupings to assess similarities and differences; and

-- Third, an analysis of the tax structure of these countries and groupings.

What do these terms mean? Do they have any real implications behind the obvious uses? The terms refer to French-speaking countries and English-speaking countries in Africa. We are referring to the official language in the country or perhaps the primary, non-native language in the country. However, often the terms are used rather casually to suggest a type of homogeneity in these countries that goes beyond just language.

There is perhaps reason to think this way because many of the Francophone countries or Anglophone countries come from a common administrative tradition which can broadly influence the governmental structure of the country. On the other hand, there may be as many or more differences than similarities among these countries that we are suggesting belong in a group. In fact, there may be very few common features apart from the common official language that they have.

It seemed like an intriguing idea to see if there was any kind of real consistency in these cubbyholes that we use to divide Sub-Saharan Africa .

Now, of course Francophone and Anglophone don't very clearly demarcate Sub-Saharan African countries. We could think perhaps more clearly of a well-defined Francophone group and then all other countries, of which English speaking countries are a subset. However, even the Francophone countries involve two different administrative traditions, the French and the Belgian. The latter covers three countries (Burundi, Rwanda, and Zaire), and there are many differences in the way the French and Belgian administrations are structured.

It would be surprising if there really is enough commonality among the countries we group under this umbrella of language as Francophone or Anglophone to provide any particular guidance to policymakers, to administrators in these countries, or to those who provide technical assistance to these countries.

Is there any real operational value to the distinction, particularly as it relates to fiscal policy and then tax policy as a sub-element of that.

I looked at two issues, including (a) a review of the country classifications in order to clarify what we are talking about in terms of Francophone versus Anglophone and (b) an examination of some of the macroeconomic characteristics which are likely to influence fiscal policy or are likely to influence tax policy in the medium term. The examination of tax structure, which is the third objective of the study, remains to be completed.

I think I must regretfully conclude that the work we have done so far says that there is not much operational use to the distinction other than the rather obvious one that relates to the countries which maintain common central banks within the Franc zone and the implications that has for administrative policy in general, fiscal and tax policy in particular.

With respect to country classification, Sub-Saharan Africa breaks down into three groups: Francophone countries, Anglophone states, and other countries which neither use English as an official language nor have any common administrative tradition with either the French or the Commonwealth type systems.

I have not focused on the third group, which is largely the Spanish and Portuguese countries -- Cape Verde, Guinea-Bissau, Mozambique, Sao Tome and Principe, and up until recently, Equatorial Guinea, because the data base is so weak for these countries that we can't compile comparable macro-indicators.

With respect to the two major groupings, the Francophone countries and the Anglophone countries, the clear demarcation among the Francophone countries is between those that came from the French administrative tradition and those that came from the Belgian tradition.

The countries that follow the French system have many similarities in terms of the administrative structure, the budget process, expenditure control, government accounting, and, as Mr. Goode discussed, some of the approaches to taxation. These elements are quite different in those countries which follow the Belgian system and the Commonwealth tradition of administration.

There are 17 countries in Sub-Saharan Africa that follow the French system (Table 1). There are two major subgroupings, the member countries of the West African Central Bank (BCEAO) and those of the Central African Central Bank (BEAC), both of which are part of a common zone linked to the French Treasury which is called the Franc Zone. Mali, which left the BCEAO shortly after independence, has recently rejoined.

There is a group of countries that also came directly from the French administrative tradition but which are not members of a common central bank including Djibouti, Comoros, Guinea, and Mauritania. The countries that are outside the Franc zone still have a number of similarities in their use of the French treasury system, the budget process, and expenditure control. However, they don't have the same policy framework as the Franc zone members.

This policy framework is quite critical because membership in these banks involves specific constraints on the economic sovereignty of these countries while at the same time providing substantial benefits.

The Franc zone has existed since the late 1940s and, in fact, the CFA franc which was established at that time has had the same exchange rate with the French franc since 1948, 50 CFA francs to the French franc. The countries, most of which achieved independence in the very early 1960s, established the common central banks from what was then a central bank that covered the French colonial areas in West Africa and in Central Africa. They have always worked under a system of fixed exchange rates, and the rate has not varied for 28 years.

Beyond the exchange rate, they have also had from the very beginning virtually complete monetary integration. That is, all of the countries have a common currency which circulates freely within the central bank areas.

In addition to the fixed exchange rate and full monetary integration, there is a great deal of cooperation in the monetary and interest rate policies. Broad credit policies are set by the union as a whole; the countries have an amount of autonomy but total credit allocation is done within this common framework for the union as a whole.

Tied into this, of course, is a relatively common interest rate policy. There have been some changes in recent years, particularly in the BEAC countries. While the central bank establishes core rates or prime rates for deposits and lending, it gives a certain margin to each country to decide where within these bands it will set rates. However, it is still fair to say that the objective of interest rate policies in all of these countries is to work together, to not set up incentives for flows between the countries or from outside the unions that would be considered distorting to the objectives of the union as a whole.

Countries that are members of the BCEAO and the BEAC have no possibility of unilaterally moving their exchange rate; they have full monetary integration; and their credit and interest rate policies are very closely coordinated with the objectives of the union as a whole.

Why do they submit to such constraints? They are linked to the French treasury which has de facto guaranteed convertibility of the CFA franc and which provides a source of balance of payments financing.

That is not to say, however, that there are not severe external and/or internal imbalances that can develop within these countries and such imbalances have arisen in members of both of these banking unions since the late 1970s.

We have countries that don't have a balance of payments financing constraint as we normally define it but, as is the case for all countries, can be subject to structural imbalances as well as short-term payments difficulties.

If we look at the membership of the unions, how do the countries evaluate the advantages and disadvantages? It is very clear that the advantages outweigh the disadvantages because if you look at the history of the unions, they have been remarkably stable. There have been no movements or changes in membership in the BEAC except the rather recent joining of Equatorial Guinea (a country that had developed completely outside the French tradition). The core of the BCEAO has remained remarkably stable throughout the whole of the 70s and 80s, the only real change occurring being Mali leaving the union almost 20 years ago and its rejoining two or three years ago. They have the advantages of the union. On the other hand, they have the limitations on policy variables and policy instruments.

The countries still have to adjust. Where does the onus of of adjustment fall? The onus of adjustment falls, basically, on fiscal policy. This is the only area in which these countries really have full independence to act (a contradiction of the theory of economic integration that points to the advantages of simultanecus monetary and fiscal integration).

Certain fiscal constraints have also always existed in these unions -- a statutory limit and this is very similar in both of the unions. It attempts to enforce fiscal discipline by limiting the total outstanding credit to a member government from the banking system in that country to twenty percent of the previous year's revenue. This is not a yearly increment that the governments may borrow. Rather, it is a stock amount. A small increase in revenue in a year will only lead to a small increase in the ceiling that is allowed to the country for borrowing from the banking system. There is a minor difference in that the BCEAO sets the twenty percent limit on tax revenue and the BEAC sets it on the tax-plus-nontax revenue, but this in practice is a rather minor difference.

This fiscal constraint has always been a part of the mechanism of the Franc zone, and it was obviously put in place to promote fiscal discipline but it never has worked very effectively. Even though the statutory ceilings have rarely been broken, they have very rarely acted as an effective limit on government expenditure or the fiscal deficit for a number of reasons. One, the ceiling itself is a ceiling on gross claims on the government. For many years, particularly during the 70s, most of the members had large creditor positions with the banking system in terms of deposits and they could drawn down these deposits as long as they did not affect the ceiling.

In addition, many of the countries, particularly during the mid 70s when they were benefitting from the commodity boom, had rather free access to foreign borrowing. Indeed, it was often easier to borrow abroad -- they had the direct links through the French market -- than it was to borrow from the central bank, to borrow locally, or to attempt to develop any kind of a domestic financial instrument market because the foreign lenders, particularly banks, were quite willing to make the funds available.

The third major reason why the statutory limits were ineffective was governments' incurrence of substantial levels of payment arrears. They weren't breaking the statutory ceiling that was set up but they still were avoiding it entirely. The financing of expenditures wasn't showing up as government financing, but the burden of financing was being shifted to the suppliers of goods and services to the government.

In sum, the statutory limit while on the books was never very effective in enforcing fiscal discipline.

In general when countries are looking at the need to adjust, they must put together a financial program that links measures in different areas. It may be a combination of monetary and interest rates, exchange rate adjustments, and fiscal policy.

In the Franc Zone countries, independent policies were largely limited to those affecting tax and expenditure. In some cases, expenditure and revenue policies were used as a proxy for exchange rate change through a tax/subsidy mechanism, although with limited success.

The countries within the BEAC and the BCEAO certainly do form a group that one has to look at collectively. In a broader macroeconomic policy sense, we are looking at the set of targets and instruments for the group as a whole. In the individual country sense, we have to look at how much individual adjustment fiscal policy can make.

The similarities among the countries within the Franc zone seem to far outweigh the differences in terms of their approach to policy. They share the French administrative tradition, the French Treasury tradition, with the countries that are grouped in other French systems. However, Comoros, Djibouti, Guinea, Madagascar, and Mauritania still maintain the other policy instruments of the exchange rate and an independent monetary and interest rate policy along with the fiscal policy tools.

Can we see any similar groupings that suggest themselves in the Anglophone countries? One can examine similarities of those countries that come from the British tradition -- broadly similar budget processes, accounting systems, and financial controls. However, with most of these countries, the break with the original system came early after independence, and it is rather difficult to say that this group of former British colonies, or group of commonwealth countries are now acting sufficiently similar in the way they are carrying out their policies to suggest any grouping. They all maintain independent control of a broad range of policy instruments.

Some groupings, of course, are possible -- Botswana, Lesotho, and Swaziland, because of their connection to the South African customs union.

With respect to the other "Anglophone" countries, Liberia certainly doesn't belong in the British tradition at all. You have countries like Seychelles which is partially French speaking but from the British administrative tradition; Somalia that came from two colonies, one of which was British and one of which was Italian; and Zimbabwe that had very much its own separate development.

Therefore, I did not see any basis for grouping these together in an sub-heading, and I looked at the Anglophone countries as a single group.

After arriving at an acceptable classification scheme, the second objective of the study was to look at some of the major macroeconomic variables to see whether we can group Anglophone countries together or Francophone countries or subgroupings of these countries together to lead to a meaningful common approach to policies or approaches to administration in these countries.

I had intended to undertake a two-phased analysis. The first was to look at these macroeconomic variables. The second was to look at the tax structure in the countries. I will mention a few words about the tax structure at the end. This is work that is continuing and that we hope to finish when an expanded new data base will become available for the relevant period within the Fund. For today, however, I would like to concentrate primarily on these other macro-variables to see what kinds of similarities, what kinds of differences exist in the groupings of countries.

The first point to be made is that, in looking at these numbers and doing any kind of cross-sectional work on Sub-Saharan Africa, one cannot over-estimate the statistical difficulties in trying to put together a comparable data base.

Anyone who has worked in several sectors of any Sub-Saharan African country knows how difficult it is to put together consistent data for that country if you are trying to prepare a financial program or trying to link monetary and balance of payments and fiscal numbers. Even to study a given country by itself involves serious statistical problems. To try to put together truly comparable data bases across the 40-odd countries that we are concerned with here is clearly impossible. Nevertheless, that said, we went ahead and worked with the best data available.

The data sources vary tremendously, particularly for the types of variables that we are looking at in terms of their consistency and their reliability.

In the IMF, we do have the Government Finance Statistics GFS) Manual which has a very consistent methodology and coverage and classification of government transactions supported by a published methodology. This is a system that has been adopted in the budgetary framework and nomenclature in a number of developing countries.

However, the GFS does not have full participation of all Sub-Saharan African countries as this participation is voluntary. Gaps in country coverage can, therefore, be due to either the unwillingness or the inability of the country to produce accurate and timely statistics in the fiscal area.

In recent years, timeliness of the GFS data has improved due to the inclusion of provisional data and partial data into the system, and the next version of the GFS Yearbook will have substantially improved coverage and timeliness.

The use of provisional data involves some tradeoffs in coverage and some tradeoffs in completeness, but we think they are worthwhile tradeoffs to improve the timeliness of the data.

National accounts data, of course, are critical for any evaluation of performance of these economies, and this is probably the weakest link in the whole system. The data are untimely and the data really are quite inconsistent across countries. It doesn't take much probing in any one of these countries to find serious problems with the national accounts. In spite of these problems, we have had to use GNP data as a basis for comparison -- most of our indicators are expressed as proportions of GNP.

Debt data, of course, are very important now. The World Bank for many years has had the Debtor Reporting System. It also publishes the World Debt Tables on an annual basis; this has fairly complete coverage for Sub-Saharan Africa.

The World Debt Tables have for many years covered the public and publicly guaranteed external debt of the country, and only in the last few years have they begun to focus on a broader coverage to include the shorter-term public debt and the private sector debt of the countries. Estimates for these categories are now included for a number of countries. But the numbers that are published by the World Bank now for total debt are somewhat less complete and accurate than numbers for the public and publicly guaranteed medium- and long-term debt.

The four international organizations -- the Bank, the Fund, OECD, and the Bank for International Settlements, that have been most concerned with debt statistics -- have produced a manual on external debt statistics that covers definitional and methological problems. The manual also details quite extensively what each of those organizations does in terms of collecting and publishing external debt statistics. The manual will be published early in 1988.

In spite of these data difficulties, I wanted to look at some of the major indicators that might have implications for fiscal policy. They fall into a couple of groups including GNP, trade, inflation rates, growth, debt, and fiscal indicators.

The first indicator that most people look at in dividing these countries is per capita GNP, and Mr. Goode has already alluded to how weak these data are. However, we still use the data as a broad scaling factor. To illustrate demographics, I have put together three columns of data based on the World Bank estimates of U.S. dollar per capita GNP, total GNP and population. (See Table 2.)

If you look at the raw data, it looks like (a) in terms of population the Anglophone countries are very substantially larger than the Francophone countries, (b) the GNP of the Anglophone group is much larger, and (c) the per capita income is about 60 percent higher in the Anglophone countries.

However, if you take Nigeria out of that group, you end up with (a) Anglophone per capita income of $354 against $343 for the Francophone group, (b) a GNP of $40 billion as opposed to $41 billion in the Francophone countries, and (c) a population of 110 million as compared with 120 million. Removing this one very large country makes these numbers look much more comparable. Nigeria has a $76 billion GNP and a population of 100 million.

The imports and exports, of course, are very important as tax bases, particularly the imports, in most of the Sub-Saharan Africa countries. The net of imports and exports could also be looked at as a proxy for the current external balance of these countries.

I was actually quite surprised when we put all the the numbers together and looked at the imports, which is a standard measure of an economy's openess, to see that the Francophone countries' imports as a percent of GDP were considerably less than for the Anglophone countries.

The numbers that are implied show a gap between imports and exports substantially smaller for the Francophone countries than for the Anglophone countries. This does not carry over as much to the overall balance where the capital flows and other current account items have been in favor of the Anglophone countries. However, gaps of this size are quite serious for these countries, particularly in the view of shortfalls in aid and the complete drying up of commercial banks as a source of financing. In 1986, it is estimated that banks around the world absorbed about $2 billion from Sub-Saharan African countries. In effect, they have become a negative means of financing for these countries.

Inflation in Francophone countries is lower, and this has been largely due to the success of the coordinated monetary policies run by the BEAC and the BCEAO. The three-year average of inflation for the BCEAO is 5 percent and under 10 percent for the BEAC countries, still quite good performances compared to developing countries as a whole and the Anglophone African countries in particular. The average for the Anglophone countries is almost 25 percent on average for those three years.

The growth rate in Sub-Saharan Africa during the early 80s were very, very low. The growth rate for the Francophone countries is about 1 percent in real terms. For the Anglophone countries, a little better, about 2 percent.

In both groups, we had five countries that showed negative growth on average for these three years and growth rates of over 5 percent were only shown by three of the Francophone and three of the Anglophone countries. In sharp contrasts, 5 percent growth rates in the 70s were considered very much on the low side.

The fiscal indicators, the government deficit, expenditure and tax revenue as a percent of GDP also show similarities.

The government deficit that I have defined is total revenue and grants less expenditure and lending operations -- that conventionally defined by the IMF. This includes grants as a revenue item. The other adjustment that has been made here is including in these figures, where it could be measured, the build-up of arrears. This is not the deficit defined on a cash basis. Instead, it is the deficit on a commitment basis -- what the the states should have paid if they had the money or were willing to spend the money. Incurrence of domestic arrears has been much more of a problem in the Francophone countries than in the Anglophone countries, but it has developed in a number of the English-speaking countries in recent years.

The two groups of countries countries come to a similar overall outcome -- an overall fiscal deficit of about 6 percent of GDP. It is, of course, extremely difficult to compare deficits across countries. One must know a great deal about what is happening in the other areas of financial policy before one can assess the macroeconomic burden of the fiscal deficit.

It could also be argued that for many of the countries the government deficit is not important. What you really need is a public sector deficit because the public enterprises are integrated as a part of a common policy with the central government and have similar types of overall impacts on the economy. All of that is very true, but it is at this stage very difficult to gather comparable data on public enterprise deficits or the impact of that whole sector in Sub-Saharan Africa. We are forced therefore to rely basically on central government statistics.

If the government deficit can be used as a measure of fiscal performance or a measure of the impact that the government has on the economy, government expenditure is probably the best proxy for the size of the government within the economy. We see not very substantial differences here, slightly larger government sectors in the Anglophone countries than in the Francophone countries.

With respect to the tax ratio -- total tax revenue to GDP, I was mildly surprised to see that the group of Anglophone countries as a whole had somewhat higher tax ratios than for the Francophone countries.

Many people have argued over the years that the tax ratio itself doesn't tell you very much about what is really being done on the tax side, and there have been many attempts to try to measure tax effort or to try to assess revenue performance in terms of its available tax bases or other characteristics of the economy. We reviewed some of the studies that that had been done in the past, particularly in the IMF, in developing an international tax comparison index. The methodology attempts to estimate a "normal" or expected tax ratio for each country based on available tax handles and other economic charateristics. To calculate the tax comparison index, the actual tax ratio to GDP is divided by the estimated ratio to determine if a country's tax revenue effort is greater than expected (an index greater than unity), as expected (about unity), or less than expected (lower than unity).

If you average the tax indices - this was done for three different periods for the Francophone countries as a whole, the resulting figure was almost exactly one. For the Anglophone countries as a whole, the number comes out to 0.98. Although these are very imperfect measures, on the whole one could conclude that there is no significant difference between the two groups in terms of tax effort related to tax capacity.

The final and perhaps the most important issue to be looked at in the present context of formulating medium-term fiscal policy is the debt position in these countres.

What is presented in Table 2 is the World Bank's external debt statistics. You can see its estimates of the total debt, the public and publicly guaranteed debt and the debt service figures. The Francophone countries are considerably more indebted than the Anglophone countries. The resulting difference in debt servicing is not as severe because the consessional element of financing appears to be higher for the Francophone countries.

One element that has to be added to this perspective -- in looking at the kind of total debt that the country has to adjust to in terms of mobilizing resources -- is the question of arrears.

Several of the Francophone countries, in particular, had accumulated substantial payments arrears even before the debt crisis. This had its impact on many sectors of the economy. The government was undertaking expenditure programs but not paying suppliers, thereby shifting the financing burden. The government was not borrowing to cover its expenditures, but the suppliers of goods and services were financing the government or the banking system was financing the suppliers. This, of course, has many negative consequences as suppliers build their expectation of payment into the pricing structure of the goods and services provided to the government.

Arrears now occur in both the Francophone and the Anglophone countries but usually for different reasons. The arrears in the Francophone countries are primarily due to the statutory liquidity constraint imposed by the BCEAO and BEAC. The arrears that develop in the Francophone countries can be both domestic and external. They may not pay suppliers. They also may not pay their foreign debt. However, the foreign arrears are not due to a lack of reserves but rather to a lack of local currency to purchase the foreign exchange to settle the external arrears.

In the Anglophone countries, the arrears are basically external although there have been some instances of domestic arrearages. The countries lack foreign exchange reserves and do not have access to sources of foreign exchange financing. The final issure we wanted to examine was the tax structure itself.

While some advances have been made, we are hoping to make even greater progress in the next few months in putting together a complete analysis of the tax structure for the country groupings. The next issue of the GFS Yearbook will be more comprehensive and will provide more data on a comparable basis for the 1983-85 period.

To summarize the work we have carried out so far, there does not appear to be much operational value in distinguishing Sub-Saharan African countries on the basis of Francophone and Anglophone.

TABLE 1.

Classification of Countries

1. Francophone countries
1.1 French system
1.1.1 Franc Zone

1.1.1.1 BCEAO
- Benin
- Burkina Faso
- Cote d' Ivoire
- Mali
- Niger
- Senegal
- Togo

1.1.1.2 BEAC
- Cameroon
- Central African Republic
- Chad
- Congo
- Gabon
- (Equatorial Guinea)

1.1.2 Other French System
- Comoros
- Djibouti
- Guinea
- Madagascar
- Mauritania

1.2. Belgian system
- Burundi
- Rwanda
- Zaire

2. Anglophone countries

Botswana	Seychelles
The Gambia	Sierra Leone
Ghana	Somalia
Kenya	Sudan
Lesotho	Swaziland
Liberia	Tanzania
Malawi	Uganda
Mauritius	Zambia
Nigeria	Zimbabwe

3. Other countries

Cape Verde	Mozambique
Ethiopia	Sao Tome and Principe
Guinea	(Equatorial Guinea)

Comparative Indicators

Data cover the period 1983-1985 and represent three-year averages to smooth fluctuations. Where data for 1983-1985 were not available, the three most re..ent years were used.

	GNP per capita $US	GNP (millions of $US)	Population (millions)	Exports (% of GDP)	Imports (% of GDP)	Inflation rate
Francophone countries	343	41450	120809	22.78	26.7376	16.55
of which: BCEAO	305	13880	45538	20.41	33.4	5.17
BEAC	910	14240	15643	30.92	23.88	9.23
Maximum	3300	8300	30557	59	42.33	51.05
Minimum	140	110	362	11.37	14.71	1.67
Anglophone countries	548	115100	210139	24.45	35.76	24.73
Maximum	1070	75940	99669	76	73.67	70.58
Minimum	170	170	65	6.33	8.67	1.14

	Real growth rate	Total debt (% of GDP)	Public debt (% of GDP)	Debt service (% of GDP)	Debt service (% of XGS)
Francophone countries	1.0	84.4	70.2	5.0	14.0
of which: BCEAO	-1.3	90.5	72.7	5.9	18.2
BEAC	3.3	45.6	38.3	5.4	9.8
Maximum	9.6	194.0	177.4	13.7	27.4
Minimum	-4.2	9.9	7.5	0.6	5.5
Anglophone countries	2.0	60.3	47.7	3.7	12.8
Maximum	16.6	210.3	150.8	6.9	30.8
Minimum	-4.7	25.7	18.2	1.2	3.9

	Government deficit (% of GDP)	Government expenditure (% of GDP)	Total tax revenue (% of GDP)
Francophone countries	-6.0	28.4	15.5
of which: BCEAO	-6.6	25.0	13.9
BEAC	-4.0	27.1	18.7
Maximum	-9.3	41.6	37.0
Minimum	-1.0	14.5	5.2
Anglophone countries	-6.9	32.2	20.2
Maximum	-15.2	57.2	35.3
Minimum	14.3	10.4	6.2

PROBLEMS IN THE STRUCTURE AND OPERATION OF SALES TAXATION IN TROPICAL AFRICA*

John F. Due, University of Illinois, Urbana-Champaign

Sales taxation, in the sense of general levies on sales, as distinguished from excises applied to particular commodities, came relatively late to tropical Africa. The tax spread through most of Europe after World War I and into Canada and Latin America in the same period. It was introduced at the state level in the United States in the 1930s. Only since 1960 has the tax been used in tropical Africa, and only in the last 15 years has the use been extensive.

THE PRESENT SALES TAXES OF TROPICAL AFRICA

As of 1987, unless there have been recent changes, only nine tropical African countries do not levy sales taxes in the usual sense of that term: Nigeria (in which selective consumption taxes, called sales taxes, are levied at the state level), Sierra Leone, Gambia, Liberia, Somalia, Rwanda, Angola, Mozambique, and Guinea-Bissau. Some countries do not label their sales taxes as such; the tax in the Sudan is called the

---

* Paper prepared for seminar on tax policy in Sub-Saharan Africa sponsored by the Africa Bureau of the U.S. Agency for International Development, Washington, D.C., October 29-30, 1987.

development tax, that in Malawi the surtax. The taxes fall into several well defined groups, as shown in Table 1, although information is not adequate on some to be certain the classification is correct.

The suspension type manufactures sales tax is dominant, with several Francophone countries having shifted to the value added technique, together with Kenya and Mauritius in part. Only Madagascar and Niger extend their tax, by law, through retail levels, but because of exemptions few retailers are in fact subject. Only Zimbabwe uses a retail sales tax.

The Revenue Importance

Table 2 indicates the revenue importance of the sales taxes in the various countries, for the latest year available, typically 1982, 1983, or 1984, based on statistics compiled by the International Monetary Fund. The heaviest reliance is in Tanzania, in which over half of the total tax revenue comes from the sales tax; high dependence is also found in Niger, 34 percent; Senegal, 32 percent; Malawi, 29 percent; Kenya, 28 percent; Madagascar, 26 percent; Zimbabwe, 25 percent; and Zaire, 25 percent. The tax is not a significant revenue source in Guinea, Benin, Ghana, or Botswana, apart from the countries that do not use the tax.

For the continent as a whole, the sales tax yields 16.8 percent of the tax revenue of the countries using the tax, 12.6 percent for all countries. Relative reliance in Africa is comparable to that of all market economy countries, somewhat less than the relative reliance in Asia and South America. But the differences are not great.

THE MAJOR CONSTRAINTS

Development and operation of an optimal sales tax system in tropical Africa is significantly affected by several major constraints, ones growing less serious on the whole, but still important at the present time.

Characteristics of Business Firms

A major constraint centers around the size and nature of most business firms and farming operations. While virtually all African countries have some large enterprises, often foreign, expatriate, or government owned, and some have large commericial farms--Zimbabwe and Zambia, for example--economic activity is typically carried on by small enterprises. Many of the operators--craft producers, repair shops, service activities, traders, farmers, are only semi literate. Their record systems are either nonexistent or very incomplete, and it is difficult to get them to improve the systems. The task of preparing sales tax returns, even of the simplest type, is beyond their capacity. Even in somewhat larger establishments and with the emergent farmers, record keeping necessary for compliance with a sales tax is almost beyond their competence.

The problem of obtaining the cooperation of firms, essential for effective sales tax administration, is made more difficult in some countries by attitudes toward the government and taxes. Especially after independence, but even yet to some degree, taxes are regarded as instruments of colonialism, not the means by which the costs of government services important to the people of the country are shared. Other countries are ruled by hated dictatorships, to which little loyalty is felt. In some countries, a substantial portion of economic activity is still carried on by non indigenous groups. Some of these persons have been subject to deliberate discrimination and many feel that they have no long period future in the country. One can hardly expect them to feel strong loyalty to the government.

Problems of Administration

While the governments of most tropical African countries have made great strides in levels of education and competence of their civil servants in revenue administration as well as other fields, there are still major shortages of adequately trained personnel. This is particularly true of technical personnel, such as auditors; there are still too few persons trained in accounting generally. Management skills are still limited. Governments are reluctant to pay adequate salaries, and thus tax departments constantly lose to parastatals and the private sector persons they have trained. In many African countries communication is still limited, and transportation facilities are inadequate and expensive- especially in countries such as Tanzania in which foreign exchange has been very limited and there are constant shortages of motor fuel and vehicle parts. While record systems are recovering from initial deterioration they suffered after independence due to lack of trained personnel, they are by no means adequate in many countries. Sales taxation is particularly suitable for computerization, requiring only very simple inexpensive computers, but personnel trained in repair and maintenance are often not available.

Political Considerations

A final constraint of this general type, one difficult to quantify, is that of corruption and political interference with effective operation. Customs and sales tax operations obviously lend themselves to bribery, and as in all aspects of government there is danger of policical influence in selection of personnel and decision making. It is impossible, in any country, to determine the extent of corruption in government, but it is believed to be widespread in some African countries, less in others. But quite apart from outright corruption, selection of key personnel may be on a political basis--to the possible detriment of effective management.

CHOICE OF THE FORM OF SALES TAX

A crucial issue is the choice of the form of sales taxation a country is to use. For most African countries now the issue is whether to change from the existing form; for a few others, if a sales tax is to be introduced, what form should it take?

The Manufactures Sales Tax

A sales tax confined to the import and manufacturing level is the most common form of sales tax in Africa today, although there are several variants. The merits of this form of sales tax are obvious. The tax applying at importation can be enforced to the extent that smuggling is prevented and customs duties are enforced. Typically half of or more of the sales tax revenue is collected at importation.* On domestic production, there are typically only relatively small numbers of manufactures in the usual sense of that term, apart from small craft producers who are usually excluded. Because these are relatively large firms, their record systems are adequate; their accounts are subject to audit by independent public accounting firms; ownership and top management is often foreign, with experience with taxes in other countries. Others are parastatals, with less incentive to avoid taxes than strictly private ventures. Examples of numbers of registered firms (the figures are not entirely current) are Ghana, 125; Uganda, 130,; Zambia, 420; Sudan, 625; Tanzania, 1,000; Mauritius, 1,589; Kenya, 2,300 (1987).

There are, however, inherent limitations to this form of tax, ones that become increasing serious as development continues. First, firms are given strong incentive to push activities and therefore cost elements beyond the point of impact of the tax to reduce tax liability. There is evidence of this in several countries using this form of a tax. When wholesale distributors are controlled by the manufacturers,

---

* Typical figures include: Madagascar, 59; Mauritania, 60; Mauritius, 65; Uganda, 60; Cameroon, 89; Zambia, 49; Kenya, 55; Ivory Coast, 47; Senegal, 36.

this step is particularly easy. Firms not wishing to integrate forward are discriminated against. Secondly, since margins on various goods differ, the ratio of tax to final consumption expenditure will not be uniform, nor conform with any possible desired pattern of differentiation. The ratio is likely to be greater on widely used commodities, which have lower markups, than on "luxury" goods. Thirdly, to raise a given sum of revenue, the rate must be higher than with a tax extending into the distribution sectors, twice as high, more or less, compared to a tax extending through the retail level. Finally, the small firm problem is not by any means completely eliminated; in all African countries there are many small craft producers (furniture, for example), as difficult to control as the usual retail shops.

Suspension vs. Value Added Approaches. If the tax is to be levied at the manufacturing level, there remains the issue of whether the suspension or value added techniques should be used to prevent cascading of tax.*/ As noted above, several Francophone countries, following the French example, have tended to use the latter, the British commonwealth countries the suspension approach, Mauritius and Kenya in part being the only exception. The answer to this question is not a clear cut one. The value added technique lessens the danger of evasion.

---

* Cascading is the taxation of goods and services more than once, e.g. taxation of both the final product and its inputs.

A substantial portion of the revenue, even on domestic goods, will be collected at importation (on materials, etc.), and sales by one manufacturer to another will be subjected to the tax. A definite audit trail is established. The use of the value added technique paves the way to ultimate expansion to the wholesale and retail sectors, when conditions permit their inclusion.

However, the suspension system at least appears simpler. Firms buy materials, etc., free of tax, and calculate their tax liability merely by applying the tax rate to taxable sales. With the value added approach they must keep and cumulate records of tax paid on purchases as well as applying the tax rate to their sales. This is not an unsurmountable task, but is of some significance, and appears, when a tax is being considered, more serious than it is. One other problem with the value added approach relates to working capital, particularly for export industries. Firms must pay tax on the importation or domestic purchases of inputs into production, only receiving credit for this tax after elapse of a period of time. In a sense this problem is serious only when the tax is introduced or the rate increased, or the firm is expanding--but given common shortages of working capital even this can be serious for some firms, perhaps necessitating special treatment of export industries. However, there are not many export industries as yet in the tropical African countries.

With regard to taxation of imports, it is important to note that application of the value added tax at importation will increase the incentives for smuggling, misreporting, and undervaluation. The higher the sales tax rate, the greater the added incentive. For some African countries, smuggling is a serious matter; for others it is not. All, though, suffer from valuation problems, lacking sufficient trained valuation officers. A major argument used in Paraguay in South America against a shift to the value added form of tax is that of increased incentive to smuggle.

Extension of the Sales Tax Beyond the Manufacturing Level

Given the nature of the distribution firms in most tropical African countries, it is simply not feasible to extend the tax beyond the import-manufacturing sector at the present time, despite the great advantages of doing so. But there are exceptions. One possibility is to include larger wholesale firms within the scope of the tax, thus bringing the tax somewhat closer to the final consumption level. In some countries--and the Caribbean Islands provide the best examples--the wholesale distribution firms are larger and easier to control than the typical manufacturer. In Zambia and, to some extent, other African countries, most wholesale firms are either foreign or government owned. Much of the problem of shifting functions forward to reduce tax will be eliminated, as it is less feasible, in the African context, to shift functions to retailers--though in time this will occur. Inclusion of wholesale firms has already been accomplished in Madagascar and considered in other Francophone countries.

Use of a suspension type tax at the wholesale level has little to commend it in the African context; there is too great danger of leakage of tax that can be collected at the import and manufacturing levels, and much wholesaling is done by small firms.

Extension of the tax through the retail level or use of a suspension type retail sales tax is not feasible today in the typical tropical African country despite the ultimate advantages of this form of tax. Only Zimbabwe uses a suspension type retail sales tax and from all indications it operates successfully, but the structure of retail distribution in that country is very different from that of most of tropical Africa. Niger and Madagascar by law extend their value added taxes through the retail level. But small firms are either exempted or subject to forfait*/ treatment; inclusion is very selective. In most African countries, some larger retail estabishments could be controlled for tax purposes. But to tax their sales, while the usual small retailer would at best be subject to tax on purchases or to a forfait assessment, would create serious discrimination and possible economic distortion. Under the value added approach, there are major complications when unregistered smaller firms sell to

* Under a forfait system, assessments are estimated without determining the value of actual transactions; e.g. using floor space of an establishment rather than the establishment's profits.

registered firms, as cascading of tax will occur unless special techniques are used to prevent it--adding to the complications of the tax structure.

If an African country does seek to include at least larger retail establishments, the issue remains as to the choice of value added vs. suspension techniques. The latter is simpler, as with other versions of suspension type taxes, and is not without merit. But the potentiality for lessening evasion by collection of a portion of the tax at preretail levels is lost. The chief source of evasion--as encountered in Zimbabwe--is misuse of exemption certificates, firms buying goods tax free as purchases for resale when the transactions are actually taxable retail sales, and the value added technique avoids this.

The political danger of trying to extend a value added tax through the wholesale and retail levels has been illustrated very well by the experience of the Dominican Republic. When the tax was introduced in 1983, the law provided for extension through the retail level. For the first year, application was confined to the import-manufacturing sector. But at the end of the year, the opposition from the retail sector was so severe that a makeshift tax was applied to the distribution sector in lieu of value-added tax (VAT) -- a tax as a percentage of tax paid on purchases. More recent attempts by the government to extend the VAT have failed politically.

Thus for most African countries in the immediate future, confining the tax to the import and manufacturing sectors appears to be optimal as a matter of necessity, with ultimate extension, preferably on a value added basis, through the wholesale and then retail sectors.

A few African countries still use a cascading turnover tax--although information on them is very limited. This form, now abandoned by virtually all countries in other continents, is so objectionable that no country can justifiably continue using it. This form encourages vertical intergration and results in widely varying burdens of tax relative to consumer spending and general loss of economic efficiency and equity. Like any tax through distribution sectors, it is difficult to administer. Confined to the manufacturing sector, it still produces the undesirable effects noted and enters into export prices.

THE TAX TREATMENT OF PRODUCTION INPUTS

A sales tax of any form, in principle, is designed to be a tax on general consumption expenditures, as distinguished from taxes relating to income or wealth or the expenditures on particular commodities (excise taxes). If this result is to be attained in optimal fashion, relative to both economic optimality and equity, it is necessary that production inputs be free of tax, either through outright exemption or through the tax credit mechanism under a value added tax. Any taxation of business inputs creates an element of cascading, thus producing economic distortions. It will affect decisions about factor combinations; it may result in price increases in excess of the amount of tax collected; it will lead to differing relative tax burdens on various commodities; and most seriously for developing economies, it raises the costs of export products, reducing the ability to export and/or the incomes of the export producers.

While the suspension and value added taxes of most African countries minimize cascading, virtually none of them exclude all business inputs. In practice, this is difficult to do, as many commodities may be used either as consumption goods or as business inputs. Taxation of some, such as office supplies, is not likely to have serious economic consequences. But some of the taxes involve substantial taxing of inputs and cascading; the so called production taxes of the UDEAC countries in West Africa appear to have the greatest amount because of failure to systematically exclude all major classes of business inputs, even materials.

Capital Goods

The issue of durable capital goods is somewhat different from that of inputs generally and the policies of the African countries differ in their treatment. Kenya, for example, deliberately taxes them; Zambia taxes imported but not domestically-produced capital goods, whereas the Ivory Coast allows credit to tax paid on them. Capital goods are of course business inputs, and a major reason European countries shifted to the value added tax was to exclude them from tax. Not only does exclusion lessen cascading, but presumably it encourages real investment by avoiding tax elements in purchase prices. But the problem is that in many African countries, capital goods are artificially cheap and labor artificially expensive, thus resulting in excessive capital intensity in industry and aggravating unemployment. Many exchange rates are set artificially high; thus imported capital goods are artificially cheap. Purchase is often financed at concessionary interest rates. Tax holidays and investment credit systems frequently give income tax relief related to capital investment, not to jobs. Labor also is artificially high cost. In some African countries at least, wage rates are inflated by payroll taxes and union dictated wage levels, carried over from colonial days and expatriate labor. Thus there is merit in applying a sales tax to capital goods--at least so long as the artificiality in capital and labor costs continues and as a means of stimulating employment. Admittedly, though, this is an arbitrary way of bringing about lessened capital insensitivity of production.

Farmers present a somewhat different problem. If a value added type of tax is used, almost certainly farmers will not be registered as tax paying firms. Inclusion is not impossible with the commercial farms, but is not feasible with the typical farmer, even the emergent ones. Thus there is no possibility of credit for tax paid on fertilizer and other farm inputs. With the suspension type of tax, this possibility does not exist. The only workable solution with either approach is outright exemption from tax of the major farm inputs: seed, livestock feed, livestock, fertilizer, and major agricultural implements--which in practice may be primarily hoes. No African country registers and collects tax from farmers.

CONSUMPTION EXEMPTIONS

A basic problem with any form of sales tax is the decision about the extent to which various consumption commodities are exempted from tax. In principle, on the basis of economic effects, there would be merit in taxing all consumption purchases, thus avoiding distortions and greatly facilitating operation of the tax. If all sales by firms are taxable, the tasks of compliance and inspection are greatly simplified. This is particularly true with taxes which include the retail level; exemptions create fewer problems with a tax at the manufacturing level but these are no means absent. But equity concerns, political pressures, and in some instances administrative considerations almost always dictate some exemptions.

The most common exemption in Africa, as well as elsewhere, is food. With a tax at the manufacturing level, domestic unprocessed food, the principal element in the consumption of most of the population, is automatically exempt as it does not pass through a manufacturing stage. If it is not exempted by law, imported food will be taxed whereas domestic food will not be. Some countries exempt processed food as well. There is, however, strong justification for taxing processed food, except for some specific items, such as milk, flour, and dried fish, that may be important in the diets of the low income groups. Otherwise, the exemption will primarily benefit persons in the middle and upper income groups. The Sudan, Zimbabwe, and Zambia, for example, tax most processed food.

Medicines are almost universally exempted, because of the importance of improved health.

There is merit in limiting exemptions to these categories, and perhaps a few others such as books, and, in some countries, items of particular importance in the consumption patterns of the poor--kerosene in some countries, for example. Otherwise, revenue yield will be reduced unnecessarily, and operation of the taxes complicated.

Taxation of Services

A related issue is the taxation of consumer services. Countries differ widely in their policies. It is not regarded as feasible in Africa to apply sales tax to services in a blanket fashion. Some countries do no tax any; the francophone countries are more inclined to tax them than the others. Many services are provided by very small enterprises without established places of business, and control is virtually impossible. The few singled out for taxation are those provided by established businesses and not consumed primarily by the lower income groups: telephone, electric power in some instances, transportation, hotels, and a few others. There is merit in including these services. But drawing the exact line between taxable and nontaxable activities is not always simple. Luxury hotels utilized primarily by tourists and other foreigners or higher income local residents are obviously suitable objects for taxation; but there is no sharp line in many countries between these and inexpensive lodging places utilized by lower income persons and difficult to control. There is also no simple obvious line between transient and more permanent housing accommodations, and in general the latter are never taxed, because of the potential discrimination against tenants in favor of home owners.

Exports

Most, but not all, countries (Gabon and the Sudan are exceptions in Africa) exempt exports from tax, and with the value added form, the tax elements on inputs are excluded. The reasoning is obvious: the desire to encourage exports and maintain income of the export product producers. Yet some of the same countries levy separate taxes on exports. Taxing of exports under a sales tax must be evaluated on the same basis as export taxes--except that primarily manufactured goods are involved. Given the competition of other countries for export markets, it is almost certain that the tax will be borne by the domestic producers, to the likely detriment of export production.

Exemption vs. Zero Rating

With the value added form of tax, if a transaction is exempt, tax does not apply, but there is no credit for or refund of tax that has accumulated on the commodity prior to the exempt transaction. With zero rating, credit is given for all accumulated tax. Exports are typically zero rated, to ensure that the transactions are completely free of tax. Usually other excluded commodities are simply exempted. While zero rating has the merit of ensuring that all tax is removed, it creates one serious problem: the need for frequent refunds of taxes. Some countries will not give outright refunds, simply allowing credit against future tax payments or other taxes due. But this does not necessarily accomplish the objective, especially on exports. But refunds complicate operation of the tax and pave the way for illegal leakage of tax revenue.

RATE STRUCTURE

One of the most serious problems in the design of a sales tax is the choice between a uniform rate and differential rates, primarily the use of higher rates on commodities regarded as luxuries, both to discourage their use (the import content is often very high) and to make the indirect tax structure more progressive. Politically there is merit in the use of multiple rates. But operationally such rates result in serious difficulties. Firms must distinguish among sales of commodities in various rate groups; there are constant problems of interpretation; record keeping is made more difficult; and chances for evasion, deliberate or otherwise, are greatly increased. While some African countries use single rates, other have a substantial number. Malawi, Madagascar and the Sudan have one main rate; the Ivory Coast and Kenya have only a small number, whereas Tanzania and Zambia use a number of rates. Typical rates are shown in Table 3.

Thus there is a very real conflict on these issues. With the value added form, the complications are increased still more; rate differentials prior to the final sale will be washed out if the final sales are subject to a uniform rate. It is particularly difficult to apply multiple rates to sales taxes extending forward of the manufacturing level, as wholesale and retail distributors will fre uently carry a number of

There is a very real conflict among various considerations. One common mistake can be avoided: the use of a number of rates, many differentiated very little from others, as for example, the use of 6, 7, and 8 percent rates. There is no possible justification for this type of fine distinction. Apart from this, however, some departure from the uniformity rule may be necessary, at least politically, and perhaps for equity and foreign exchange reasons. The issue then becomes: how best to accomplish this. With a purely import-manufacturers tax, the use of a few different rates--perhaps 10 basic, 25 and 50, may be workable. With taxes going forward of the manufacturing level, however, especially with the value added technique, the preferable approach is to use a uniform basic sales tax rate, and then employ separate consumption or excise taxes on those commodities, such as motor vehicles, on the purchase of which a heavier burden is sought. These supplementary taxes will not be subject to the tax credit of the sales tax, but will not apply on a cumulative basis, utilizing the suspension system.

The selection of the commodities for the higher rates should be based upon at least rudimentary information about consumption patterns by income group, not on the ideas of the framers of legislation about what constitutes "luxuries." For example, sugar is singled out for special high rates in some countries, yet studies show that doing so makes the tax more regressive, not less. The theory of optimal taxation would dictate rate differences based on elasticity of demand. But lack of information on demand elasticity and administrative considerations preclude any serious consideration of the proposal.

Studies in various developing countries have shown that the use of differential rates has little effect in making the tax structure more progressive. Exemptions, removing tax burden from the lowest income groups, are significant; rate differences are not.

Rates on Imported and Domestic Goods

Several countries, including Zambia, Malawi, and most West African Francophone countries, apply higher rates to imported than domestic goods, thus adding to protection. This policy is one of the worst followed in the sales tax field; there is great merit in confining protection to customs duties and related taxes, avoiding complications in the sales taxes structure. Only by doing so is rational protection policy possible. Zambia taxes all taxable imported goods at 15 percent, domestic goods at varying rates.

The Rate Level

The question of the level of the basic rate of the tax is one for which there is no scientific answer. Rates under 6 percent, or even 10 percent, especially at the manufacturing level, are not likely to yield sufficient revenue to make the tax worthwhile--given the compliance and administrative costs. General levels in excess of 20 percent are likely to be self defeating, as a result of evasion and avoidance, and may aid inefficient firms which collect the tax from customers but do not remit it to the government. The current Kenya rate of 17 percent at the manufacturing level may well represent a maximum at that level; the Zimbabwe rate of 15 percent at the retail level is one of the highest sales tax rates found anywhere in the world. Figures from 12 to 15 percent at the manufacturing level, 8 to 12 percent at the retail level, may be about optimal in terms of desired objectives. Obviously government expenditure levels and potential revenue from other sources play a major role in selection of the actual rates--but it must be recognized that there are minimum and maximum constraints.

THE SPECIAL PROBLEM OF SMALL FIRMS

Regardless of the nature of the sales tax in any developing economy and even in some highly developed countries, sales tax treatment of small firms encounters significant problems. With a tax at the manufacturing level, the problem is with small craft producers; with taxes through the retail level, the problem is the large numbers of small traders, sidewalk and road side stands, market sellers, itinerant vendors, that play such a major role in retail distribution in African countries. It is essential to exempt the smaller firms; it is frequently not worthwhile to attempt to force them to register and collect and remit tax. They will not do so consistently; delinquency will be high; the costs of collection from them will exceed the revenue.

The problem, however, is to draw the line. There are various criteria used. Sales volume (or tax liability) below a certain level is the most common basis but suffers from the problem of determining these figures for the marginal firms.

Use of capital equipment, as in the Sudan, is an alternative, but may let some relatively large firms escape and is usable only at the manufacturing level. Capital investment is difficult to determine. Use of the number of employees suffers from the major objection that it may discourage firms at the margin from hiring more persons. Allowing the revenue department to make the decisions based on an estimate of potential compliance, as in Ghana and Tanzania, is more flexible, but paves the way for bribery and nonuniformity. In the African context, use of power driven machinery may be the most satisfactory measure if the tax is confined to the manufacturing sector.

There remains the issue of the treatment to be given the firms below the exemption line. One is to exempt them completely and thus no revenue is obtained, although they will be taxed on their purchases. This is the usual rule in British Commonwealth countries. The other major alternative, found in the francophone

countries, is to subject the firms below the exempt line to forfait assessment; revenue officials estimate the likely sales volume in negotiation with the firm. Unfortunately, this approach is an open invitation to bribery and nonuniformity. Taxing small firms on an estimate of gross receipts at a low rate converts this portion of the tax into a turnover levy and may not operate any more satisfactorily than the basic tax. There is no optimal answer to this problem.

THE STRUCTURE OF THE ACT

The typical sales tax in most parts of the world applies to all sales at the specified level, except for commodity groups specifically designated exempt by category such as food. But the sales taxes of Uganda, Tanzania, and Zambia (and Guyana in South America) specify taxable and exempt items and those in various rate classes by tariff (BTN) number. A few other countries specify exemptions by this means. The result is to provide a very large sales tax act, running to hundreds of pages. This approach likely increases the tendency to apply a wide rage of different rates. All in all, there is great merit--and necessarily so if the tax goes beyond the import and manufacturing level--to avoid this approach and follow the more standard method.

THE MAJOR OPERATIONAL PROBLEMS

The basic operational problems of sales taxes are similar in all countries, but some are more severe in tropical Africa, given the constraints noted above.*/

Smuggling

Since in most African countries half or more of the sales tax revenue is collected at importation, the problem of smuggling is significant for sales tax as well as customs

---

* A major reference is the paper by Milka Casanegra de Jantscher, "Problems of Administering a Value Added Tax in Developing Countries," an Overview," World Bank, Provisional Papers in Public Economics, Washington: 1986.

duties. It is always difficult to know just how much smuggling occurs. Some countries, such as Zambia, have generally not regarded it as serious, given the nature and environment of the country's boundaries. Others have regarded it as serious--Ghana, for example, and even the Sudan, smuggling mostly in small boats across the Red Sea. The problems are aggravated when ethnic groups spread across country borders, as is frequently the case, and when the neighboring country is not particularly cooperative. Use of a sales tax, particularly at high rates, increases the incentive to smuggle and the need for greater effort to stop it. Smuggling of high value goods in travelers' luggage has become a serious problem in some countries.

Transfer Pricing and NonArms Length Transactions

On imports, underpayment of both customs duties and sales taxes results from invoicing of transactions at artificially low prices, most commonly between jointly controlled companies. Some obvious cases may be caught by customs officers, but serious control requires the use of trained valuation officers. Few customs departments in tropical Africa, however, have adequate numbers, if any at all.

Internally, with transactions between jointly controlled firms or with collusion, the same problem of escape from appropriate tax arises and is difficult to control. With a retail sales tax or a value added tax extending through the retail level, this problem is less serious, but no African country actually utilizes the latter form of tax as yet to any major degree.

Registration of Firms

It is imperative to develop a register of firms subject to the requirement for filing returns and payment of tax. This may require a check of income tax registrants and door to door check by enforcement personnel. These tasks are relatively simple so long as the tax is confined to the manufacturing level and are not too serious even if the tax is extended through the retail level.

Effective operation requires the assignment of a registration number to each firm subject to the tax. There is merit in use of a master file covering sales and other taxes, those firms subject to sales tax being coded accordingly. There are various ways in which the master file can be kept, ranging from ledger pages or cards to computer systems, now much more feasible than in the past because of the availability of simple inexpensive computers. But the latter are not imperative--particularly when the number of firms is small. Ledger cards are much more suitable than ledger pages.

Some countries have faced the problem of firms registering when they should not be registered, primarily in order to purchase tax free under the suspension form, and then not filing returns because they do not make taxable sales.

Filing of Returns

On domestic transactions, taxpayers are required to file returns and pay the tax due. There are several issues:

1. Return Forms. It is highly desirable for revenue departments to provide tax return forms to taxpaying firms. Yet some governments do not do so, materially complicating the

handling of returns when they are filed. Standardization of returns documents is highly desirable. These should be made readily available to the firms; the optimal system involves preprinting of forms with the firm's registration number, name, and address, and distributing them prior to the filing date--if equipment and personnel permit.

It is also highly important that the returns be kept simple, requiring no more information than is essential for the revenue department. One of the major problems with African sales taxes, especially in the Francophone countries, is the complexity in the taxes and consequent complexity in the return forms. It is not necessary to require a number of duplicate copies.

2. Filing. The filing date should be a reasonable length of time after the end of the period, perhaps three weeks or a month. Filing (and making payment) should be as simple and convenient as possible. If the mail system permits, filing by mail should be permitted; an alternative is to provide for acceptance of the

returns and payment by the banks, acting as agent for the government. Bureaucratic rules, some carried over from colonial days, are in some countries a major obstacle to efficient operation.

3. Payment of Tax. It should be possible to allow simultaneous filing of returns and making of payment. Yet traditional procedures in some countries require that these two be handled by separate offices.

4. Recording of Tax. The basic file system determines the form of recording of filing and payments. Some countries, such as the Sudan, have continued to use ledgers. The optimal system involves introduction of the information into the computer file, where the equipment in use permits this. But, as with the master file, computerization is not imperative but is much more feasible now than it was a decade ago. Only now is Kenya introducing computerization, and many countries have not considered it.

Delinquency -- Failure to File Returns and Pay Tax

All countries, even the most developed ones, have a continuing problem with failure of firms to file and pay. The Kenya experience is reasonably typical, though better than some. In August 1987, for example, 271 firms failed to file and pay tax by the due date, 11 percent of the registered firms. The figure in Zimbabawe has been 7.5 to 10 percent. Other countries report higher figures; for example, in Mauritius and Zambia the figures have been as high as 50 percent. However, most returns come in the following month.

Minimization of delinquency requires several actions. First, the penalty of failure to file and pay on time must be adequate and automatic; the revenue department must be able to apply it without court action. There is merit in use of a minimum monetary amount, and a monthly percentage; the Kenya 2 percent a month figure is not regarded as adequate, for example, given high interest rates and shortage of working capital. In addition, immediate ascertainment of deliquents and action against them is essential to discourage delinquency. Ascertainment simply takes the form of checking ledger pages or ledger cards manually or, with more modern systems, computer checks and preparation of delinquency notices. The immediate contact, by enforcement personnel, through visits, phone (if possible), or mail is necessary. In all countries, most delinquents pay up before drastic legal action is necessary. But there are always a few hard core delinquents, and adequate action, such as revokation of registration, seizure of assets, and closing of the business, must be taken on a few. Threat of action is usually adequate.

A peculiar problem has arisen in a few African countries--Ghana in the past, for example--the failure of government corporations to file returns and remit tax. A revenue department can scarcely take action to close down government operated hotels or the railroad system. This is a problem that only the head of government or the cabinet can resolve.

Audit

The other major problem with returns relates to the accuracy of the information shown. Some of the problems arise from misunderstanding and inadequate record keeping, some from deliberate understatement of tax liability. Only by careful examination of the returns and comparision with information in the firms' records can accuracy be determined.

It is impossible in any country to audit carefully all returns--but substantial audit is necessary to ensure reasonable accuracy. The basic problem is that virtually all revenue departments in tropical Africa lack the resources and personnel for effective audit programs. While the numbers of persons trained in accounting and auditing is much better than it was two decades ago, the numbers are still not adequate in many countries. Furthermore, specialized training is imperative, as well as adequate salaries to enable the revenue department to retain trained competent personnel.

In some African countries, the audit task is complicated because records and accounts are not kept in the standard language of the countries. This may be a matter of different ethnical languages, but more commonly it arises because the firms are operated by nonindigenous persons who keep records in their own languages.

Information for Taxpaying Firms

Few developing countries do an adequate job of getting information to taxpaying firms. A must is a simple nontechnical information bulletin, with frequent updates, provided to all firms. These should be provided at registration of the firm and updates distributed on a current basis. Equally, firms should be able to obtain information from the revenue department on questions on which they are in doubt.

The Organizational Structure

There are several major organizational problems that must be solved, with related matters of personnel.

Location of Sales Tax Administration. There are two general approaches to the location of sales tax administration. In the francophone countries, as in Latin America, typically sales tax is administered by the income tax department, and this is also true in Uganda, Tanzania, and Zimbabwe. In most British Commonwealth countries, as in the U.K. itself and Canada, the sales tax is administered by Customs and Excise. The choice between these two has often been made on the basis of tradition and power politics, not logic. Each approach has merits. With much of the revenue collected at importation and with an excise tax administration already located in Customs and Excise, it appears logical to assign the sales tax to the same unit. But there are two objections. First, Customs and Excise personnel are not trained in accounting and their emphasis is on physical control, not control through records and accounts. Secondly, especially in audit, some of the information required for income and sales tax administration is identical; some integration in audit is desirable, to strengthen the operation of both taxes. Finally, sales taxes administration may be better if the tax is placed in the income tax service; in some countries, the income tax service has a greater prestige and better salaries than Customs and Excise, partly because of the higher level of training that is typical.

With appropriate adjustments, sales tax administration can function effectively under either system. But if it is located in Customs and Excise, the sales tax unit must have a substantial degree of autonomy, be headed by a person with accounting training, and recruit its own personnel on the basis of the necessary background. If sales tax administration is located in the income tax unit, satisfactory liaison with Customs is necessary with regard to tax collected at

A third alternative, as in Kenya, is to establish a separate sales tax department, coordinated with both Customs and Excise and Income Tax. Coordination with both of the other units is imperative--but this system allows independent development of personnel in light of the needs of sales taxation and clearly centers responsibility for the tax. It has merit only if the sales tax is a major revenue source.

Functional Organization. If the sales tax is administrated by the income tax unit, a decision must be made with regard to functional vs. type-of-tax organization. Under the former, the same personnel handle various activities for all taxes involved. Thus enforcement personnel will deal with delinquents of both sales and income taxes, and firms will be audited on an intergrated basis for both taxes. Tanzania is one of the few African countries to use this approach. This allows most effective use of personnel and minimizes travel time and cost, but lessens responsibility for sales tax operation. And personnel may not be equally trained in both of the major taxes. Experience elsewhere suggest that one or the other of the taxes tends to dominate the activity.

As a sales tax grows in importance, there is merit in concentrating responsibility for it in a sales tax unit, but with closely cooperative, if not a completely integrated, audit.

Some other administrative issues will be noted briefly. One is regionalization vs. centralization of administration. In small countries with geographic concentration of population, it is feasible to handle all activities in headquarters. But many African countries are very large in area, with limited transport and communication facilities. Accordingly, regional offices become imperative, for providing information to taxpayers, insuring that all firms are registered, dealing with delinquents, and performing audits. But supervision of the various offices by headquarters to ensure uniformity is imperative, as well as location in headquarters of a few highly trained auditors for dealing with larger business firms.

The question of computerization has been noted above. Computers are particularly effective for sales tax administration, in keeping master files, serving as the basis for recording of information from the tax returns, determining delinquency, recording the results of audit, determining total collections and collections by area and type of firm, etc. But computerization is not imperative; if the number of firms is small, more traditional manual systems will function satisfactorily. But given the trends in computer availability, most countries ultimately can justify a move to computer use for sales taxes.

SOME CONCLUDING THOUGHTS

The basic problem with development of optimal sales taxation in tropical Africa is the inability, for operational reasons--the nature of business activity and the training of administrative personnel--to use the form of sales tax universally regarded as most satisfactory, namely a value added tax extending through the retail level or a retail sales tax. Thus any form of sales tax that is used in an African country is second best--dictated by operational expediency. Under the circumstances, a tax confined to the import and manufacturing level is the most satisfactory, utilizing the value added technique if the nature of the firms permits this. This form can ultimately be extended to the large wholesale sector and ultimately to retailing--but not for some decades. Zimbabwe is one of the few, if not the only, tropical African country that can use a retail sales tax with adequate effectiveness.

The constraints that dictate this choice of tax also dictate simplicity in tax structure--avoidance or minimization of rate differences and exemptions, except those imperative in the interests of equity and administration. Refinements in the interests of equity and in some instances of economic efficiency may be impossible or at least undesirable, given operational considerations. Exemption of unprocessed food is imperative, as is the exclusion of major inputs into production activity, with the possible exception of durable capital equipment. But one basic rate, with possibly a few supplementary rates or separate levies on such commodities as motor vehicles, is essential for effective operation. In the words of Professor Peter Robson of St. Andrews University in Scotland, who has worked extensively in Francophone West African countries, the chief defect of the sales tax structures in those countries is the complexity. Simplicity is all important. Also hightly desirable is use of sales taxes for revenue, not for protective, purposes. A logical system of taxes on imports, for protection and foreign exchange reasons, can be obtained only by sole reliance on customs duties and related levies, not by discriminatory features of sales taxes. Even more undesirable is the failure of a few countries to tax imports under a manufacturers sales tax.

A final word relates to bad advice which developing countries, in Africa and elsewhere, receive from international agencies and foreign advisers. The World Bank and the IMF, particularly in the work of their missions, place so much stress on short time solutions to trade and debt problems that they endorse features of sales taxes that are contrary to long run optimal sales tax structures.*/ In some instances, they have forced the delay of important changes in sales taxes for fear of possible revenue loss. A further problem is that the periodic missions of the two groups often make off the cuff suggestions for tax structure changes, suggested by persons on the missions who are not experts in the indirect tax field. Recommendations from advisers from foreign governments--including those sponsored by USAID--may make equally unsatisfactory proposals. African countries need to rely more and more on their own talent, persons familiar with the circumstances of the country and adequately trained in the field.

* Zmarak Shalizi and Lyn Squire, "Consumption Taxes in Sub-Saharan Africa: Building on Existing Instruments," (World Bank Provisional Papers on Public Economics, Washington: 1986) stress this consideration.

TABLE 1

TYPES OF SALES TAXES IN TROPICAL AFRICA, 1987

I. Taxes confined to the manufacturing and import level (a few, such as that of Ghana, do not apply at importation).

A. Suspension type

Eastern and Southern Africa:
Sudan
Uganda
Tanzania
Zambia
Malawi
*Botswana
*Lesotho
Swaziland

West Africa:
*Mauritania
Dahomey
Togo
Guinea
Burkina Faso
Ghana

West Africa: incomplete exclusion of materials and parts:
UDEAC countries:
Central African Republic
Cameroon
Chad
Gabon
Congo
Benin

*Zaire
*Ethiopia

B. Value Added Features

Kenya (partial)
Ivory Coast
Senegal
Mali
Mauritius

II. Taxes Including the Retail Level

A. Value Added through the Retail Level (in part)

Madagascar
Niger

B. Retail Sales Tax

Zimbabwe

III. Turnover Taxes

*Burundi
*Equatorial Guinea

Information is limited on those marked with an *

TABLE 2

IMPORTANCE OF SALES TAXATION IN TROPICAL AFRICAN COUNTRIES

Country	Colonial Background	Revenue from Sales Taxation as a Percentage of Total Tax Revenue
Tanzania	B	54
Niger	F	34
Senegal	F	32
Malawi	B	29
Kenya	B	28
Madagascar	F	26
Zimbabwe	B	25
Zaire	Belg.	25
Mali	F	22
Ivory Coast	F	22
Uganda	B	22
Chad	F	18
Zambia	B	15
Mauritania	F	15
Gabon	F	11
Central African Republic	F	11
Cameroon	F,B	11
Togo	F	11
Ethiopia	-	10
Lesotho	B	10
Burkina Faso	F	8
Botswana	B	3
Benin	F	3
Ghana	B	2
Guinea	F	1

B: Great Britian
F: France
Belg: Belgium

SOURCE: John F. Due and Carrie Meyer, Major Determinants of Tax Structures in Market Economy Countries, University of Illinois Bureau of Economic and Business Research, Faculty Working Paper #1309, November 1986, based on data in International Monetary Fund, Government Finance Statistics Yearbook, 1985 (Washington 1986).

TABLE 3

TYPICAL SALES TAX RATES IN TROPICAL AFRICAN COUNTRIES: MID 1980s

COUNTRY	BASIC RATE	OTHER RATE
Madagascar	15	--
Senegal	20	7,50
Ivory Coast	20	10,26
Niger	25	15,35
Kenya	17	25 to 100
Zimbabwe	15	18
Tanzania	12	24,40,et al.
Zambia	15	Several
Sudan	5	--
Malawi	25	30 (imports)

NOTE: Rates of the first four countries are from Milka Casanegra de Jantscher, "Problems of Administering a Value Added Tax in Developing Countries," World Bank, Provisional Papers in Public Economics, 1986, Table 1.

SELECTED REFERENCES

Casanegra de Jantscher, Milka, "Problems of Administering a Value Added Tax in Developing Countries: An Overview," Provisional Papers in Public Economics, Washington, DC: World Bank, 1986.

Cnossen, Sijbren, "Sales Taxation: An International Perspective," in John G. Head, ed., Taxation Issues in the 1980s, Sydney: Australian Tax Research Foundation, 1983, chapter 16.

Due, John F., "A Comparison of Four Manufacturers Sales Taxes and Two Retail Sales Taxes--Ghana, Kenya, Tanzania, Zambia, Barbados, Iceland," Bulletin for International Fiscal Documentation, 30 (November 1976), pp. 464-76.

____________, "The Experience of Zimbabwe with a Retail Sales Tax," Bulletin for International Fiscal Documentation, 37 (February 1983), pp. 51-58.

____________, Indirect Taxation in Developing Countries, forthcoming, Johns Hopkins University Press, 1988.

____________, "The Uganda Sales Tax on Importation and Manufacture," Eastern Africa Economic Review, 1 (June 1969), pp. 1-16.

Heian, Betty C., and Monson, Terry D., Value Added Taxation in the Côte d'Ivoire, Provisional Papers in Public Economics, Washington, DC: World Bank, 1986.

Hill, John, Sales Taxes in Francophone Africa, IMF DM/24/69 (Washington, DC: July 1974).

Koumoue Koffi, Moise, La Taxe Sur La Valeur Adjoutée Dans le Dévelopmment Economique de la Côte d'Ivoire (Paris: Librairie Génerale de Droit et de Jurisprudence, 1981).

Lent, George E., Casanegra, M., and Guerard, M., "The Value Added Tax in Developing Countries," IMF Staff Papers, 20 (#2, 1973), pp. 319-78.

Shalizi, Zmanak and Squire, Lyn, Consumption Taxes in SubSaharan Africa: Building on Existing Instruments, Provisional Papers in Public Economics, Washington, DC: World Bank, 1986.

Tait, Alan, The Value Added Tax: The Treatment of Retailers and Small Traders, International Monetary Fund FAD/86/2, Washington, 1987.

Tanzi, Vito, Taxation in SubSaharam Africa: Statistical Analysis, International Monetary Fund DM/81/21, Washington, 1981.

Union Douaniere et Economique de l'Afrique Centrale, Secretariat Generale, Etude sur l'instauration de la taxe sur la valeur ajoutee en UDEAC, Octobre, 1984.

TARIFFS: REVENUE GENERATION, PROTECTION, AND OTHER SELECTED ISSUES

Pradeep Mitra, IBRD

When Don Harrison asked me to talk about tariffs and their related aspects in Sub-Saharan Africa, the first thing I told him was that while I had contributed to the literature on tariffs and had worked on implementation of tariffs and tax reform in some of the low-income countries, I had never worked before explicitly on Sub-Saharan Africa. Being a polite gentleman, Don Harrison said, "That's fine. That implies that you will have the advantages of an open mind."

In that spirit, I want to share some thoughts with you on aspects of tariffs and tariff reform that in my experience occur very frequently in low-income countries. My colleagues in the World Bank, who have worked on similar problems in Sub-Saharan Africa, suggest that there is an overwhelming degree of similarity in the kinds of issues that one is facing in this area.

Since I don't pretend to be an expert on Sub-Saharan Africa, I am hoping to learn at least as much as I can tell you about some of these issues. I, of course, also have the advantage of being the fourth speaker in a long day and look forward to a more participatory style of conducting this seminar.

I am going to talk about the numbers to start off with in order to provide some kind of quantitative perspective. The first table shows how important different kinds of taxes are in a sample of 36 Sub-Saharan African countries. (The tables can be found at the rear of the paper.) You will see from section three, the lower panel of that table, that taxes on international trade --

import and export taxes -- account for some 46 percent of tax revenue, on average, in these countries. I think at this point it is premature to say whether it is too high or it's too low.

Table two compares the structure with that in some of the other commonly-used regional groupings. Again, if one looks at section three on international trade taxes, one finds that the share of trade taxes in total tax revenue is higher in Sub-Saharan Africa than it is in other regions of the world.

There is one caveat that I ought to introduce. When these data were put together, they referred to what in most countries are called customs duties. They do not include other levies on imports that a number of countries introduce. By and large with a few exceptions, the customs duties used here cover the vast majority of import tax revenue but there are exceptions. For example, Malawi has a levy called the surtax which also applies on imports on top of the customs duty and that kind of tax is not included here. If anything, there might be a slight underestimate in this number of 46 percent as a share of total tax revenue.

Table three breaks the numbers down for Sub-Saharan African countries into those which have above-average reliance on trade taxes, average reliance, and below average reliance. For example, if you look at the top of table three, there are countries such as Gambia which has more than 80 percent; Lesotho 68 percent and so on. At the other end of the scale, one has countries in panel 1.3 where it is less that 30 percent. Obviously, there is a great deal of variation.

If you go back to the second column in table one, there is an indication of how the relative importance of the taxes has been changing over time using the period from the middle 1960s to early 1980s. On average, there is a decline in the share of international trade taxes in tax revenue, although they are still quite high.

If you turn to table four, what that table shows is the growth rate in the tax revenue in Sub-Saharan Africa over the period, 1966 to 1981, of each of the tax categories and the contribution to the growth rate of total tax revenue made by each of the categories. For example, looking once again at international trade, one sees that the growth rate of trade tax revenue has been the lowest of the three categories -- A, B and C -- identified in that table with 15 percent. However, since the original share was still quite large, the contribution to the growth rate of total tax revenue, which is reported in the second column, is 42 percent. While it's the highest of the three categories, that simply reflects the fact that the base was relatively high to start with.

Clearly what that emphasizes is that any proposal for tariff reform -- whether motivated by reasons of industrial effieciency or the need to promote exports or the need to have some kind of a greater degree of competitiveness in the domestic, industrial sector -- very rapidly comes up against a revenue constraint because these taxes are simply so important in revenue. Tariff reform is fine as a microeconomic goal or is good for the allocation of resources. However, unless one is careful and, in particular, unless one talks about alternative revenue resources, what one might be in danger of doing through tariff reform is eroding the public revenue base. That is a fairly important issue that one simply cannot in applied work afford to lose sight of.

If you would please turn to table six, "Stability of Tax Revenue." This table looks at how much the volatility of overall tax revenue depends on the breakdown into trade taxes and other kinds of taxes. Not surprisingly, those figures show that countries that rely quite heavily on trade taxes are also likely to experience more fluctuation, more volatility in their overall tax revenue.

What table nine reports is the buoyancy of individual taxes in different countries of Sub-Saharan Africa with respect to corresponding tax bases. If one looks at the very bottom row which says "average," it shows that the most bouyant taxes are the direct taxes followed by the domestic, indirect taxes. What this is describing is how does the tax revenue that one gets either from indirect taxes on private consumption or from direct taxes changes in response to the base on which they are levied. Therefore, the data include the effect of any built-in changes as well as whatever discretionary measures the authorities are introducing in the budget from year to year.

There is a problem with this data which I don't want to discuss in great detail because I don't have the time. It is very hard in this kind of aggregated data set to get reasonable estimates of, for example, the buoyancy of indirect taxes. What is the correct base? Obviously, one wants to get some sort of production base, but aggregate production figures are not available at this level of generality. We calculated the change in indirect tax revenue with respect to private consumption. That is not quite the right base to be using. But these are illustrative.

Please refer to the last column in table nine, "Import Taxes with Respect to Imports." Those have the lowest buoyancy, which is consistent with a conscious effort on the part of the authorities to shift away from import taxes and towards domestic-based sources of revenue.

My mandate, of course, is to talk not just about the revenue generating aspects of tariffs but also to talk about protection. Here one is on slightly trickier grounds for the following data reason. There is nothing wrong with taxing imports. Indeed, when Professor Due was talking earlier about sales taxes or value-added taxes, the point he made was that taxes ought to apply equally to domestic goods as well as to imports. That is not an issue.

The issue is, however, how much of these taxes contain a protective element in them? That is to say, the real comparison for protection purposes has to be a comparison of some kind of rate on imports against the rate on corresponding domestic goods. The very general comparative data set used here does not give us an indication of what the protective element is.

How we do measure how much of the domestic import tax regime embodies protective considerations as opposed to simply revenue generating ones? For that, I would ask you to turn to table five. For example, let's look at row one, "Import taxes with respect to imports." We have taken in this table the import tax collections and divided them by the base in order to see what is the average rate at which imports are being taxed by the country.

In all of these calculations, it is very important to look at the actual collections divided by the base as a way of getting at the rate. Some people call that an effective rate. Some people call that an implicit rate. There are all kinds of semantics floating around. The important point I wanted to make is not simply to eyeball the statutory tax rates in the book. If one looks at the budget books, one can get a picture of what the statutory tax rates are that the authorities have imposed over the years in their budgetary measures. That may or may not bear any relationship with the effective or the implicit rates. That is a fairly obvious point but I think it bears repetition.

In row four of table five, we have indirect taxes and used private consumption as the base. As I said earlier, that is not quite the right base to be using. What one wants to do, ideally, is to get some measure of aggregation in national accounts data, data however that are not generally available.Across Sub-Saharan states, the implicit tax rate on imports is almost 16 percent and 5 percent on domestic production, quite a substantial gap. Similarly look in table seven and table eight. The same information has been presented for import taxes and export taxes for the individual countries. One might say that the system is really providing quite a lot of protection.

These are, however, two caveats. One, the data is not telling you anything about items such as quantitative restrictions (QRs) and so on that are being used to provide protection. There is nothing about that in this data set. Everybody knows that those are at least as important, as protective devices, as import taxes.

The second point is that our estimates are incomplete. One has to look at individual countries in trying to figure out how much protection is being provided and that obviously would have to be done at a much more disaggregated, sectoral level than looking, as we have done, at an overall macroaggregate.

What I have done -- if you would please turn to table eleven -- is such a comparison for one country. We have a situation where there is taxation on final goods -- both domestic and imported. There is taxation of intermediate goods -- both domestic and imported. Every time a domestic manufacturer produces an extra unit of a good for final demand, he of course pays tax to the government. However, all of the intermediate inputs that he buys in order to produce that good are also taxed. Therefore, the government gets a much greater tax bite out of an extra unit of final demand produced than if one simply looked at the tax on the final output.

Column three is total tax, taking into account the taxes that are paid on all the inputs used to make the final output, both domestic and foreign, and column four is simply the tax that is paid on final output. Obviously for most commodities, the number in column three is higher than the number in column four.

Two observations follow from that. Let me just direct your attention, first of all, to column seven of that table. Again, this is at a fairly high level of aggregation but if, for example, one looks at say item number 20, pharmaceuticals and chemicals, one finds that for an extra unit produced by that sector, the tax element is of the order of 7.9 percent. That is column three. Whereas the tax on the equivalent import, if one looks at column seven, is 15.8 percent. The system on the whole for that sector is providing protection. This is the kind of data that is typically put together in trying to arrive at some judgment on this issue.

While this is a step beyond the table which simply looked at implicit aggregate import taxation rates, this has to be supplemented with a consideration of QRs. Also, even at this level, one is talking at a fairly aggregated level. Pharmaceuticals and chemicals, for example, is still a fairly aggregated category; there are a number of products included in it. However, that is the level at which the data usually appears. These kinds of data can give one an idea of how much protection the tariff-cum-domestic tax regime is actually providing to domestic industry.

That is the second aspect of tariffs to which I wanted to draw to your attention. The first, recall, was importance in revenue; the second, that there is a protective element which one can discover by looking at the appropriate wedge between the import tax rate and the corresponding domestic tax rate.

The third item of note is that tariffs and QRs are used not only for revenue and protective reasons. They also are often utilized for balance-of-payment reasons; they are used in lieu, perhaps, of the exchange rate as a way of meeting what is perceived to be a foreign exchange scarcity. In many countries, there is a bias in favor of using tariffs and QRs to regulate the demand for imports as opposed to the exchange rate.

In any proposal that one makes for tax and industrial policy reform that calls for rationalizing the structure of tariffs, very early on a response that one meets is that we are a foreign exchange poor country. How do you expect us to achieve equilibrium in the balance of payments if we take off the tariffs or reduce them, as you are suggesting? One has to address the question of what are the alternative instruments for equilibrating the balance of payments? One really ought not to expect a fiscal system to bear the brunt of balance of payments adjustments as well as the other objectives that it is supposed to further.

A final issue before I move to recommendations is the whole question of administration. Because of the importance of customs revenue, the customs people are usually pretty important in the civil service. In a number of these countries, the customs -- and in many cases excise -- tax is part of the same service. Customs and excise people typically are more important than the income tax people. This creates problems for the recommendation that is typically made in various countries to move towards, for example, consumption-based taxes. A sub-recommendation that there should be more liaison and more cross-checking between the income tax department and the customs and excise people runs up against all kinds of problems because one part of the service regards itself as the Brahmins and the others are not similarly regarded. While not new, the issue in terms of the politics of giving advice looms very large.

Thus, the three important aspects of tariffs include (a) revenue, (b) protection, and (c) the balance of payments. The overarching theme is administration; any reform proposals would obviously be conditioned on the extent to which one can build on existing instruments or whether one needs far more radical and thorough-going change including administrative improvements. Administrative improvements are frequently quite difficult to implement in low-income countries.

One recommendation that the World Bank has been making is that states should move to broad-based consumption taxes. Imports really are no different from anything else. Therefore, if one is really trying to move as far as the constraints will allow on broad-based consumption taxes, imports should be certainly part of that base. The thrust, thus, has been to suggest that one should move to a value-added tax in the first instance covering the manufacturing stage and imports and then, as circumstances allow, go through to the retail stage.

This recommendation gets implemented with varying degrees of enthusiasm. The important thing, however, to notice -- and this endorses what Professor Due was saying earlier this afternoon -- is that there are quite a few countries in Sub-Saharan African which have taxes with many of these above cited, desirable characteristics. They are not full-blown value-added taxes (VATs) and even a lot of them don't extend very satisfactorily through the import-manufacturing stage -- because often imports are taxed at a different rate from domestice goods. There also are some elements of cascading -- double taxation -- because not all raw materials and intermediate good qualify for either the exemption under the suspension system or the crediting under the "VAT." Nonetheless, there are quite a few countries which have these kinds of taxes, taxes with consumption-tax-like characteristics, if you like, or, as some of my colleagues are fond of saying, "embryonic" consumption taxes. In other words, there is some administrative capacity. There is experience with running these types of taxes. If one looks at the numbers, one will find that the importance of these taxes has been increasing.

I draw your attention to table ten for a sample of 13 countries. The table records the change in the importance of these consumption-type taxes from the period 1966 through 1982.I think the caveat that Professor Due drew attention to is relevant. It is very difficult to keep these numbers very current and they keep on changing all the time. Nonetheless, what I wanted to draw your attention to was really the last row -- the average. There is an upward trend there. I wouldn't commit myself to the fact that in 1982, it was 22.36. One is never quite sure. But there is an upward trend. These were 13 countries for which we initially had data.

If one looks at the largest Sub-Saharan African sample of the 36 countries on the basis of which I presented the earlier tables, one finds a lower average. However, the important fact is again that between the mid 1960s and the early 1980s, one sees an increase.

In other words, not only is the administrative capacity there but the administration is actually doing something about it. Therefore, the position of consumption taxes has been growing in importance, although admittedly they are moth-eaten, they are not very good, there are exemptions, and they don't go through to the retail level. The movement, though, is in the right direction. Most of the taxes do includes imports in the base. They generally do not apply to exports. They apply to imports and domestic manufacturers.

There are fairly large informal sectors in Sub-Saharan Africa, and over time, the recommendation is to bring the informal sector into the tax net. Obviously at this point that is not cost effective. However, the informal sector is being taxed . While not paying tax on its output, the sector is paying taxes on inputs. The sector is not getting credit or exemptions for the inputs that its buys.

We have heard that the tax system is promoting the informal sector at the expense of the formal. Not necessarily so. The point is that you are taxing them in different ways. The formal sector is essentially paying output based taxes (with credit for input taxes), while the informal sector is paying input based taxes. It is difficult to know whether one is discriminating in favor of the one or the other. Secondly, even if one did know, it is not quite clear what one could do about it.

Let me turn to the issue of the kinds of recommendations that are given in the area of protection. Imports and domestic goods should be treated exactly the same way by the VAT. When I say VAT, I mean both the VAT and sales taxes of the kind that Professor Due talked about earlier. If imports and domestic goods are taxed in exactly the same way, there is not going to be any protective element built into that system.

The question that one faces, of course, is that all governments are interested in protection. What are the instruments that one is going to use to promote protection? Here I think there is room for considerable disagreement on the choice of instruments.

It is unlikely that there are a lot of infant industries spread across large sectors of the economy in Sub-Saharan Africa. While protection should only be given to a few, governments are in practice not very good at picking winners in industrial policy and deciding that this sector should be discriminated in favor against another.

The question that arises is whether one should provide a measure of protection to all industries or to a subset of industries. The answer is far from clear. There are genuine differences of opinion on this issue. What then is the right set of instrument for protection?

According to one view for example Professor Due's, protection should be furnished through a separate levy and let's call that the customs duty.

Let's think a little bit about what that implies. Essentially one is saying that one wants to subsidize the domestic producer of the commodity, whatever that commodity, we think is worthy of protection. That person is going to be subsidized. How is that subsidy going to be paid for? The answer that the customs duty gives us is that whoever is using the commodity should pay because the price that he pays is inclusive of customs duty. In addition, of course, it overcompensates because it also raises some revenue for the government.

The person who is using the commodity you are interested in protecting pays both the subsidy to the domestic producer of the commodity and in addition hands over some revenue to the government. That is exactly how the customs duty works.

The question that one might want to ask -- and this I think ultimately will be an administrative matter but I think economics can shed some light on the options -- is there any other way of financing that subsidy? With the customs duty we are doing a form of earmarking. The person who is going to use this product, whether it is beer or whether it is an intermediate good of some kind, is the person who should pay. Is that the right thing to be doing or should the subsidy come out of general revenue, so that the government pays the subsidy through means other than the customs duty?

It is not a question of <u>who</u> should be getting the subsidy. You have decided now who is going to get the subsidy. The question is how do you finance it.

I think the argument that people put forward in favor of the customs duty is that it is easier to collect. Let us also not forget the political economy argument. Certainly, duties are a lot less transparent. If every year you have to give that money out of the budget and it appeared as a budgetary item, a subsidy to this sector which is producing beer, to that sector which is producing paper clips and that sector which is producing something else, questions would get asked much more readily than if it were done by this automatic mechanism called the customs duty. The second reason governments, thus, prefer to use customs duties for protection is because it is a lot less transparent, apart from the fact that it is easy to collect.

The other element that comes up in our protection discussion is that considerable use is made of QRs in many low-income states, including the Sub-Saharan African countries. What happens with the QRs, of course, is that the competition is kept out, but at the same time the government is not making any money either unlike a tariff.

If you want to protect this industry, let's do it at a slightly lower cost, converting the QR into a tariff. The person gets the protection as he did before, but the government is now going to make some money.

Much of what one hears about there being a revenue constraint would sound a lot more convincing in the policy dialogue if one finds countries a little more willing to convert QRs into tariffs and make some money. And quite frequently such reforms could give you quite significant amounts of revenue without deprotecting domestic industry.

The political economy problem with doing away with QRs is that the people who get the licenses are also earning the rents and they may be quite powerful people. If you convert the QR into a tariff, the government in general will get the revenue. Obviously you know straight away who are the people who are going to oppose the move from QRs to tariffs. It's a distribution argument.

Finally, on the balance of payments, I think I hinted at what kind of recommendation is given here. While governments say that tariffs and QRs are used to control the demand for foreign exchange and that this poses a constraint in removing the tariffs and QRs, the discussion, instead, should focus on exchange rate policy. The exchange rate is the appropriate regulator for the balance of payments. Governments should adopt realistic exchange rates and use the tariffs and QRs for the purposes for which they were originally intended.

Before somebody tells me that I haven't heard of the Franc zone, let me just say that there is a special problem about using the exchange rate to control the balance of payments. Franc zone countries are not free to use exchange rate adjustments as a policy tool because they are in monetary unions.

There are various proposals that have been made. One of the proposals that has been talked about for a long time is to use across-the-board tariffs and export subsidies instead of the exchange rate to control the balance of payments, if the exchange rate can't be utilized as policy tool.

The problem is that once you have an across-the-board tariff for balance of payments reasons, you are automatically building in a protective element. The answer typically given to this complex problem is control the balance of payments through the tariffs and subsidies and use domestic taxes in order to offset the protection that would otherwise be built in.

I have summarized these proposals without evaluating them because I recognize that there could be a lot of institutional features about the Franc zone of which I am innocent. Therefore, if people have some remarks on this issue in the discussion period, I would be very interested to hear how one should handle this particular problem.

Finally, let me say a little bit about the way in which administration impinges. Whenever we talk about import taxes being integrated with the VAT or the sales tax, the advice has been to keep it simple and go for one rate which applies to everything. However, that itself will generate multiple rates for the following reason. Remember the informal sector is exempt. Therefore, the effective tax that the informal sector pays is going to be different in ways that it is hard to know but it is going to be different from what the formal sector is paying. Straight away, one has more than one rate even though legislatively there is just one.

Secondly, because of the need to promote exports, one wants to zero-rate exports, the details of which Professor Due talked about. There are different institutional mechanisms for zero-rating exports and the experience is mixed.

It is extremely important to think in terms of what the international constraints are. That is to say, in the absence of policy coordination among neighboring countries, it is simply not going to be feasible to have particularly high tariff rates because they are just going to be evaded.

In view of that, it is quite surprising, in view of sort of the a prior stories about smuggling, that the amount of revenue that governments collect from customs duties is quite as high as it. The important point is that international considerations always act as an upper bound on how much you can raise your tariffs. Thus, if you want to protect your domestic industry, you really have to do it through domestic subsidy instruments because porous borders across various countries are not going to allow you to do it in any other way.

The final point I wanted to make which I guess transcends my own mandate is that unless there is commitment at a fairly high level to implement these kinds of changes, to rationalize the structure of protection, to treat imports and domestic production on a comparable basis, and to institute, generally, more transparency into the whole incentive structure, it is very unlikely that proposals like this will get very far. Nonetheless, I would hope that all of us would keep trying.

Table 1: **SUMMARY OF TRENDS IN THE STRUCTURE OF TAXATION (SSA 1966-1981)**

	Computed Shares of Total Tax Revenue: Mean Value of Shares (%) (1)	Computed Shares of Total Tax Revenue: Mean Trend Coefficients 2/ (2)	Projected Mean Values 3/: 1966 (3)	Projected Mean Values 3/: 1981 (4)
1. Direct Taxes	29.72	0.56*	23.24	33.64
1.1 Income Taxes	27.29	0.37	24.33	29.98
Personal	(9.74)	(0.26)	(7.66)	(11.56)
Corporate	(14.72)	(0.32)	(12.16)	(16.96)
Other income	(2.83)	(-.21)	(4.51)	(1.36)
1.2 Social Sec. Taxes	1.93	0.07	1.37	2.42
1.3 Payroll Taxes	0.67	0.03	0.43	0.88
1.4 Property Taxes	1.55	-0.04	1.87	1.27
Immovable	(0.36)	(-0.01)	(0.44)	(0.29)
Statistical Discrepancy 1/	-1.72	0.24	-2.76	0.91
2. Indirect Taxes	23.95	-.024	24.14	23.78
2.1 Goods/Serv. Taxes	21.06	0.15	19.86	22.11
Sales	(8.57)	(0.34)*	(5.63)	(10.95)
Excise	(9.25)	(-0.04)	(9.57)	(8.97)
Other	(3.24	(-.16)	(4.66)	(2.19)
2.2 Other Indirect Taxes	2.98	-0.17*	4.34	1.79
Statistical Discrepancy 1/	-0.09	-0.004	-.06	-0.12
3. Int'l Trade Taxes	46.3	-.52	50.48	42.68
3.1 Import	36.40	-0.62*	41.36	32.76
3.2 Export	9.34	-0.02	9.5	9.20
Statistical Discrepancy 1/	.58	+.16	-.38	1.42

1/ Each row is determined independantly, hence figures do not always add up to the next level of aggregation due to variations in periods covered and rounding errors.

2/ Percentage point per annum. Asterisks denote statistically significant at 95% level.

3/ Data series are not available for the whole period for all countries, hence the need to project forward and backward with the aid of the trend coefficients to obtain given year values.

Table 2: TAX STRUCTURE IN AFRICA COMPARED TO OTHER REGIONS (1977-80)
(percent of total tax revenue)

Tax Structure	Sub-Saharan Africa (1)	Asia (2)	Middle East (3)	Western Hemisphere (4)	Europe (5)	All Countries (6)
1. Direct Taxes	29.72	35.45	42.81	44.24	60.98	41.59
1.1 Income Taxes	27.29	30.32	31.28	27.09	34.73	29.75
(Corporate)	(14.72)	(17.36)	(28.32)	(17.40)	(5.42)	(17.54)
1.2 Social Sec. Taxes	1.93	1.44	7.70	14.48	23.83	9.29
1.3 Property Taxes	1.55	3.69	3.83	2.67	2.42	2.55
2. Indirect Taxes	23.35	37.23	18.46	32.28	32.16	28.99
2.1 Goods & Services	21.06	36.11	10.59	28.83	28.27	26.09
(Excise)	(2.25)	(16.53)	(4.30)	(13.22)	(16.01)	(11.86)
2.2 Other Indirect Taxes	2.98	1.12	7.87	3.45	3.89	2.90
3. International Trade Taxes[1]	46.3	29.20	41.00	26.67	14.67	33.57
3.1 Import	36.4	22.09	39.55	18.91	14.65	26.51
3.2 Export	9.34	7.11	1.45	7.76	0.02	7.06

Source: "Quantitative Characteristics of the Tax Systems of Developing Countries", V. Tanzi, IMF DM/83/79; Table A.2.

Table 3: General Structure of Taxation (1966-81), with SSA Countries Ranked by Degree of reliance on International Trade Taxes(1)

Country	Share of Tax Revenues Originating from International Trade Transactions(2)		Share of Tax Revenues Originating from Principal Types of Domestic Transactions: Direct Taxes		Share of Tax Revenues Originating from Principal Types of Domestic Transactions: Domestic Indirect Taxes(3)	
	Mean (%)	Trend (%p.a.)	Mean (%)	Trend (%p.a.)	Mean (%)	Trend (%p.a.)
1.All Countries(SSA Average)	46.32	-0.52	29.72	0.36 *	23.95	-0.02
1.1-Above SSA Average(4)	59.01	-0.56	25.25	0.75	14.75	-0.20
Gambia	82.07	-0.64 *	13.33	0.66 *	4.58	-0.02
Lesotho	68.48	1.20 *	14.68	0.51 *	16.84	-1.71
Togo	63.57	-3.91 *	24.90	3.08 *	11.53	0.83 *
Benin	61.62	0.29	22.24	-0.02	16.15	-0.23 *
Guinea	61.46	4.44 *	26.64	-2.05	11.90	-2.38 *
Botswana	57.86	-0.47	38.25	1.04	3.89	-0.57 *
Zaire	56.08	-2.90 *	30.42	1.88 *	13.58	1.10 *
Sierra Leone	55.40	-1.07 *	27.94	.00	16.66	1.08 *
Swaziland	54.75	2.22 *	39.53	-1.73 *	5.71	-0.09 *
Gabon	54.68	-3.81 *	34.84	4.28 *	10.49	-0.47
Somalia	53.32	1.12 *	10.89	0.27 *	33.79	-1.39 *
Burkina Faso	53.11	0.03	24.62	-0.27	22.27	0.24
Cameroon	51.99	-2.07 *	27.55	1.14 *	20.46	0.93 *
Seychelles	51.68	-2.26 *	31.59	1.86 *	16.73	0.48 *
1.2-Approximating SSA Average(4)	46.70	0.09	23.82	0.31	29.48	-0.40
Rwanda	50.94	0.42	24.38	0.31	24.76	-0.73
Ivory Coast	50.88	0.27	21.45	0.96 *	27.73	-1.24 *
Sudan	50.77	0.53 *	12.28	0.76 *	36.95	-1.29 *
Chad	49.61	1.34 *	20.09	0.45	30.30	-1.79 *
Uganda	49.41	0.93	13.71	-0.71	36.89	-0.21
Mauritius	46.33	0.79 *	31.64	-0.43	22.23	-0.34 *
Senegal	45.67	-0.78 *	25.47	0.72 *	28.86	0.07
Ghana	45.39	-0.44	23.25	0.17	31.36	0.27
Ethiopia	43.70	-0.69 *	28.50	0.59 *	27.79	0.09
Madagascar	43.22	-0.42	20.73	0.08	35.94	0.33
Burundi	42.46	-0.54	27.98	0.73 *	29.56	-0.19
Niger	42.03	-0.22	36.62	0.12	21.35	0.20
1.3-Below SSA Average(4)	28.19	-1.20	41.68	0.58	30.19	0.67
Mauritania	38.93	0.70	31.40	0.68 *	29.66	-1.28 *
Congo, P.R. of Republic	36.08	-2.27 *	33.63	2.69 *	30.29	-0.43
Liberia	35.52	-0.26	41.09	-0.37 *	23.39	0.63 *
Nigeria	33.18	-4.38 *	53.24	6.12 *	13.58	-1.82 *
Mali	31.86	-0.99 *	24.04	1.03 *	44.10	-0.03
Tanzania	30.15	-1.97 *	31.87	0.09	37.99	1.88 *
Malawi	29.59	-1.44 *	42.87	-0.11	27.54	1.55 *
Kenya	28.63	-0.96 *	38.32	-0.35	33.05	1.31
Zambia	9.57	3.39	60.58	-3.40 *	29.86	3.31 *
Zimbabwe	7.49	-0.59	59.75	-0.61	32.44	1.66 *

Note: Asterisks denote Statistically significant at 95%.

(1)-Refers to the share of tax revenue collected from different classes of taxes.

(2)-Imports and Exports.

(3)-Sales, excises and other taxes not clearly allocable.

(4)-The groups are defined by whether they deviate from the Sub-Saharan Africa average by more than 10%, i.e. (above average)>1.1R, .9R<(approximating average)<1.1R., (below average)<.9R, where R is SSA average.

Table 4: NOMINAL GROWTH RATES OF DIFFERENT TYPES OF TAXES AND AND THEIR CONTRIBUTION TO THE GROWTH RATE OF TAX REVENUE (SSA 1966-81)

Type of Tax	Nominal Growth Rates 1/ (1)	Contribution to the Growth rate of Total Tax Revenue 2/ (Percent) (2)
A. Direct	17.9	34.0
Income	18.0	30.0
(Personal)	(16.0)	(10.0)
(Corporate)	(21.0)	(20.0)
Social Security	22.0	2.0
Payroll	15.0	1.0
Property	13.0	1.0
B. Indirect	17.0	24.0
Goods & Servic , 3/	17.1	22.0
Other Indirect	6.8	2.0
C. International Trade	15.0	42.0
Imports	14.0	32.0
Exports	16.0	10.0
Total Tax Revenue	16.3	100.0

1/ Percentage point per annum. These figures represent annual compound growth rates derived from logarithmic equations, and differ from the trend coefficients reported elsewhere, which are derived from linear equations.

2/ These are weighted using the computed long-term averages from Table 5.

3/ All components of this category (Sales, Excises, etc.) have approximately the same growth rates.

Table 5: **IMPLICIT AGGREGATE TAX RATES (SSA 1966-81) 1/**

	Mean (%) (1)	Trend 2/ (2)
1. Import taxes with respect to imports	15.82	-0.25*
2. Export taxes with respect to exports	7.02	0.33
3. Direct taxes with respect to Private Disposable income 3/	5.04	0.25*
4. Indirect taxes with respect to Private Consumption	4.92	0.14

1/ Using National Accounts data (all ratios are in nominal terms).

2/ Percentage point per annum. Asterisks denote statistically significant at the 95% level.

3/ Using GDP less direct taxes (as GNP series was not available for many of the countries in the sample).

Source: Annex Tables.

Table 6: **STABILITY OF TAX REVENUE (SSA 1966-1981)**

Type of Tax	Ranked in terms of estimated percentage change in the coefficient of variation of total tax revenue due to a percentage change in the share of each major tax in tax revenue 1/	
	Decomposition I 2/ (1)	Decomposition II 2/ (1)
Foreign Trade	1.13**	
Exports		1.69**
Imports		1.10**
Domestic Indirect	0.73**	
Excise		1.16
Sales		0.80
Direct Taxes 3/	0.57*	
Corporate income		0.66
Personal income		0.16

1/ The figures represent the sample average parameter estimates derived from regressing the coefficient of variations of tax revenue with respect to the share of revenue collected from each type of tax.

2/ ** is used where the parameter is significant at the 99% level and * at the 95% level.

3/ Social Security, pavroll and property taxes have lower or negative parameter values.

ANNEX

Table 7: IMPLICIT AGGREGATE TAX RATES (SSA 1966-81) WITH COUNTRIES RANKED BY TAX RATE FOR EACH GENERAL TYPE OF TAX 1/

Import Taxes with Respect to Imports

	Country (1)	Mean (%) (2)	Trend 2/ (% p.a.) (3)
1.	All countries (SSA Average)	15.82	-0.25*
1.1	Above SSA Average 3/	20.53	-0.40
	Sudan	31.02	-0.89*
	Somalia	24.61	0.77
	Ethiopia	22.61	-0.65*
	Guinea	22.04	-0.31
	Cameroon	21.74	-0.70*
	Togo	20.20	-1.06*
	Sierra Leone	19.41	-0.30
	Ivory Coast	19.27	0.54*
	Madagascar	18.92	-0.80*
	Senegal	18.52	-0.74*
	Gambo	18.48	-0.59
	Bourkina Faso	18.00	-0.68*
	Burundi	17.93	-0.39*
	Gambia	17.68	-0.18
	Benin	17.56	-0.08
1.2	Approximating SSA Average 3/	15.19	0.22
	Botswana	16.78	0.77*
	Niger	14.52	-0.15
	Chad	14.26	0.04
1.3	Below SSA Average 3/	11.52	-0.20
	Ghana	13.93	-0.53*
	Nigeria	13.77	-0.24
	Swaziland	13.74	0.89*
	Zaire	13.56	-0.54*
	Lesotho	13.46	0.17
	Kenya	12.88	-0.10
	Rwanada	12.81	-0.26*
	Mauritius	11.64	-0.12
	Liberia	11.38	-0.09
	Tanzania	11.32	-0.60*
	Congo, P.R. of	11.22	-0.80*
	Uganda	10.55	-0.39
	Malawi	10.54	-0.25
	Mali	9.54	-0.43*
	Mauritania	8.47	0.14
	Zambia	5.48	.00
	Seychelles	-	-
	Zimbabwe	-	-

1/ Using National Accounts data (all ratios are in nominal terms).
2/ Asterisks denote statistically significant at the 95 percent level.
3/ The groups are defined by whether they deviate from the Sub-Saharan African average by more than 10 percent, i.e., above average = >1.1u; 0.9u < average < 1.1u; below average = < 0.9u.

ANNEX

Table 8: IMPLICIT AGGREGATE TAX RATES (SSA 1966-81) WITH COUNTRIES RANKED BY TAX RATE FOR EACH GENERAL TYPE OF TAX 1/

Export Taxes with Respect to Exports

Country (1)	Mean (%) (2)	Trend 2/ (% p.a.) (3)
1. All Countries (SSA Average)	7.02	0.33
1.1 Above SSA Average 3/	19.32	1.5
Uganda	40.29	7.23
Guinea	22.83	3.93*
Ghana	20.20	0.60
Zaire	20.16	-1.00
Rwanda	14.57	0.25
Burundi	14.56	0.19
Ethiopia	12.98	1.14*
Ivory Coast	8.92	-0.31*
1.2 Approximating SSA Average 3/	6.69	0.33
Madagascar	6.69	0.33*
1.3 Below SSA Average 3/	2.87	-0.04
Cameroon	6.27	-0.11
Sudan	6.03	-0.12
Sierra Leone	6.01	0.37*
Gabon	5.61	-0.38
Togo	5.48	-0.01
Mali	5.26	0.11
Tanzania	5.26	0.66*
Mauritius	4.25	0.20*
Chad	4.24	-0.15*
Niger	4.12	-0.23*
Gambia	3.36	-0.01
Somalia	3.24	-0.29*
Senegal	3.09	-0.33*
Swaziland	2.87	0.42*
Bourkina Faso	2.57	0.02
Lesotho	2.06	-0.41
Congo	1.77	-0.39*
Benin	1.58	-0.04
Nigeria	1.49	-0.29*
Botswana	1.09	-0.20*
Mauritania	1.05	0.08
Kenya	0.37	0.05
Liberia	0.29	-0.02*
Malawi	0.00	0.00
Seychelles	0.00	0.00
Zimbabwe	0.00	0.00
Zambia	0.00	0.00

1/ Using National Accounts data (all ratios are in nominal terms).
2/ Asterisks denote statistically significant at the 95 percent level.
3/ The groups are defined by whether they deviate from the Sub-Sararan African average by more than 10 percent, i.e., above average = > 1.1u; 0.9u < average < 1.1u: below average = 0.9u.

Table 9: Buoyancies of Individual Taxes with Respect to Corresponding Tax Base in SSA

	Country	Export Taxes with Respect to Export	Direct Taxes with Respect to Disposable Income	Indirect Taxes with Respect to Private Consumption	Import Taxes with Respect to Imports
1.	Benin	0.81*	0.14	1.17*	0.97
2.	Cameroon	0.78*	1.42*	1.58*	0.80*
3.	Chad	0.49*	1.47*	-0.03	1.02*
4.	Congo	-0.80*	2.09*	0.86*	0.58*
5.	Gabon	0.60*	1.53*	1.47*	0.77
6.	Gambia	0.99*	1.41*	0.98*	0.90*
7.	Ghana	1.21*	0.74*	0.69*	0.87*
8.	Guinea	1.93*	1.38*	-1.35*	0.91*
9.	Ivory Coast	0.78*	1.176*	0.96*	1.17
10.	Liberia	0.24	0.81*	1.43*	0.92*
11.	Mali	1.44*	1.25*	1.04*	0.66*
12.	Mauritania	2.23*	2.36*	1.26*	1.08*
13.	Niger	0.71*	1.13*	2.13*	0.93*
14.	Nigeria	-0.93*	1.66*	0.88*	0.91*
15.	Senegal	-.006	1.44*	1.28*	0.67*
16.	Sierra Leone	1.74*	1.06*	1.65*	0.87*
17.	Togo	0.96*	1.35	2.86*	0.65*
18.	Burkina Faso	1.04*	1.66*	1.40*	0.77*
19.	Botswana	0.18*	1.48*	0.77*	1.25*
20.	Burundi	1.06*	1.24*	1.48*	0.87*
21.	Ethiopia	2.08*	2.00*	1.68*	0.69*
22.	Kenya	1.72*	1.19	1.60*	0.93*
23.	Lesotho	-.18	1.61*	1.03*	1.05*
24.	Madagascar	1.53*	1.55*	0.97*	0.60*
25.	Malawi	-	1.21*	1.99*	0.84*
26.	Mauritius	1.23*	1.00*	0.99*	0.93*
27.	Rwanda	1.11*	1.15*	1.41*	0.91*
28.	Seychelles	-	-	-	-
29.	Somalia	0.16	1.22*	0.66*	1.12*
30.	Sudan	0.77*	0.92*	0.68*	0.83*
31.	Swaziland	3.55*	1.12*	0.70*	1.40*
32.	Tanzania	2.83*	1.16*	1.63*	0.58
33.	Uganda	1.67	0.39*	0.39*	0.56*
34.	Zaire	0.78*	1.04*	1.05*	0.79*
35.	Zambia	-	0.49	2.05*	0.94*
36.	Zimbabwe	-	0.87*	1.46*	-
	AVERAGE	1.02	1.25	1.16	0.87

* significant at 95% level.

Source: Government Financial Statistics, International Monetary Fund and Country Economnic Memorandums, World Bank.

Table 10: The Quantitative Importance of Embryonic Consumption-Type Taxes a/

Country	Revenue from Embryonic Consumption-Type Taxes as a Percentage of Total Tax Revenue				
	1966	1970	1974	1978	1982
Benin	6.10	5.10	8.00	7.24	8.70
Burkina	12.10	12.70	14.29	13.98	20.77
Ethiopia	4.11	6.77	8.63	8.17	10.49
Ghana	9.49	10.97	6.36	6.84	11.55
Ivory Coast	22.27	27.07	27.50	28.77	30.70
Kenya	6.31	6.70	23.66	25.32	29.77
Madagascar	14.30	30.49	32.92	18.12	25.68
Malawi	12.96	16.66	26.02	26.66	29.95
Mauritius	8.85	9.72	5.57	6.15	7.60
Senegal	-	21.03	23.41	28.86	31.3 b/
Tanzania	5.01	23.84	30.88	34.51	54.84
Zaire	1.29	1.97	3.58	10.13	18.97
Zambia	1.46	0.97	6.79	12.25	10.32
Average	8.69	13.38	16.74	17.46	22.36

Source: Government Financial Statistics, IMF/IBRD, various issues.

a/ Excluding import duties and excise taxes but including broad-based turnover and related commodity taxes in addition to VAT-like and sales taxes.

b/ 1980

Table 11: Total Tax Element by Sector

		(1) Total CDST on Intermediates	(2) Total Excises on Intermediates	(3)=(1)+(2) Total Tax on Intermediates	(4) Effective Tax	(5)= (3)-(4) TDIFF	(6)= (5)÷(3) INTAX	(7) Effective CDST on Final Imports
1	Rice	0.17	0.26	0.43	0.00	0.43	1.00	0.00
2	Wheat	0.27	0.99	1.26	0.00	1.26	1.00	0.00
3	Jute	0.07	0.12	0.19	0.00	0.19	1.00	0.00
4	Cotton	7.05	0.06	7.11	6.72	0.39	0.05	0.00
5	Tea	1.01	3.32	4.33	2.46	1.87	0.43	0.00
6	Other Crops	0.31	0.15	0.46	0.21	0.24	0.53	8.98
7	Livestock	0.14	0.29	0.42	0.00	0.42	1.00	0.00
8	Fisheries	0.28	0.26	0.55	0.00	0.55	1.00	0.00
9	Forestry	0.04	0.05	0.09	0.00	0.09	1.00	0.00
10	Sugar	3.41	1.24	4.65	4.19	0.46	0.10	29.59
11	Edible Oil	1.43	0.44	1.87	0.99	0.89	0.47	12.24
12	Tobacco Products	0.40	42.73	43.13	42.56	0.57	0.01	0.00
13	Other Food	0.55	3.17	3.73	3.09	0.64	0.17	2.64
14	Cotton Yarn	16.05	2.39	18.45	14.53	3.92	0.21	0.00
15	Cloth	5.76	1.41	7.20	0.39	6.81	0.94	6.77
16	Jute Textile	0.19	3.05	3.24	2.25	0.96	0.30	0.00
17	Paper	10.07	6.61	16.66	12.94	3.74	0.22	7.84
18	Leather	0.74	0.55	1.29	0.00	1.29	1.00	0.00
19	Fertilizer	0.28	1.04	1.32	0.04	1.28	0.97	0.00
20	Pharmaceutical and chemical	6.25	1.61	7.85	6.61	1.24	0.16	15.81
21	Cement	10.94	3.97	14.91	12.31	2.60	0.17	0.00
22	Basic Metals	25.41	0.19	25.60	20.91	4.69	0.18	0.00
23	Metal Products	5.95	2.14	8.08	4.81	3.27	0.40	74.05
24	Wood and Other Industries	7.07	3.92	10.98	8.28	2.70	0.25	41.49
25	Urban Housebuilding	6.23	1.24	7.47	0.00	7.47	1.00	0.00
26	Rural House Building	2.16	0.42	2.60	0.00	2.60	1.00	0.00
27	Other Construction	8.82	1.18	10.00	0.00	10.00	1.00	0.00
28	Petroleum	2.88	3.71	6.59	1.19	5.39	0.82	[illegible]
29	Electricity and Gas	1.34	19.22	20.56	15.60	4.97	0.24	0.00
30	Transport Service	0.32	0.40	0.72	0.05	0.67	0.93	0.00
31	Housing	0.24	0.06	0.29	0.00	0.29	1.00	0.00
32	Health	1.41	0.41	1.82	0.00	1.82	1.00	0.00
33	Education	0.29	0.18	0.47	0.00	0.47	1.00	0.00
34	Public Administration	0.67	0.34	1.01	0.00	1.01	1.00	0.00
35	Trade and Other Services	0.18	0.41	0.60	0.26	0.34	0.57	0.00

TAXATION IN SUB-SAHARAN COUNTRIES

Some Remarks Based on Experiences of IMF Technical Assistance Work

Leif Muten, Senior Advisor, Fiscal Affairs Department, IMF

Those who heard Dick Goode yesterday and have seen my outline today will notice that I have been working under him long enough to take up the issues of this conference mainly in his spirit. For the same reason, much of what I shall be saying today will mainly be supplimentary to what Dick Goode said in his inspiring speech of yesterday. I should also add that what I am giving is my personal view, not necessarily shared by the International Monetary Fund.

I. OBJECTIVES

1. Revenue

The objective of taxation is first of all revenue collection. Sometimes the question is raised whether we in the Fund have not misunderstood our function, trying to spread the benefits of a high-tax society to developing countries. Allegedly, these countries would thrive more, if they cut expenditures as well as taxes and established a supply side-oriented, low-tax profile.

To be sure, quite a few of these countries do already have a low-tax profile. The worst thing is that these countries sometimes have very high taxes according to the law, while what is actually collected is so little as to represent a very low tax burden. Sometimes the effective burden on the taxpayers is very much higher than appears from the Treasury accounts, the difference being illicit payments. In some countries these may be quite high, even in proportion to what is actually paid in taxes.

When we advise countries, we must certainly try to promote fiscal responsibility both on the expenditure side and on the revenue side. My subject today, however, does only include the latter.

2. Growth

Some critics also say that if we make countries increase their taxes, this is tantamount to impeding economic growth. It is stressed that we should not forget that structural reform has to take into consideration growth. I think that we do indeed pay attention to growth, however. As a matter of fact, on the usual menu of tax reform measures, there are those that can be taken both to the benefit of the Treasury and to the benefit of growth.

3. Redistribution

Finally, redistribution remains an objective, and a complicated one. This is so, first of all, because effective taxation is much more easy to implement in the modern sector than in the other sectors of the economy. If redistribution is directed exclusively against a few people easily identified, while ignoring the middle income sector of traders, artisans, black marketeers, and the like, who are difficult to reach with tax measures but who have considerable tax-paying capacity, we are facing a difficult equity problem.

Moreover, if one uses progressive taxation as an instrument of redistribution, one has to be aware that in most countries, those affected may have an escape route. Brain drain is a vexing problem in many countries. And it is a fact that no country, developed or developing, can do completely without expatriate experts. The idea to tax the well-paid expatriates at high progressive rates aimed at redistributing income and wealth, is not very realistic, if those expatriates are hired under net-of-tax contracts. Redistributive taxation does not affect the position of these expatriates. Yet, I have seen countries where taxpayers in the highest brackets virtually exclusively consisted of expatriates. While Africanization is a legitimate policy objective, it is not necessarily a good idea to use taxes to price expatriates out of the market. Africanization of jobs can be achieved by less expensive means, such as immigration regulations, and perhaps even some rules concerning the mandatory training of local counterparts.

II. MEANS

1. Simplicity

Simplicity may be seen as an objective (as in Dick Goode's paper) or as a means to achieve one of the other objectives. In either case, it is important. There is much work to do in this area. Many countries, perhaps not least the francophone African countries, have a tendency to introduce new taxes to cover new revenue needs or fulfill new fiscal objectives rather than amending existing taxes. With time, this leads to an overly complicated system.

From time to time, a sweeping-up action is needed, a kind of general house-cleaning. In the course of such an operation, it is often discovered that taxes enacted with the best of purposed actually do not apply in the real world.

In this connection, I feel that a particular word of warning is needed with respect to the tempation of using tax systems for experimental purposes. A case in point is the expenditure tax. India and Sri Lanka benefited little from experimentation with a progressive expenditure tax. The countries were poorly equipped to make such a bold experiment a success. And to take an African example with the same source of inspiration, I recall a West African country were a capital gains tax had been introduced and some scare staff entrusted with its implementation, quite without regard to the fact that land titles did not exist, nor a stock exchange, nor a bond market, nor very much other opportunity to make capital gains. Hence, no revenue at all was collected from the tax. Certainly, putting those tax inspectors to work to taxing regular incomes was a change for the better. Now, the situation might be different, if it is true what we have heard that a land title system has since been developed.

Another example of useless complication are those earmarked taxes, often not even entered in the government budget, yet destroying the logic of the system. Take for instance tourist taxes. They tend to be collected by tourist promotion agencies, far beyond Treasury control. The alleged objective is to promote tourism, viable or not, but it happens that the money is spent on items rather remotely connected with the purpose. Those in charge rarely know anything about assessing, auditing, etc.; expenditure control is often absent; and the tax is merely a nuisance, possibly scaring tourists away. Such taxes should be part of the sales tax system and subject to usual controls.

Simplicity also means adapting taxation to the facilities of taxpayers. The heavy colonial heritage of complicated tax laws may have had a reasonable function at the time the laws, mainly or exclusively applied to people who played guest roles in the colonies but whose real economic affiliation was with the mother country. Once this situation had changed and the bulk of the taxpayers were locals, the relevant consideration were the circumstances of that population. It will not do to keep on the statute books numerous sophisticated provisions that will not be applied in practice and often not even be relevant to the tax officials or the taxpaying public.

2. Generality

As Dick Goode stressed yesterday, special exemptions erode the system and should be minimized. This holds for all kinds of taxes, including, for instance, customs. In quite a few countries we have found that more than half of all imports slip in duty exempt. With extensive exemptions, it is very difficult to check that the exemptions are used in accordance with their purpose.

With respect to importers who usually may claim exemption for industrial inputs, it is not rare for the customs agents to dig down into the big containers to find those bottles, those radios and air conditioners that might lie on the bottom. It is a better idea to have at least some duty on most or all imports, so that the importer cannot count on a totally free ride past the customs agent.

Similarly, with sales taxes, we are basically in favor of uniform rates. John Due's criticism against differentiated sales taxes hits us (IMF) to some extent. In our recommendations of simple sales taxes at the importer/manufacturer level, we have, indeed, gone along with rate differentiation. After all, at importation, it is easy enough to know what is imported, and a manufacturer should know what he manufactures.

In contrast, the differentiation of a sales tax at the retail stage is doomed to fail. No retailer can ever know exactly how much he has sold of one category of goods or another. For a VAT, it is also quite inefficient to have differentiation, although that mistake is as common as to be almost the rule. After all, regardless of whether administratively possible or not, the sales tax differentiation tends to take on permanency, yet its rationale may soon escape both the taxpayers and the administrators, diminishing their respect for the tax system.

Hence our general line is to make the sales tax as uniform as possible. If a differentiation against sumptuary goods is seen as needed, it should take the form of excises instead. Of course, the exemption of unprocessed local foodstuffs is evidently practical, both as a means of achieving some degree of progression and to simplify administration.

Concerning differentiation between incomes from different sources, our (IMF) line, as stated yesterday by Dick Goode, has been in favor of a global income tax, at least as a long-term objective. The big problem here is that business income, particularly in francophone countries, has traditionally been taxed much higher than salaries and wages. Historically, the reason is that those self-employed are in fact not expected to declare all their profits. Therefore, if they are taxed a bit higher on a profit base all those involved know is underestimated, the result may well come out right in relation to those poor wage and salary earners, who supposedly have to pay tax on all their income.

Nevertheless, if we graft upon such a traditional differentiated system, a new, effective assessment and audit machinery, the upshot may well be discriminatory taxation. If we fail to change the differentiation and yet tell those self-employed to change their habits and declare their full profits, they may rightly point out that the rate differentiation implies that they are expected to underdeclare.

If we want a uniform global income tax system, we must, at least on paper, increase the tax burden on wage and salary earners and/or reduce it on the self-employed. Politically, that is a tall order. It is not made easier by the tendency people have to judge a tax reform on the basis of its differential effects in relation to the old system, rather than on the merits of the new system as such.

To expand on this a bit, let us consider that if a tax system is quite irrational and we want to transform it into a completely rational system, the difference between the old system and the new one will look just as irrational as the old system. The traditional example here is the (I hope nonexistent) country where they had a tax on red-haired people. Once the budget situation permitted, the decision was made to do away with that silly tax. Whereupon, of course, there was an uproar amongst the taxpaying community. Should only red-haired people benefit from the tax relief?

3. Realism

Realism was already mentioned in the context of simplification. Allow me one more story to illustrate what it means, a true one this time. I was somewhere in West Africa, in a country where all employees paid tax by withholding. After the end of the year, the law provided for an assessment, and there was provision for supplementary payments, as needed, as well as for refunds. The withholding system was a bit simpler than the British PAYE.

Much staff time was used filling big ledgers with figures for monthly wages, monthly withholding, and yearly totals for all employees reported by the withholding employers. At the end of the year, the tax for the year was computed. If there had been overwithholding, the differential was filled in with red ink, the figure representing the refund coming to the employee. A random sample of ledger pages indicated a total number of refunds in each year of some 12,000. Yet, some further inquiry disclosed that very few refunds took place at all, and virtually none with respect to overwithholding from employees.

4. Incentives

Most of us would, of course, like the investment codes to disapear tomorrow. The main reason for having them is that others have got them. It is very difficult to tell a country to go alone, abolishing its investment code, while countries it competes with still offer incentives.

Admittedly, they also have the purpose of promoting investment, not the least foreign investment. All experience tells us, however, that there are other factors more important than even the most generous investment code, including (a) economic and political stability, (b) a good and well-trained labor force, (c) adequate infrastructure, (d) closeness to markets, etc., not to forget a reasonable tax system. Investment codes come in way down on the list. On the other hand, abolishing them is not easy and requires some care.

Some countries have, indeed, been advised to change their investment codes to a point where they do not even offer customs exemption for the first delivery of machinery and plant and sales tax exemption for them, either. In combination with a minimum tariff duty, this might well impose a hefty burden for the new investor. In one African country I think that the total duty and sales tax burden on new machinery and plant is something like 34 percent, if they have not changed it lately. That seems to be too much for any country, even if one might have sympathy for the idea of not promoting capital-intensive activities but rather labor-intensive ones.

With a good nontax environment and with a permanent tax system without excesses, chances are that investors can be attracted even without special tax incentives. If one does have an investment code, however, the benefits should not be overdone. The most important benefits are those that come early. Instead, one can skip those 25 years tax holidays, those costly customs exemptions for consumption goods imported by expatriate staff, etc. A ceiling may be set for the tax holiday benefit, so that unexpectedly high profits can be taxed. From such reasonable restrictions on benefits to the 34 percent entrance fee is a long way, however. We have to stay somewhere in the middle.

Also, as Dick Goode reminded us yesterday, there is a conflict between being selective, with the bureaucratic procedure that implies, and offering a free-for-all that means that incentives may be granted where they are not needed. The painful thing is that an incentive that is not needed is inefficient and costs real money in terms of revenue forgone. In contrast, an incentive that is really a necessary condition for the activity to take place at all and for its financing to be made available, does not cost anything. There is no revenue forgone in that case. This makes the computation of "tax expenditure" or revenue forgone by investment incentives so tricky, particularly when it comes to foreign investment.

Let me give an example: A country has a 90 percent income tax on higher incomes. As an incentive, a starting high-tech industry is allowed to take in expatriate staff under tax exemption over a three-year period, costing say $50,000 per head. Is revenue forgone to the tune of $45,000 per employee? Most probably not. Without the exemption, they would in all likelihood never have been hired. One could as well maintain that at a tax rate of 99 percent, the revenue forgone would have been $49,500 per head!

Similarly, a country may have a prohibitive import duty on certain items and decides to waive it for a newly started industry, calling it an incentive. What is the difference in revenue forgone, assuming the prohibitive duty was 100 percent, 1,000 percent, or 10,000 percent? Assuming that we are dealing with foreign investment or with other money that would not have had dutiable imports as alternative use, no revenue at all is forgone since with a prohibitive tariff, no import takes place.

This should, of course, not be understood as denying the fact that with most incentives, particularyly too generous ones, revenue is actually forgone. Most incentives might not be needed, and those that are needed may often be misplaced. What line should we take to prevent that? We know that too much selectiveness may lead to unnecessary bureaucracy and sometimes to corruption. Yet, there are many sharks out there, and some selectiveness is needed as protection against them.

Mostly, it is the big multinationals who must bear the brunt, since they are the most visible. More often, however, the real sharks are those anonymous investors, often from tax-haven countries, who fly by night after making quick profits. I remember a landlocked poor African country that finally had found a taker for its generous investment benefits. He wanted to manufacture matches and was promised all conceivable exemptions. Once his approval had been granted, the authorities asked him when production would start. "We'll see", was the answer. "First I have to find somebody who knows how to make matches, because that I don't know."

III. LIMITATIONS

1. Administration

Administrative feasibility often sets the limit for what you can achieve by tax reform. The tax administration may not be able to deal with more than a very limited number of taxpayers.

It may be able to deal with a few more, if administration is computerized, and that is very often a good thing, if carefully implemented. But computerization is not a panacea. Quite a few countries have destroyed functioning systems, computerizing too hastily. Yet the computer is a useful tool and can widen the scope of what is feasible.

Basically, we have to advise countries not to be too ambitious. The choice of manufacturer/importer taxes over retail taxes is a case in point. The fewer the taxpayers, the better the chances are of administering the tax with the limited resources at hand. It is much better to have a limited tax that hits a few taxpayers, but hits them effectively, than to have a tax that is broad in concept but fails to fulfill its purpose because the machinery is not there to identify the potential taxpayers and see to it that they pay their dues.

It is sometimes said that the traditional differentiation between tax policy and tax administration is not relevant in the Third World. Instead, tax policy _is_ tax administration.

The resources and the powers given to tax administration decide what can be achieved, what legislation will mean in actual practice. There is no point in having legislation that remains theoretical.

Let me underscore this. It is extremely important for countries to be honest in their tax legislation. If a country has a complicated tax law that is not applied in practice and if it has high tax rates that people don't pay, it may make the outside world believe that it is a high-tax country while in reality it is only collecting the revenue of a low-tax country. It will lose revenue and yet not reap the fruits of recognition as a low-tax country. If a country really wants to be a low-tax country, it is a much better idea to be open about it.

2. Illicit practices

In many ex-colonial countries, it used to be a civic virtue to sabotage the tax system. Once independence was gained, many people hoped that taxes -- a colonial evil -- would disappear. Few leaders have been willing and able to implant in their peoples anything contradicting that belief. The anti-tax attitudes and habits are often there, and they run deep.

And what do we do about corruption? First of all, we cannot moralize. It is, of course, probably true for most of us that we could not corrupted by being offered bribes. In that respect, one might consider oneself honest. But on the other hand, most of us here have probably never been exposed to the unpleasant knowledge of where our lower corruption point is. Where is the point at which you sell your honor because you cannot feed your wife and kids? That lower corruption point exists for everybody who is not ready to die for his honor and let his family die with him. In poor countries, I have met far too many who know where they have their corruption point. I take my hat off for those, whose point is low. I doubt whether I ever met somebody, to whom it did not exist.

To illustrate, I remember the recruiting officer in the Ministry of Finance telling me that for each position in Customs, they had 500 applicants, for each position in Income Tax 450, for each position in the Pawnbroking Office, they had 2. They also told about trouble recruiting trainers for the tax service. Officials preferred being in direct contact with the taxpaying public.

That is the problem of those we advise. I am afraid we sometimes talk with a forked tongue. On the one hand, in general consultations, we may tell a country to cut down on the payroll. At the same time, with the poor salaries they are paid, tax administration officials cannot be expected to stay honest.

One partial solution to this contradictions to trim the payroll in parts of the public service other than the tax administration. Also, experience of censuses taken has shown that in some cases, there is a realistic opportunity to save on payroll expenses, if the usual prudent rule is followed -- to terminate salary and wage payments to those who are already dead, those who never show up for work, and those who never existed in the first place Another way is to differentiate the pay, but if one does chances are that workers in other parts of the public service will eventually catch up.

3. Technical assistance

How much can we achieve with the technical assistance we offer? We have to train counterparts. It is useless to send out experts to do the day-to day job substituting for somebody locally employed. Yet, counterpart training is often given in vain, officials in poor administrations being quickly promoted to their level of incompetence. The counterpart the advisor trains may be recognized as good, perhaps thanks to the training he was given, and he will accordingly be promoted, leaving to the expert the ungrateful task of starting the counterpart training all over again with a new beginner.

We have to implant a spirit of professionalism and specialization. That is not easy in underpaid and underequipped administrations.

How often do we not meet those advisors who have been out advising so long that they have nothing to advise about any more? They may need retraining. But if it is difficult to train local counterparts, it is well-nigh impossible to train technical assistance experts!

The problem is also one of money. Let me tell you about a story told by one of our consultants, who had come back after assignment from another, private sector organization. He had estimated the necessary time for a particular assignment at two weeks but was advised that this type of job should be seen as a two-month assignment. If that mentality comes in, it spells disaster. We have to keep technical assistance a prestigious enterprise with a good name.

IV. FUTURE

There is a lot to be done, and many people willing to do it. Here we come to the conflicting advice problem. The Minister of Finance who wants to do nothing has a sure way of getting nothing done. He calls in first one organization and then a second one for a second opinion, and then a third and as fourth one. And after circumstances have changed, he can start shopping around again in a new sequence.

I have been invited to countries where thay have received a bunch of expert reports and they have complained about not knowing what to do with them, asking us to make an action program out of the bundle of reports. That, at least, can lead to something. It is worse when the Minister gets paralyzed, confronted with one organization advising one line of action, the other an opposite policy.

If we want action, we can, in principle, include the technical assistance recommendations in our conditionality. That may be all to the good, provided that the country implements the conditions according to the book. But if the measures at issue are not popular and if those in charge are less than enthusiastic about making them succeed, there is no tax advice as perfect as not to be botched up by an unwilling administration. Therefore, I am not convinced that by combining the technical assistance with conditionality we are always contributing to the success of the technical assistance.

International collaboration in the administration of taxes is important. The problem is trust. France, Germany, the United Kingdom, and the United States collaborate in the Group of Four. Tax administrators from these countries meet periodically to discuss international tax cheating. The OECD and the Council of Europe have recently opened for ratification a multilateral convention on exchange of information and administrative assistance in tax matters. The United States has a network of bilateral conventions. For the LDCs, virtually all we had was the OTITO, a tax office in London to which Commonwealth countries could send their complicated tax files for assessment by people with experience. However, most countries feared that these officials would side with the taxpayers from the rich countries. Hence, the activity faded out. We have a long way to go, before we get the kind of international collaboration needed. For instance, a Sub-Saharan country will typically have less staff with international tax experience than the tax department of a small multinational corporation. Moreover, if a multinational has a choice, whether it wants to be on friendly terms with the tax administration of the host country or in case of conflict with say the U.S. and the I.R.S., the multinational will choose the latter. The best we can hope for is the ongoing work by the ECOSOC group of experts. They face a difficult problem.

Lofti Maktouf
Counsellor for Taxation, IMF

I would like to concentrate on the legal aspects of technical assistance in the tax field. Unlike economics, legal principles do vary from country to country. There are large familes of law commonly known as (a) the civil law system that started in France and was adopted in mostly Latin American, French African-speaking countries and some countries in the Middle East and (b) the common law system which was started with the British.

The U.S., also, is in the common law system. There are other legal families, of course, in the Orient, the Islamic, and so forth.

It is very important for someone involved in technical assistance in the tax field from the legal viewpoint to take into consideration the distinctions, identifying to which legal family that particular country belongs. If you are in Guinea or Senegal, it is more or less the civil law system. If you are in Uganda, it is more or less the common law system.

I want to give a few examples in order that you can see how it is different. A simple example. You are in a common law system; you are sitting in your office; you call your secretary for some dictation; and your secretary gets a heart attack and is about to die. If you don't like her, you can just keep on dictating. It is not very nice. She will die but it is not an offense.

Under a civil law system, say you are in France, and you call in your secretary and she has a heart attack or she chokes. If you don't help her, you commit an offense.

Now, of course, there are qualifications, but the basic principle is that there is a major distinction between the two familes of laws.

Another example closer to the tax field pertains to the presumption of innocence or guilt. Generally, under a civil law system, there is a presumption of guilt. Maybe that is the tradition of the French in dealing with their taxes which generated this principle. There is a presumption of innocence generally in the common law countries.

Another example is in the field of the institutional infrastructure. For instance, the concept of a trust, which does exist and constitutes a major feature of the Anglo-Saxon system, does not exist at all under the civil law system. In France, you cannot set up a trust. It doesn't exist.

Presumably if a trustee, American trustee, goes and purchases a piece of property in France, the trustee acted in his or her own capcity. It is the trustee who purchased the property which means that, for French purposes, if the trustee dies, his or her estate would have a right to inherit that particular piece of property. The beneficiary wouldn't like it very much, but he should have hired a lawyer who knew about these issues.

One notices differences in the tax principles as well. For example, France adopts a territorial system when it comes to taxation of foreign income or a resident with foreign income.

It is coupled with what is called the inception system whereby everything generated within France would be subject to French taxation but anything generated outside of France by French residents would not be computed in the tax base. There are some exceptions but the basic principle is that it is a territorial system.

It is different in the United States which adopts what is called the worlwide taxation system. Wherever you are, the IRS will look you up, even if you generate income on the moon. Technically, you have to declare it. You get some sort of a foreign tax credit which becomes quite complicated with the new tax reform, but the basic thrust is the same.

Also, with respect to taxation of corporations and shareholders, the United States and other countries adopt what is called the double-tax system. You tax the income at the corporate level and then upon distribution at the shareholder level. France, followed by the United Kingdom, adopts partial integration. The shareholder gets a credit for any assessments at the corporate level.

For francophone states, there is a distinction between assessment and collection in tax administration, and it derives from a legal principle. The basis for the system is to avoid or limit corrution. One person would assess your taxes and another person would collect. Those persons are presumably very different. This is, again, quite different in other systems, including the U.S. system. The collection and the assessment are not two distinct functions with two distinct offices having two distinct statuses. If we are to give some technical assistance or legal advice to a francophone African country, one would have to remember this distinction.

When legal principles are not respected, there is a very serious risk that the advice given both on the tax policy side and the legal side won't work. More important, it is illegal and unconstitutional to provide advice which is not in line with the constitutional and legal principles of the country.

Strong attention also should be paid to the social institutions, especially the family. In many African countries, there is polygamy. The concept of a family is very different. It is not limited to the small nucleus we know. It has some impact, of course, on the way you design a tax system and the way you define a taxable unit.

Some other institutions are also very important, like land tenure. It is very important to remember that in most Africian countries the State plays a very important role in the land tenure. It owns much of the land.

In fact, in francophone countries it is not really the State that owns the land; it's the nation. The concept has been created in Senegal which has been adopted in all of the francophone countries. It is called the Domain National. It is very different. The land does not even belong to the State. It belongs to the nation.

This reminds me of a very well known 19th century French lawyer, who criticised the concept of the state arguing that it doesn't exist. "I never had dinner with the State."

This has implications for land use. Banks cannot provide mortages on the lands. You cannot just present your land and then get a line of credit. Land tenure has its own principles and the way the land is kept, used, transferred is very crucial to any real estate taxation, to any economic transactions.

I would like to close with the following anecdote. As I said, I just came back from an African country. I remember my legal mission coincided with an Arab department mission. Over the weekend, my colleagues from the Arab department decided to go on a very quick safari to the western part of that country, and they said they would be back by 6:00 o'clock, Sunday. Eight o'clock, Sunday, I was having dinner by myself at the the hotel and I started to worry. I asked the waiter, "What would happen if their jeeps were to break down?" And he said, "Oh, don't worry about that. The "fishers of men" would pick them up." I said, "who are they?" He said, "Well, it's just a religious group and there are many of them in this country." I said, "Why would the "fishers of men" pick them up?" He said, "Well, because you know they have buses and they cover the whole western part of the country. They have about ten or 12 buses. So, don't worry about it." I said, "Very interesting. So, if I want, I can have a safari for free." He said "No, no, no. They do charge you for the buses."

The next morning, I checked on the issue of taxes and chargeable organizations. I found out that there is a old small, little regulation which has never been given to me, exempting religious organizations. It doesn't say non-profitable. It doesn't say charitable. Just religious organizations.

I went to see the Commissioner for Taxes. How come the "fishers of men" are engaged in the business of transporting people in the western part of the country? And he smiled and he said, "Yes, it's true. It is a very interesting loophole. Isn't it?"

After much talk and negotiations, we ended up having a new regulation, amending the old one and limiting the number of vehicles imported by those religious, non-profit organizations, to three. Moreover, if any of the organizations were engaged in any trade or business, the exemption would disappear.

THE TAX REFORM IN JAMAICA

Roy Bahl*

The Government of Jamaica began a major reform in its income tax structure in 1986. A complicated, narrow-based individual income tax, levied under a progressive statutory rate structure, was replaced by a broad-based, flat rate tax. In 1987, the company income tax was also simplified and its rate reduced from 45 percent to match the new individual income tax rate of 33-1/3 percent. To keep step with the structural reform, the organization of the Revenue Services has been completely revamped, a comprehensive program of revenue agent training has been established, and a full computerization of the tax administration is well underway.

First indications are that the program is a success. The structural reform seems to have gained general acceptance from the public, government revenues are up, the business sector of the economy is performing better than in recent years, and there has been a noticeable improvement in tax administration. However, the reform program is far from complete. A general

---

* Maxwell Professor of Political Economy, Syracuse University. This work draws from the research results of the Jamaica Tax Reform Project, and especially from James Alm and Roy Bahl, "An Evaluation of the Structure of the Jamaican Personal Income Tax," Jamaica Tax Structure Examination Project Staff Paper No. 15, Metropolitan Studies Program, The Maxwell School (Syracuse, NY: Syracuse University, December 1984 (revised March 1985); and Roy Bahl and Matthew Murray, "Income Tax Evasion in Jamaica," Jamaica Tax Structure Examination Project Staff Paper No. 31, Metropolitan Studies Program, The Maxwell School (Syracuse, NY: Syracuse University, November 1986).

consumption tax of the value-added type has been designed to replace much of the present, complicated system of five separate indirect taxes, and a total overhaul of the payroll tax has been proposed. In both cases the accent is on simplication, fairness, and revenue neutrality. Finally, any comprehensive tax reform needs protection from abuses and loopholes that tend to creep back into the system, and the Jamaican reform is no exception. A program to close off the reemergence of loopholes is under consideration.

The tax reform project was carried out jointly by the Revenue Board of the Government of Jamaica and the Metropolitan Studies Program of the Maxwell School at Syracuse University. The Co-Directors of the project were Canute Miller, Chairman of the Revenue Board, and Roy Bahl, Maxwell Professor of Political Economy at Syracuse University. The research staff included Jamaica's top tax analysts and several of the most experienced public finance scholars and practitioners in the world. The project began in mid-1983 and the collaboration ended in September, 1987. Funding for the project was provided by A.I.D., but the US government was not an active partner in the substantive end of the work.*

---

* A set of 36 staff papers from the project are available from the Metropolitan Studies Program, Maxwell School, Syracuse University, Syracuse, New York 13244-1090.

THE ECONOMIC AND POLICY SETTING

The Jamaica case may dispel a longstanding myth about comprehensive tax reform- the proposition that it cannot take place in a weak economic setting. Severe economic problems had to be confronted during the period of the tax reform, and the government could not keep its attention focused solely on restructuring the tax system and improving the administrative setup. The following will give some idea of the calls on economic policy during this period.

-- There was a serious exchange rate disequilibria which eventually led to a devaluation, beginning in 1983.

-- The bauxite industry collapsed, depriving the government of a major foreign exchange earner. The performance of tourism, the other major foreign exchange earning sector, was spotty.

-- There was a substantial government deficit (no lower than 8 percent of GDP). This is an especially important policy issue because the government is a major employer of unskilled workers, hence expenditure retrenchment (vs. revenue increases) would be a very difficult path.

-- There was a heavy debt service burden, averaging over 45 percent of export earnings in the mid-1980s.

-- Both the inflation rate and the unemployment rate remained high during most of this period.

-- The International Monetary Fund and the World Bank brought pressure on the government to take drastic measures to control the size of the fiscal deficit and to reform its tariff structure.

-- It was reasonable during this period to suppose that a US tax reform was in the offing, and that the lower US corporate tax rate would force a reduction in the Jamaican corporate tax rate.

In short, there was a great deal of pressure to find ways of raising more revenue to solve some of the government's immediate problems. The prospects of having to raise tax rates in the short run to eliminate a revenue shortfall would seem incompatible with the goal of developing a structural reform that would gain broad public support and stimulate new private investment.

But not all was negative. Prime Minister Seaga was elected in 1980 with a mandate to "free-up the economy," and there was much to free up. The foreign trade sector was characterized by quotas and licensing to restrict imports and compensate for a fixed and overvalued Jamaican dollar. An inherited import substitution growth strategy and a very complicated tariff structure were in place, and there were substantial price controls, government ownership of some traditionally private sector activities, and very high marginal income tax rates. The Prime Minister's economic strategy of replacing government controls with market forces fit very well with a structural tax reform program designed to "get the prices right." Moreover, the Seaga administration won an overwhelming majority in Parliament in a 1984 election. This enhanced the possibilities of eventually passing a tax reform bill. Another stimulus to action in this area came from the external donors--the United States government, the World Bank, and the IMF- all of whom were enthusiastic about Jamaica's plans for tax reform. Finally, the Jamaican income tax had become so onerous, so obviously unfair, and so out of control that there was substantial public sentiment for a major overhaul of the system. In many ways, then, the time was right for tax reform.

THE TAX POLICY STRATEGY

At the outset of the project, assessment of Jamaica's tax problems pointed to three issues. First, taxes were too high. This is a normative statement and requires some qualification. Taxes were too high by comparison with other countries at similar levels of income and foreign trade. More important, however, is that the Jamaican system taxes such a narrow base that the average and marginal rates of taxation had to be very high to generate an adequate revenue yield. For example, a value added tax, equal in yield to the present indirect tax system and using the same exemptions as existed in 1983, would have required a rate of about 20 percent, a rate considered very high. Another example is that the top marginal personal income tax rate was 57.5 percent (not including payroll taxes) and was reached at the relatively low income level of J$14000 (U.S.$1=J$5.5).

The second basic problem was that the tax structure was deficient. It was complicated and therefore difficult and costly to administer and there were important disincentives inherent in the rate and base structures. Interest was tax free but dividends were taxed twice, there was a high income tax rate on formal sector (PAYE) labor income but the self-employed went virtually untaxed, the high marginal tax rates produced a substantial incentive for evasion and avoidance, many types of imports were exempt from the indirect tax system, and so on. The system was also characterized by poor enforcement which compounded the inequities. The problem was simply that the Jamaican tax structure had evolved over a period of time in a very haphazard manner--as much because of year-to-year IMF pressures to solve budget deficits as for any other reason. By 1983 the issue was clear. The government had gone as far as it could with piecemeal tax reform and the time was right for a comprehensive overhaul of the tax structure.

Third, the administration of the tax system was weak. There were too few trained tax administrators, salaries were not competitive with the private sector, and there was limited opportunity for advancement. These administrative problems were heightened by the complicated system, which was difficult to administer in any case, and by outmoded procedures. For example, there was no manual for income tax administration, nor were there procedures in place to assess the self-employed or to use third party information to detect nonreporting or under-reporting. Audit activities were limited and not productive,and the administration of the income and payroll taxes was not integrated. Finally, the administrative system was manual rather than computerized and there was general disarray in the record keeping.

In the face of these problems, the Tax Project took the view that the highest priorities were (a) simplification of the system and (b) making the tax structure more neutral with respect to consumer and investor choices. The policy direction of these objectives is clear: establish broader based, flatter rate taxes that are more easily administered. The basic hypothesis is that the price effects introduced by non-neutralities in the Jamaican tax system do matter, i.e., the tax system has contributed to a reduced work effort, increased capital and labor mobility from the formal to the self-employed sector, led to thin capitalization, promoted capital flight, encouraged consumption relative to investment, and created a larger underground economy.

The project did not take the view that the correct tax reform strategy was to develop a system that would lead and "fine tune" economic policy. The general position taken was that the market and not tax treatment should dictate business and individual economic decisions, especially in light of the weakness of the tax administration. Experience with the existing system, which is in more of an interventionist tradition, was that progessive rate structures were not generating a progressive distribution of tax burdens, complicated provisions for payroll taxes of the self-employed could not induce them to make payments, tax incentives for overtime were being abused and not leading to increased overtime work, a system of nontaxable perquisites had become a major loophole rather than a tax relief and was beyond the control of the income tax administration, etc.

This assessment of problems and definition of objectives of the project led to a three-part program for the tax reform: policy analysis to restructure the system, improved administrative procedures, and the establishment of a training program. The basic tenet of the Tax Project was that the reform should be comprehensive and that the administrative improvements should follow the policy changes. To try to improve the administration of a system so deficient as that in Jamaica clearly would have been counterproductive.

THE INDIVIDUAL INCOME TAX

The individual income tax base, in theory, included all sources of income except bank deposit interest. In practice, there was no tax on capital gains and most self-employed income was outside the tax net. There were two rate structures--depending on whether income was above or below J$7000. The top marginal rate was 57.5 percent (Table 1). When payroll taxes are taken into account, the marginal tax rate on a relatively low Jamaican income (J$14000) was well in excess of 60 percent. There was no standard deduction but taxpayers could qualify for 16 separate tax credits (Table 2). These credits had been added to the tax system over a period of years, for purposes that ranged from personal allowances, stimulation of savings and home ownership, and even employment of helpers in the home. Because the credits were not indexed to inflation, their value had been substantially eroded during the early 1980s. The income tax administration did relatively little monitoring of the credit system.

The base of the tax was further eroded by the practice of permitting employers to grant nontaxable prequisites ("allowances") to employees. These perquisites were a matter of negotiation between employer and employee (including government ministries) and it was not required that they be reported to the Income Tax Commissioner. There was a greater deal of speculation about the magnitude of allowances--some prominent Jamaican analysts argued that the allowance-taxable wage ratio averaged as much as 40 percent.

TABLE 1

CURRENT RATE STRUCTURE OF THE INDIVIDUAL INCOME TAX

Statutory Income[a]	Marginal Tax Rate
If Income is Less Than J$7,000	
J$ 0 - 4,000	0
J$4,001 - 7,000	.70
If Income is More Than J$7,000	
J$ 0 - 7,000	.30
7,001 - 10,000	.40
10,001 - 12,000	.45
12,001 - 14,000	.50
14,001 and over	.575

[a] "Statutory Income" is the tax base for the personal income tax. It is the amount that is entered on the personal income tax return. It equals the sum of income from employments and offices; pensions; rent of land, houses, or other property; dividends, interest, annuities, discounts, estates, trusts, alimony, or other annual payments arising within Jamaica; sources outside Jamaica; sources not stated elsewhere; and trade, business, profession, or cultivation of land or farming; less capital allowances.

SOURCE: Income Tax Department.

TABLE 2

SUMMARY OF CREDITS FOR PERSONAL RELIEF: 1983

Credits	Amount	Limit of Credit
Personal Allowance	J$600	Not applicable
Wife Allowance	J$140	Not applicable
Wife's Earned Income Allowance	40 percent of wife's earned income	J$320
Children Allowance	J$100 (J$120 for university students)	Not available if child's income exceeds J$200 (J$300 for university students)
Female Relative	J$40	Not applicable
Dependent Relative Allowance	J$40	J$80 (for two relatives); not available if relative's income exceeds J$200
Maintenance and Alimony	40 percent of maintenance or alimony, whichever is less	J$160
Life Assurance Relief	60 percent of premium paid	10 percent of statutory income; 4.2 percent of principal amount;
J$360		
Pensioner's Allowance	J$400	Not applicable
Donations	40 percent of donations	2 percent of statutory income
Capital Growth Investments	60 percent of investments	J$360
Mortgage Interest Relief	40 percent of mortgage interest	J$60
Medical Expenses Relief	40 percent of medical and dental expenses	J$40
Subscription for Shares	60 percent of subscription for shares	J$360
Household Helper	J$4 per week	J$208
Special Credit	J$156	Vanishes at income of J$12,000

SOURCE: Income Tax Department, Government of Jamaica.

The analysis of reform options required first estimating the number of taxpayers, taxable incomes, nontaxable perquisites and tax credits--all by income class. This was done by drawing a large random sample of Jamaican taxpayers and manually recording data on taxable income, tax credits, tax liability, etc. from the files on each individual. The Prime Minister organized a special survey of employers to estimate the value of notaxable allowances by income bracket. This was supplemented with a sample survey of a large number of self-employed individuals to determine the extent of evasion by nonreporting. The results of this analysis, reported in Figure 1, indicate that about half of potential individual income tax liability was not covered in the tax net. Moreover, as described in Figure 2, higher income Jamaicans--many outside the PAYE system-tended to avoid or evade a substantially higher percentage of their tax liability than did lower income families. The progressivity of the statutory rate structure was all but negated by evasion and avoidance.

Simulation of alternative rate and base structures, with a revenue neutral target in mind and with simplification and neutrality as primary objectives led to the following reform program:

-- Replace the 16 tax credits with a standard deduction of J$8580 per year.

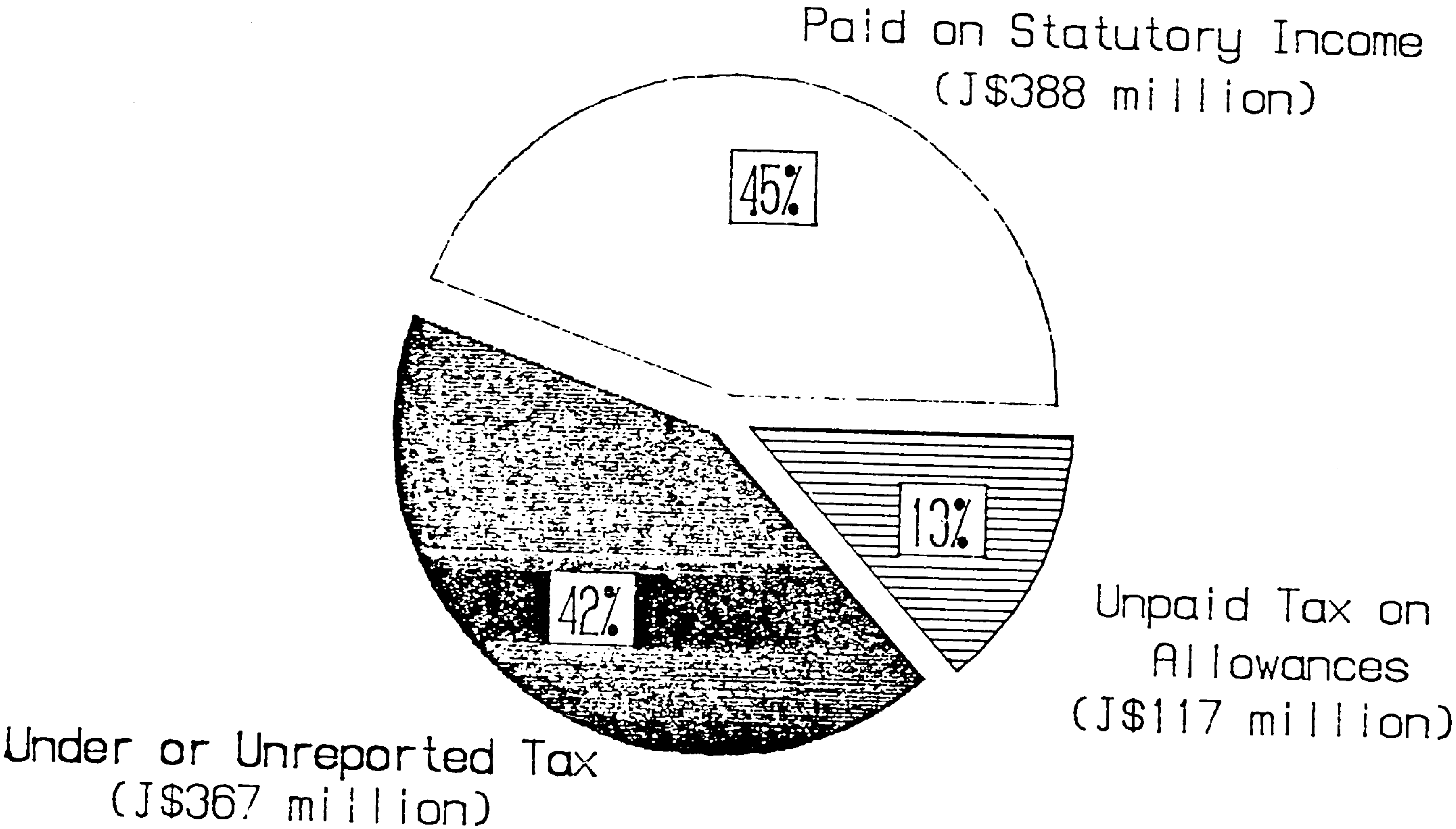
-- Replace the present rate structure with a flat rate of 33-1/3 percent.

-- With a few exceptions, bring all nontaxable allowances into the base.

-- Include bank deposit interest (above some ceiling) in the income tax base.

FIGURE 1

REVENUE POTENTIAL FROM TAXED AND NONTAXED INCOME IN 1983

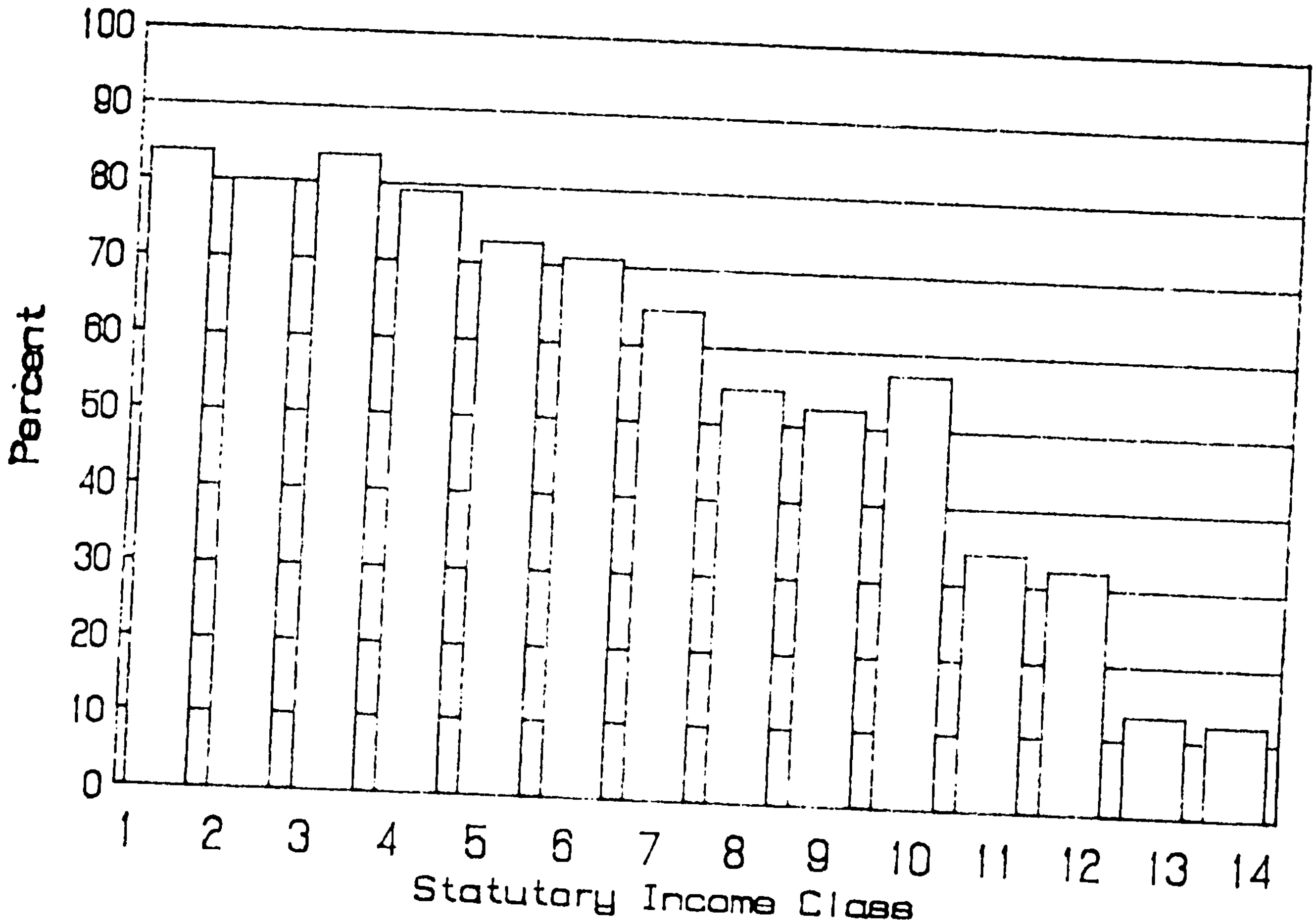


Source: JTSEP

FIGURE 2

TAXES PAID ON STATUTORY INCOME

(as a percent of Total Taxes Payable)



Source: JTSEP

Key:
1 = Under J$2000
2 = J$2001 - 4000
3 = J$4001 - 6000
4 = J$6001 - 8000
5 = J$8001 - 10,000
6 = J$10,001 - 12,000
7 = J$12,001 - 14,000
8 = J$14,001 - 16,000
9 = J$16,001 - 18,000
10 = J$18,001 - 20,000
11 = J$20,001 - 25,000
12 = J$25,001 - 30,000
13 = J$30,001 - 50,000
14 = Over J$50,000

The Government enacted the tax reform after a Tax Reform Committee of private sector citizens spent several months scrutinizing and amending the proposals. The Committee, made up of union, business and public interest group representatives, reached consensus that the flat tax seemed more fair than the present system and recommended its adoption to the Prime Minister. The income tax reform became effective at the beginning of 1986 and was almost totally operative by the end ofthe first quarter.

THE COMPANY INCOME TAX

Prior to reform, companies paid a basic rate of 35 percent plus an "additional tax" of 10 percent, but the additional could be offset against withholding tax on dividends. To complicate matters further, there was separate treatment for agricultural companies, incentive firms and financial institutions.

This system led to three basic problems. First, the tax was complicated, not easily administered, and was unfair to certain types of firms. Second, it discriminated in favor of debt and against equity finance. The "optimal" dividend distribution rate for a firm was about 27 percent of profits--above this amount "additional" profit tax liability would be due. Moreover, in the eyes of investors, dividends were taxed twice (as company profits and as taxable personal income) whereas interest received from savings accounts was not taxed. Third, the reduction in the top personal income tax rate to 33-1/3 percent and the reduction in the US corporate rate brought new pressures to lower the company tax rate.

The Government enacted a comprehensive reform of the company tax in 1987 that did address these problems. The tax rate was reduced to 33-1/3 percent and the "additional tax" was eliminated. This removed the disincentive to larger dividend distributions, and, though the Government did not eliminate the double taxation of dividends, it did bring interest income into the tax base thereby removing another disincentive to equity finance.

A SUCCESSFUL INCOME TAX REFORM?

No effort has yet been mounted to systematically monitor the impacts of the flat tax reform, i.e., to try to estimate the separate economic effects of the tax reform. The major problem, of course, would be to try and separate the effects of tax changes from the effects of everything else that is affecting the Jamaican economy. Still, from the macro evidence, there is some indication of success. Perhaps the best indicator is the lack of any continuing public discontent with the tax reform. The press has not been critical, the political opposition has not raised substantial objections, labor seems to be pleased with the relatively high standard deduction and with the equality associated with a flat rate, and the business community clearly has benefited from the lower company tax rate. To be sure, there was initial resentment to taxing interest income--this led to exemption for small deposits- and there was the expected grousing from special interests about the loss of tax preferences. The important point, however, is that the public seems to have adjusted to the initial shock of the change, and, though taxes are never as low or even as fair as citizens would like, the new system would appear to be much more palatable than the previous one.

Have the income tax reforms stimulated the economy in 1986 and 1987? Something has. Corporate profits are up--through August 1987 the 16 largest listed companies are reporting post-tax profits 84 percent higher than the same period last year. The Jamaican stock exchange has had record growth during 1986 and 1987. The market index went from 941.5 at the end of 1985 to 1499.8 at the end of 1987 and now stands at 1757.7 (9/22/87). Of course, the tax reform has been only one of a number of positive factors affecting the Jamaican economy. The interest rate has dropped from 23 percent at the beginning of 1986 to 16.7 percent by latest available figures for 1987. The real growth in exports was up by 10.3 percent in 1986. The rate of inflation declined from 25.7 percent for all of 1985 to 15.1 percent for 1986 and was running at 7.1 percent for the first five months of 1987. On basis of available evidence, no one could argue the extent to which these changes are due to the tax reform, but many would be prepared to argue that so favorable a performance of the Jamaican economy could not have taken place under the old regime.

The revenue neutrality target of the reform has been attained, perhaps even surpassed. Comparing the same quarter in the first year of the reform (1986) with 1985, PAYE collections were up 9.7 percent; in 1987, the same comparison shows a 17.9 percent increase over 1986. Total company and personal income taxes in the second quarter of 1987 were running about 18 percent above second quarter 1986 collections--a substantial increase in real terms. Some part of this increase is due to administration. The simpler income tax system has made it possible for the income tax department to concentrate more on enforcement of the system and there is evidence of a more effective audit and examination activity. More vigorous audit activities have led to a tripling of additional taxes and penalties over 1986.

Finally, there is the question of the fairness of the new reform. The Tax Project has estimated that the combination of the lower, flat rate, the J$8580 standard deduction and broadened base did not increase the regressivity of the system. Indeed, improved administration holds the promise of making the new system more progressive than the old.

The reform is not without problems- no reform ever is. Perhaps the major problem is that the door was left open for abuse on some perquisites--the housing allowance, the travel allowance, and uniform allowances. There already appear to be some misuses of these provisions for nontaxable income, and, if they continue to grow, they could compromise the fairness of the new structure and bring pressure for a rate increase. Provision has not yet been made to index the standard deduction, and this could be another important policy problem, especially if the rate of inflation were to return to higher levels. To mitigate the burden on lower income savers, there is no tax on interest of bank deposits of J$2000 or less. This could encourage some splitting of deposit holdings by higher income depositors. While these are all potential problems, all can be dealt with by continuing policy review.

COMPREHENSIVE REFORM: UNFINISHED AGENDA

The Tax Project also recommended reform in the remainder of the tax structure. A simple general consumption tax of the value added type has been proposed to replace the present complicated system of consumption duties, import surcharges, retail sales tax and certain excises. A comprehensive reform has also been proposed for the payroll tax system, to bring about an administrative integration with the individual income tax, to simplify the system, and to lower the contribution rates. A reform program has also been designed for taxation of financial institutions and for the property tax. The government has not yet acted on these proposals.

There has been a great deal of activity in reforming the administration of the tax system. The revenue services has been reorganized to better integrate assessment and collections; an extensive training program for revenue agents has commenced; a number of courses for income tax assessments and collections have been successfully completed; and computerization of the revenue services is now well under way.

The Jamaican tax reform is in its early stages and therefore is fragile. Indications are, however, that its early performance has been successful. The objective of creating a simpler system that is more easily administered appears to have been achieved, and the objective of creating a more neutral system with fewer price distortions likewise appears to have been achieved. This has been done without compromising revenue yield and, using the project's estimates, without having unfavorable effects on the distribution of tax burdens.

USAID TAX REFORM INITIATIVES: THE CASE OF SENEGAL

Jacqueline Damon, IMF and Richard Greene, USAID

This afternoon, we are going to be looking at an effort in tax reform that A.I.D. is undertaking in Senegal. In contrast to the effort in Jamaica, this one is a lot more modest in terms of the resources that are being applied, and it is in its early stages.

We are fortunate to have Jackie Damon who was at the OECD in Paris. She was on loan to A.I.D.for three years in Senegal where she was present at the conception of the program. She now is working at the African Department of IMF. We also have Richard Greene who is Program Economist for A.I.D. in Senegal. Before that, he had been in Kenya and Haiti, and he is now the midwife of the Senegalese tax reform program.

Jacqueline Damon, IMF

In Senegal, what really struck us was the declining tax ratio and the difficulties on the revenue collection side. During the period 1968-78, Senegal had been commended by the IMF for its revenue efforts. Tax revenues were as high as 23 percent of GDP. In 1979, deterioration commenced. The tax ratio fell every year until it reached 17 percent of GDP in 1984.

We also did some calculations on income elasticities, and we determined that in both the direct and indirect tax area elasticity had declined considerably. However, it had declined even further in the direct tax area.

We used the IMF international comparison of tax effort index which involves an econometric relationship which explains tax ratio as a function of (a) per capita, non-export income, (b) the share of mining in GDP and (c) the ratio of exports to GDP. On that basis, we calculated in index which, if it is one, indicates that the tax effort is what it should be; if its less than one, tax effort leaves something to be desired; and so forth. For 1979, we obtained the result of about 0.93, and, by 1983, the ratio had fallen to 0.63. Based on previous revenue efforts, the Senegal economy was not performing as it should.

There are certain similarities between the problems described in the Jamaica case and our experience with Senegal. We were struggling with the complexity of the system, although, it doesn't sound anywhere near as complex as that described for Jamaica. However, there is a binary system for income tax which combines a global income tax and a series of schedular income taxes. The system was found to be cumbersome and required a major discretionary input from the tax administrators.

We found that Senegal's tax rates, at least on the books, were excessively high. Effective tax rates were probably considerably lower. The highest income tax rate was about 65 percent. However, depending upon how the schedular income taxes were applied, the overall marginal rate could actually exceed 65 percent rate.

We found that the foreign trade taxes, if you applied all of the rates, in some cases would be as high as 140 percent.

We also found that despite Senegal's remarkably diversified economic structure the tax structure seemed to continue to rely very heavily on foreign trade taxes as the single largest source of revenue. There was clearly a tradeoff between reliance on foreign trade taxes, which also served to enforce a protectionist stance, and the desirability of examining other potential sources of revenue in the economy. For example, foreign trade and value added taxes were contributing about 70 percent of tax revenue while direct taxes were only contributing about 30. At the same time, one of the most thriving sector of the economy, namely real estate, was contributing only between 1 and 1.5 percent of tax revenue.

The A.I.D. Mission in Senegal based upon the statistical evidence, determined that tax reform was essential, and a multi-pronged initial tax survey was initiated.

A.I.D. sought out technical assistance -- French-speaking individuals who were familiar with francophone tax systems and possible alternatives. The A.I.D. Mission located a team of French economists from the University of Clermont Ferrand, and they undertook a preliminary survey of the direct tax system. In particular, the team attempted to calculate tax incidence and to determine how certain modifications in rates could affect revenue.

Concomitantly, the A.I.D. Mission also requested a group of tax administrators from the International Revenue Service (IRS) to examine means of streamlining collections. They did not speak French which created a certain number of misunderstandings. However, between the interpreter which was hired and A.I.D.'s Senegalese personnel, we were able to overcome many of the difficulties.

A third component of the initial tax survey involved a mission conducted jointly by Mr. Maktouf, Counsellor for Taxation for the IMF, and Professor Oldman from Harvard University.

These three reports provided the A.I.D. Mission with different perspectives of the direct tax system. A.I.D. decided to focus and concentrate its limited resources on the direct tax system. Reform of direct taxes, although accounting for a relatively small percentage of total tax revenue, has significant potential long-term impact as Senegal's economy continues to develop. In addition, on the indirect tax side, there were a number of reports available from the World Bank, the IMF and France, who already were heavily involved in an ambitious scheme to computerize indirect tax collections.

Unlike the Jamaican case, The Government of Senegal was not prepared for major, across-the-board tax reform. There had been no abrupt political change; rather the government represented continuity with the regime since independence.

The impetus for tax reform came from the IMF, in particular, but also the World Bank. The Government had established a commission on tax reform, with a number of working groups dealing with direct taxes and the general tax code. Several of the groups had been deliberating for three, four, five years. Every successive IMF stand-by arrangement promised some kind of tax reform. However, the recommendations of the working groups were repeatedly delayed.

In response to the delays, donors attempted to apply pressure on the authorities from outside to stimulate interest in tax reform.

The new Minister of Finance, however, was interested. He was the former Director of the African Department at the IMF, Mr. Mamadou Toure. He was favorably disposed to the features of the U.S. tax system and encouraged American participation in tax studies to counterbalance the traditional French approach to the taxation. However, at every stage, he was countered by individuals in the bureaucracy who supported the Francophone system.

Unlike the Jamaican situation, we were working in the context of no real internal impetus for the tax reform process and, to a certain extent, there was a degree of hostility from the bureaucracy which was unfamiliar with the U.S. tax system.

However, the A.I.D. mission was able to contribute to the tax reform process because we identified a fairly small area of intervention (e.g. direct taxation). The A.I.D. Mission was fortunate in obtaining financing of $15.0 million for this new program, $14.0 million of which took the form of a cash transfer.

Project development commenced in early 1986 and by August, it was approved. The short development time, however, apparently did not have negative impact on the A.I.D. tax program. Unlike the Jamaican case, we were able to draw from analyses already completed by other donors. We were not overly concerned with the generation of a comprehensive assessment of the tax structure exclusively through A.I.D. support.

Strong donor coordination contributed significantly to the tax reform effort Senegal, perhaps unlike other countries, already had established a committee comprised of different arms of the government to monitor economic reforms in the economy. The donors pushed the tax reform effort through the good offices of this committee which benefited from a high degree of visibility within Senegal.

Also, the process of developing tax reform proposals was facilitated by the Finance Minister's invitation to A.I.D. and the French to participate in the Government's discussions with the IMF. Thus, all pertinent high-level government officials, the French, the U. S., the World Bank and the IMF team made their recommendations and commented on other donor's recommendations. The practice greatly facilitated mutual understanding as well as the exchange of information on developments in the economy as a whole.

In addition, Senegal relied heavily on cash transfers from the U. S. Government to finance budget deficits which allowed A.I.D. to excercise considerable leverage.

Nevertheless, there was some friction among donors. One problem arose from heavy IMF reliance in Senegal on French nationals to provide technical assistance in the fiscal area. In certain instances, these experts felt that interjecting a U.S. position was counterproductive for it would delay the reform process.

Also, the World Bank developed an interest in tax reform at a somewhat later stage. The Bank concentrated on the indirect tax area and frequently promoted views which were not compatible with French interests, such as the reduction in protection accorded to domestic manufacturers. Many of the domestic industries were French-financed and owned and had developed import substitution products for internal consumption.

However, overall there was a certain degree of cross-fertilization and donors were able to contribute positively to the tax reform process.

Mr. Muten's point this morning regarding the government's ability to play one donor off against the other is relevant. Effective donor coordination mechanisms limited the potential damage of this tactic. Delays were minimal.

With respect to the design of the conditionality, the A.I.D. Mission was compelled to determine to what extent it should specialize in a specific area or try to reinforce conditionality proposed by another donor. A.I.D. would utilize a cash transfer in order to leverage or buy policy reforms. The Mission's primary emphasis was on direct taxation. However, since reforms in this area would take considerable time to implement owing to the need for considerable additional technical assistance and administrative improvements, A.I.D. also supported World Bank conditionality in the area of indirect taxation.

Another major aspect of the design process was the appropriate pace of reform. There are linkages here with the Jamaican experience. If conditionality is based upon an increase in a tax rate or modification of tax law, conditionality can be more quickly satisfied. Presumably, such modifications are actually going to have an impact on effective rates of taxation and tax revenues.

On the other hand, the critical area of tax administration requires more time to achieve improvements. Hence, it is difficult to link conditionality with administrative improvements.

A major A.I.D. concern was the small degree of actual reform contained in the new tax code proposed by the Senegalese officials. The work of the commission had been touted for five years. However, proposed changes were relatively minor. For example, the highest tax rate was to be reduced from 65 to 60 percent. Certain of the proposals would have increased the regressivity in the direct tax area. Other proposals would have been detrimental to the future development of the private sector. For example, a payroll tax on employers was to be maintained. Also, a licensing fee collectible up-front from businesses also was being recommended.

Let me now turn the discussion over to Richard Greene.

Richard Greene, A.I.D.

Let me start by saying, I think the donor coordination has continued to be quite excellent. We still all meet jointly to discuss tax issues. Partly that is a decision on the part of the government to play fair with everybody. Also, there is so much on the government's policy dialogue platter in Senegal that the desirability of avoiding numerous separate meetings is becoming more and more important.

Tax reform in Senegal is only part of a much, much larger and broader system of policy reforms that the government under the leadership of Toure is proposing. One of the problems with comprehensive reform across a number of broad areas is that each individual reforms gets relatively less attention. Therefore, you might be better off perhaps to have fewer things going on.

In addition, all of these reforms taken jointly tend to have a number of short-term negative effects that receive heavy consideration by the politicians who have a short time frame horizon. That is another consideration that slows things up.

You have to characterize the Senegalese tax system as overly complex which leads to uneven administration and to charges of unfairness in the incidence of taxation. This leads to non-compliance and resistance on the part of taxpayers. It also has a tendency to undermine the morale of the tax administrators themselves who don't really, in many instances, feel that they are administering a fair system.

The tax system in Senegal is predatory with regard to incomes in the modern sector that can actually be identified. Whether you pay taxes or not depends more on whether you can be located and nailed than on whether you should be paying taxes and how much tax you ought to be paying.

The system is undermined through all sorts of legal exonerations and exemptions that make (a) calculations of incidence of taxation and (b) analysis of questions of whether or not a tax reform would be more fair or less fair almost impossible. In fact, many of the exonerations and exemptions pre-date the existing government and even the existing State. The exonerations and exemptions are well entrenched in the system and are reflected in the existing structure of production.

In addition, there are large disincentives to efficient production that are inherent in the system. Some of the calculations that were done on effective protection, for example, indicated that flour milling back in the early 1980s was getting 512 percent effective protection; paint production, 388 percent; and vehicle assembly, 277 percent. In support of protection, the "infant industry" argument was used. However, these may or may not be areas that Senegal could claim to have a long-term comparative advantage.

On the other hand, the soap industry was receiving minus 71 percent effective protection; confectionary and some food-processing, minus 58 percent effective protection; and one of the most important, largest industries in the country, peanut oil processing, had a minus 0.5 effective rate of protection. From an economist's point of view, the system was not defensible.

Finally, the system was failing to meet the country's revenue needs. The tax elasticity which had been about 1.4 in the period 1972-79 had deteriorated to 0.6 percent during the period 1980-84.

By the time the project design had gotten seriously underway, it was becoming clear that the Government of Senegal was not putting direct tax reform on the front burner. Although there were forces favoring tax reform that we could identify in (a) the Ministry of Finance, (b) the tax administration, and (c) certainly at the level of the president, tax reform was something that was not going to happen quickly.

In addition, the World Bank in the meanwhile had become quite interested in customs and the issue of effective protection. I think analytically that fit very well with the A.I.D. strategy. We supported the Bank's efforts. It made sense to seek reforms in the area of the industrial structure as well as in the direct tax system.

Therefore, the conditionality for the USAID program was set in three tranches -- $5 million dollars for the first tranche, $5 million for the second tranche, and $4 million for the third tranche.

Since the total monies allocated for the project were $15 million, it left us only $1 million for technical assistance to assist in implementing the tax reforms.

However, in the longrun if tax reform takes off, we are going to have to come back with a development assistance-type project that can get us some kind of long-term presence on the ground to work through the administrative changes that are inevitably going to be necessary.

The first tranche conditionality to be implemented in 1986 involved the publication of a new customs code, the publication of a first round of reduced tariffs, and the publication of regulations removing quantitative restrictions (QRs). The reduction of tariffs together with removal of QRs would reduce protection of domestic enterprise.

A second tranche was slated to reward a second round of tariff cuts in July 1987 and the removal of QRs. The third piece of conditionality for the second tranche was that the tax working group would continue in existence. The group would develop a plan for further studies leading to (a) transformation away from a schedular tax system toward a global, unitary system and (b) reduction in marginal rates.

The third tranche would reward a third round of tariff cuts, a third round of QR reductions, and the introduction of a new investment code that would be compatible with the changes in direct taxes and tariffs that had been contemplated.

The new customs code was approved in August of 1986. The first round of tariff reductions was approved in July 1986, and the customs tariff, which is only part of the foreign trade taxation system, essentially divided all goods into two categories, social goods and others. Social goods include pharmaceuticals and books and educational materials; they attract a zero rate of tariff taxation. All other categories receive 15 percent.

Also, a system of seven categories for the fiscal tax was established with a progressively higher rate of taxation for each one. Social goods received zero percent taxation; raw and semi-finished products and capital equipment, 10 percent; finished goods with no equivalent local production, 25 percent; finished goods with local production, 35 percent; and various luxury goods from 10 to 60 percent. The fiscal tax amendation represented an improvement and a simplification over the system that had been in existence before.

In 1986, QRs also were removed on mechanical and metal-working industries and paper and cardboard.

A second tranche took place in September 1987. The associated conditionality has been implemented in July 1987 on schedule. There was a second round of tariff reductions, and QRs were removed on building materials, shoe parts, food processing, office supplies, stationery, and chemicals.

The tax working group has remained in effect. It has been carrying out studies and providing technical assistance. A trip to visit some of the countries that have already begun to implement the unitary tax reform was funded.

The tax working group worked with Prescott Berry of the U.S. Internal Revenue Service. The group also is interfacing with Oldman. We are going to be having Richard Bird come out to work on the international tax aspects of the reform, and the tax working group will be coordinating with him.

The third tranche would be scheduled for September of 1988 based on changes in July 1988 which (a) would reduce the customs tariff from 15 percent to 10 percent, (b) would raise some of the other fiscal duties and lower others to a more uniform configuration and (c) would eliminate the remaining QRs in Senegal.

If we can succeed in getting rid of all QRs in a period of two or three years, I think we will have been doing quite well.

The third item which was originally scheduled for the third tranche was a new investment code. However, the investment code already has been revised and was approved on July 30, 1987. Therefore, that part of the conditionality has already been met. The purpose of the new investment code is to encourage (a) small and medium scale industry, (b) decentralization, and (c) technical innovation.

The code consists of a common regime of tax incentives and four special regimes. Basically, the benefits under the common regime cover almost everything -- agriculture, fishing, cattle, industry and small and medium scale industries in a number of areas such as cinematography, health, assembling industries and industrial maintenance. The benefits include exemption from the value added tax, exemption from import taxes on investment goods not produced in Senegal, and exemption from turnover tax, in addition to subsidized credit. Exemptions would apply for a period of two to three years.

There is a separate special regime for industries that are going to be established in four or five less-industrialized areas in Senegal. There is a special regime for industries that are based on local resource content and a special regime for small and medium scale industries.

The advantages of this system are somewhat more apparent than they appear from a description of the complicated nature of the system. The reason they are important is because they represent a change of what has been going on in the past.

Basically, all of these exemptions and exonerations would be uniform and would be applied without prejudice to all industries as opposed to the industry by industry, deal by deal approach that government has adopted in the past. If this is really enforced, it is a major step forward. Regardless of whether the exemptions and the system are as good as they could be, the fact that they are going to be applied on a uniform basis is encouraging. According to government, there won't be any more new special conventions of the type that were negotiated in the past.

The second advantage of the new industrial code is that the exemptions are limited in time varying from five to 12 years, and they will gradually be phased out with a 25 percent reduction in each of the last three years.Since many of the exemptions that currently are in place, pre-date the current government and even predate independence in some cases, the idea of introducting a time limitation to these types of exemptions is going to be a major step forward, if implemented.

The third advantage of this approach is that all of these criteria are transparent; they are codified. As a consequence, the committee, that in the past had reviewed individual industrial proposals and decided without objective criteria and without much public disclosure of the costs and benefits whether or not exonerations would be given, will be eliminated.

There is no A.I.D. conditionality, per se, involved with the revised general tax code. The revised general tax code was passed and approved by the assembly in February 1987. A number of the rates have been lowered in line with increased fairness and uniformity. The lower rates should improve enforcement. Also, a number of the brackets were adjusted for inflation. The scope for the value added tax was widened somewhat, and there was a change from specific to ad valorem rates on a number of excise taxes. That ad valorem rates will be applied to petroleum products, which are a major import, is especially significant.

To implement the program, A.I.D. technical assistance is limited to only $1 million. With the technical assistance money, we brought out tax expert Oliver Oldman from Harvard and Bernard Castagnette from the University of Paris for initial discussions with the legislative drafting group in the Ministry of Finance. Castagnette has now prepared a paper containing an explanation of the advantages of a unified global tax system and a description of how it has worked in Gabon. This paper is being reviewed by the Ministry of Finance.

We funded a study trip to Congo and Togo by people from the Finance and Tax Department. The trip was a good success. They have written a good report. I was very impressed with the detail at which they looked at the tax systems in each one of the countries they visited. I think these types of trips can repay their costs. The Senegalese have been hearing the advantages of tax reform from the A.I.D. mission. They hear it from the IMF. They hear it from people like Oldman. However, if they hear it again from Africans that are already implementing tax reforms, the trips are probably a worthwhile investment.

At the end of November, we are going to have David Rosenbloom and Richard Bird come out to look at the international aspects of tax reform, particularly with regard to the company tax. Finally, we had our representative, Mr. Prescott Berry, come out from the IRS to look at the administrative procedures that would need to be implemented in order to actually administer a fairer system, once it was put into place.

I am relatively new in the mission. I have only been there since the end of January. I guess from my perspective the necessity of not getting too far ahead on the administrative reforms before (a) the policy aspects are agreed with government and (b) the broad outline of changes are established is probably important.

With the limited pool of technical assistance monies, we are not going to be able to maintain the three-or-four-year presence of five or six people, minimum, that is going to be necessary to push the policy dialogue along, get the legislation drafted, and then translate that into administrative procedures. If we are successful in getting beyond the study stage, we are probably going to be looking at a follow-on project.

We also will be using part of our technical assistance money to computerize some of the data. The type of data that we will be getting is basically wholesale price data, production data, data on inputs, output data, sales data and so on.

What we would like to get as outputs are wholesale price indexes, production indices by industry, input price indices, import price indices, growth rates of various industries, and employment indices. With that type of a data base in the

A.I.D. Mission and in the Senegalese government's Direction de Statistique, we should be able to track the major effects of the reform program.

The basic statistical analysis is going to be carried out in the Direction de Statistique. We have provided the microcomputers. We have trained the people to mount the data from studies, and they are already collecting data, including unifying the coding system. You can make substantial gains in data collection; you can collect the unified data set more accurately with the same number of personnel. I think that part of the technical assistance effort is going pretty well.