Research in Brief
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Obstacles to Increasing Tax Revenues in Low Income Countries

Summary of working paper 15 by Mick Moore, December 2013

This joint ICTD/UNRISD/SDC paper asks why governments of low-income countries do not raise more tax revenue, and explores options for increasing it.

Obstacles to tax collection in low income countries

The average low income country raises less than 20% of GDP in revenue compared to 30-45% in OECD countries, and increasing the tax take is difficult. This is because:

- The structure of national economies in low income countries makes taxing difficult. It is easier to raise revenue from economies that are high income, urban, non-agricultural, and where the ratio of international trade to GDP is high.
- Effective tax systems depend on cooperation and coordination between revenue agencies and a wide range of other public and private actors. It is hard to make quick improvements to this complex organisational network.
- There are political constraints on the capacity of governments to raise revenue. Wealthy individuals and companies are able to influence tax policy formulation and administration in order to pay less than their 'fair share'.
- Organisations that collect taxes engage in extensive 'rent-taking', cutting deals with taxpayers or using coercion to make money illegally for their own staff and for their political masters. This significantly reduces the amounts collected, and also brings tax collection into disrepute, decreasing overall willingness to pay.
- Governments use their ability to grant tax exemptions as a direct instrument of rule, selectively favouring some individuals and companies or penalising others, thereby securing support and political financing. This can result in huge tax losses.
- The design of a country's political and government institutions can affect the tax take, increased capacity to tax being associated with higher concentration of tax raising and spending powers within a single authority. The degree of income and wealth inequality may also affect the tax take, although evidence for this is still inconclusive.

The scope to close revenue gaps

In addition to rent-taking and unjustified tax exemptions, other major causes of revenue gaps in low-income countries are evasion by transnational corporations, under-taxation of profits of mining companies, and under-taxation of land and property. There may be some scope to address these through policy and administrative reform but there are no silver bullets:

- There is wide international consensus that the current system of taxing international ➤

> "Tax is simultaneously a highly political and a highly technical issue."

economic transactions needs reform. Of particular concern is tax evasion by transnational corporations that use transfer mispricing to relocate profits to places where they pay little or no tax. However tackling transnational tax avoidance requires sustained collective action by OECD and BRICS governments, and global reform efforts risk being undermined by individual countries pursuing competitive policies in order to maximise their own shares of tax revenue. Moreover, low income countries lack the capacity to challenge accounts presented by transnational companies and may find it hard to benefit from changes to the international tax system.

- Under-taxation of mining activit es by transnational companies is a major cause of low tax takes in many low income countries. There may be some scope to address this separately from more general reforms to the international tax system.
- Land and property are currently grossly under-taxed in low-income countries. There should be good prospects for reform, supported by technology. However there are political and institutional obstacles including resistance from property owners, and a lack of interest from higher levels of government (property taxes being essentially local). International tax experts including the IMF and OECD have also given little attention to property tax.
- Low income countries could adopt a package of tax administration reforms developed and implemented in OECD countries. They are largely driven by low-cost information and communication technologies, and could also work in low income countries. The reforms include a focus on larger taxpayers, cross checks on reliability of self-assessment, and measures to reduce direct personal interaction between tax collectors and taxpayers.

Implications for policy makers

It is unrealistic to expect tax rates in low income countries to approach those in OECD countries, or to expect rapid results from specific tax reform measures. However constraints arising from economic structure and political and institutional context do not mean that efforts to improve tax policy and administration are not worthwhile: countries with similar incomes and economic structures can have very different tax takes. Tax is simultaneously a highly political and a highly technical issue. The most effective approach to increasing tax revenue may not be a frontal assault (for example on corrupt practices) to close the most obvious revenue gaps, but a more covert approach that combines highly technical changes (for example to the design of VAT) with political cunning. Potentially far reaching changes could be presented as technical measures to improve tax administration or broaden the tax base; and progress could be made by adopting incremental, indirect approaches that are appropriate to a specific context.

Further reading

Moore, Mick (2013), *Obstacles to Increasing Tax Revenues in Low Income Countries*, Joint ICTD/ UNRISD/SDC Working Paper 15, Brighton: December

Credits

This ICTD Research In Brief was written by **Mick Moore,** Professorial Fellow in the Governance Team at IDS and Chief Executive Officer of the ICTD. Mick Moore specialises in the interaction between money, public finance and politics. This paper was commissioned for the UNRISD research project, Politics of Domestic Resource Mobilization for Social Development and co-funded by the Swiss Agency for Development and Cooperation (SDC) as part of the IDS project 'The Governance of Service Delivery'.

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