

## Regulatory Burdens in Tax Administration and Firms' Compliance Costs in Africa

Summary of Working Paper 78 by Merima Ali

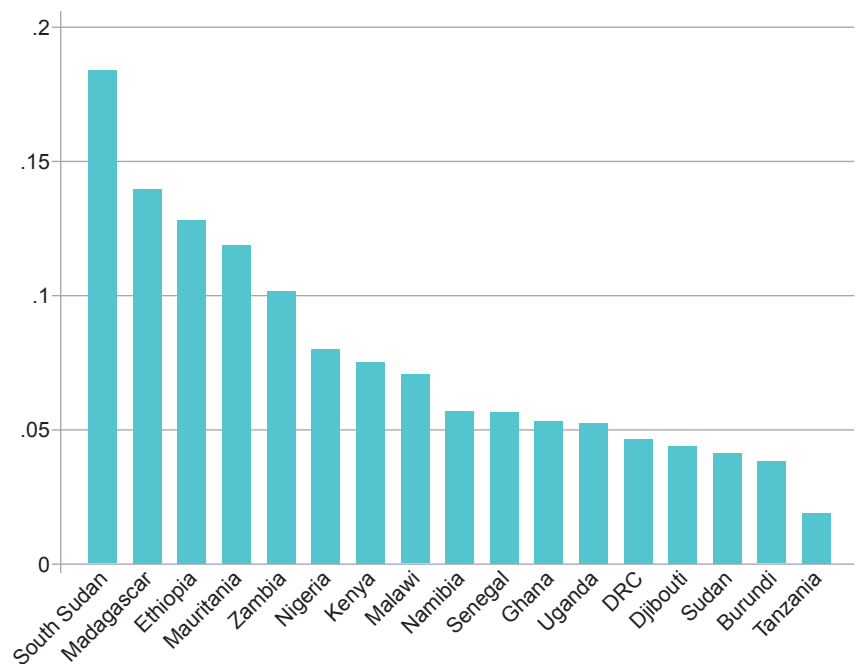
There is a growing interest among policy makers to cut red tape in government regulations in order to help improve the performance of businesses and create more jobs. However, most businesses, especially in Africa, still face challenges in meeting various government regulations that contributes to higher compliance costs. Compliance costs are the extra costs incurred by businesses in the process meeting various government regulations. Although previous studies looked at the effects of compliance costs on firm's performance, little is understood to what extent the different regulatory burdens contribute to overall compliance costs. This paper examines empirically the effect of regulatory burdens related to tax administration on firms' compliance costs in Africa. Using cross-country firm-level data, the paper show that regulatory burdens related to tax administration significantly increase firms' compliance costs compared to burdens related to other kinds of government regulations.

### Compliance costs across countries

The paper uses firm-level indicators of compliance costs, which is measured as the percentage of management time spent in dealing with various government regulations in one week, such as on taxes, customs, labour regulations, licensing and registration. Data is obtained from the World Bank Enterprise Surveys. Figure 1 shows that there is variation in compliance costs across firms in different countries. Firms in South

Sudan have the highest compliance costs, with a typical manager spending on average around 18 per cent of their time per week dealing with various government regulations. Madagascar, Ethiopia and Mauritania also have their managers spending on average 12-13 per cent of their time dealing with government regulations in one week. Countries like DRC, Djibouti, Sudan, Burundi and Tanzania, on the other hand, have low levels of compliance costs, with a manager in a typical firm spending on average less than 5 per cent of their time dealing with government regulations.

**Figure 1** Average percentage of management time spent in dealing with government regulations



Source: Author's calculation using data from the World Bank Enterprise Survey

## Tax administration burden and overall compliance cost

The paper examines the effect of regulatory burdens related to taxation on overall compliance cost empirically. After controlling for various firm-, sector- and country-specific factors, it is found that regulatory burdens related to tax administration significantly contribute to compliance costs compared to burdens related to other kinds of government regulations. An increase in firm's perception about the burden of tax administration on the performance of their business by one unit is associated with an increase in compliance cost by about 14%. The study also finds that firms that operate in countries with higher tax compliance cost, in terms of hours spent in preparing and paying taxes are associated with higher compliance cost on government regulations. Figure 2 shows this correlation between overall compliance costs on various government regulations with compliance costs associated with tax payment.

The study further examines how firms' relationship with tax officials affect their compliance costs. While firms that are frequently inspected by tax officials are found to have higher compliance costs, firms that are requested to pay bribes by

tax officials, on the other hand, have lower compliance costs. These results highlight that regulatory burdens related to taxation play a bigger role in increasing compliance costs in Africa than other forms of regulatory burdens, and that firms may look to informal ways to reduce the burden by paying bribes to tax officials.

## Implications for research and policy

The results of this study add to the growing literature on the impact of the tax administration burden in developing countries by providing evidence on its importance to firms' overall compliance costs compared to other forms of government regulations. Policies that aim to help the growth of the private sector in Africa by improving the overall business environment should take measures that also help ease regulatory burdens associated with tax administration. Furthermore, the finding of the study that reveals that frequent inspection by tax officials not only increases overall compliance costs but also raises the likelihood of bribe requests by tax officials, suggests that countries should invest in alternative mechanisms to increase tax compliance that can help minimise direct contact with tax officials.

## Further reading

Ali, M. (2018) 'Regulatory Burdens in Tax Administration and Firms' Compliance Costs in Africa' Working Paper 78, Brighton, IDS: May.

## Credits

This paper was written by **Merima Ali**. Merima is Senior Researcher at CMI (Chr. Michelsen Institute) in Bergen, Norway and Assistant Professor of Economics at Syracuse University, USA.

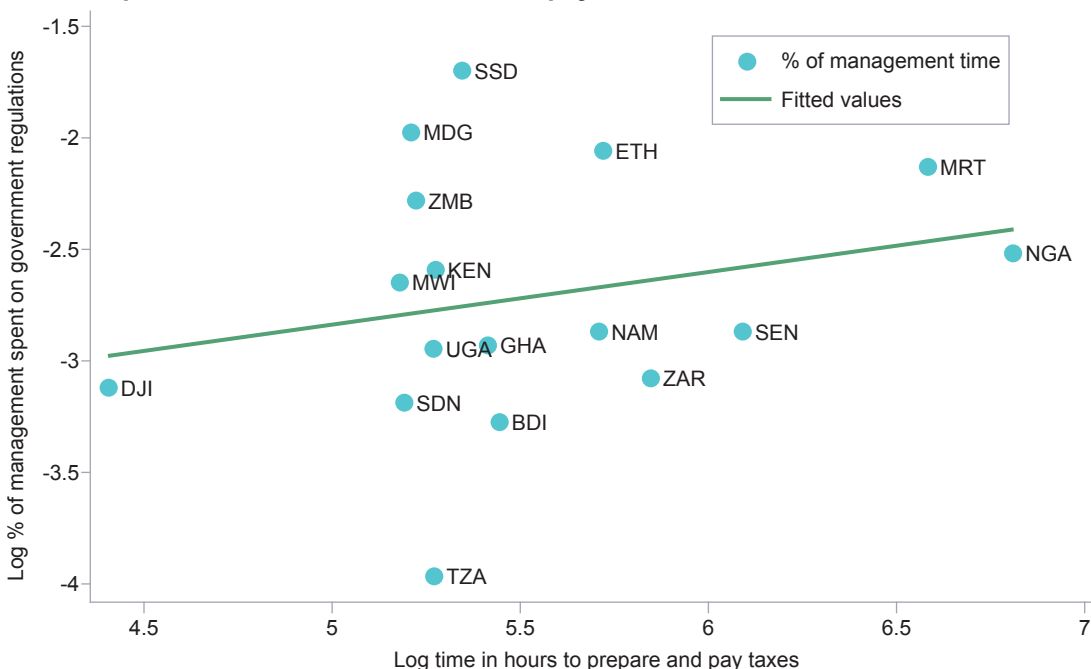
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**Figure 2 Correlation between overall compliance costs on various government regulations with compliance costs associated with tax payment**



Source: Author's calculation using data from the World Bank Enterprise Survey and the World Bank's Doing Business database