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TAX AND DEVELOPMENT

Aid Modalities for Strengthening Tax Systems

This document is submitted to the DAC for APPROVAL under written procedure. If no comments are received by 14 September 2012 c.o.b. it will be considered approved and will be issued for publication as final. The report has been finalised by the OECD/DAC-GOVNET Tax and Accountability Task Team as a key deliverable in the Programme of Work and Budget 2011/2012 (DCD/DAC(2010)31/FINAL). It was approved by GOVNET members under written procedure on 13 July 2012.

The paper is a joint OECD/DAC Network on Governance (GOVNET)/ International Tax Compact (ITC) report that examines the aid instruments donors can use to assist developing countries in strengthening their tax systems. The assessment draws on three sources: a review of the relevant literature; a survey of aid agencies officials; and six case studies that afford a ground-level view of how various modalities work in practice. This report is a direct response to the growing awareness of the potential mutually beneficial links between taxation and governance. The analysis and insights in this paper have already been taken forward by the joint DAC/CFA Tax and Development Programme in the form of principles for international engagement in tax matters which will be validated and finalised in 2012/13. The paper also offers valuable guidance for donors and will be launched and disseminated during the next cycle of OECD Task Force on Tax and Development meetings in 2013 (dates tbc). Please note that this document is only available on OLIS in pdf format.

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Foreword

The topic of Domestic Resource Mobilisation has become a top priority of the international development agenda. Together with other international fora and initiatives, the OECD is one of the leading trendsetters in this field. By setting up a joint programme and the Informal Task Force on Tax and Development, the OECD has brought together, for the very first time in the organisation's history, the working areas of the Development Assistance Committee and the Committee on Fiscal Affairs.

The German Federal Ministry for Economic Cooperation and Development is very glad to be able to support this work in the framework of the International Tax Compact (ITC), a platform for dialogue and action for tax reforms in developing countries. The present publication is a result of this successful cooperation between ITC and OECD.

In developing countries the benefits of strong, sound tax systems are self-evident – efficient revenue raising, fair distribution of the tax burden, and the balancing of public and private needs towards national development goals. However, many such countries experience great difficulties in collecting revenue. Impediments range from widespread informality to tax evasion from elites and a dearth of tax administration skills.

They are caught in a vicious circle, where the lack of domestic resources from fair and efficient taxation impairs governance which, in turn, impairs tax compliance. But where there is a vicious circle there can be a virtuous one, argues this book. *Tax and Development: Aid Modalities for Strengthening Tax Systems* is a timely response to the growing awareness of the potential mutually beneficial links between taxation and governance. As the report states: “The time is now right for donors to scale up support for tax reforms and tax modernisation programmes in partner countries where tax systems are seriously underdeveloped.”

Tax and Development: Aid Modalities for Strengthening Tax Systems examines the aid instruments that donors can use to assist developing countries in strengthening their tax systems. From general or sector budget support, to basket financing modalities and other joint instruments, stand-alone bilateral aid and South-South regional programmes, it looks at the strengths and weaknesses of each modality. It considers the needs and context to which each one best responds and describes how mixed “packages” may often best fit the bill. Crucially, it also affords thoughtful insights into how tax reform can yield governance dividends and provides examples from the experience of a number of developing countries, culminating in six illuminating case studies in tax reform. Although they consider difficulties as well as successes, they offer practical pointers to future directions for research and action.



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Acronyms and Abbreviations

AfDB	African Development Bank
AFRITAC	Africa Regional Technical Assistance Centre
ARTF	Afghanistan Reconstruction Trust Fund
ASYCUDA	Automated system for customs data
ATAF	African Tax Administrators Forum
BETF	Bank-executed trust fund
CABEI	Central American Bank for Integration
CF	Common fund
CGD	Centre for Global Development
CIAT	Inter-American Center of Tax Administrations
CIDA	Canadian International Development Agency
COD	Cash on delivery
CTPA	Centre for Tax Policy and Administration
DAC	Development Assistance Committee
DAI	Development Alternatives Inc.
DANIDA	Danish International Development Agency
DED	German Ministry for Development
DFID	UK Department for International Development
DGD	Customs Directorate
DGI	Directorate General for Taxes (Mali)
DP	Development partner
DPG	Development partners group
EAC	East African Community
EC	European Commission
ECOWAS	Economic Community Of West African States
EITI	Extractive industries transparency initiative
FIRST	Financial sector reform and strengthening initiative
FTC	Free-standing technical cooperation
FY	Financial year

GBS	General budget support
GDP	Gross domestic product
GFG	Good financial governance programme (Ghana)
GIZ (formerly GTZ)	Deutsche Gesellschaft für Internationale Zusammenarbeit (German Technical Cooperation agency)
GoG	Government of Ghana
GoM	Government of Mozambique
GRA	Ghana Revenue Authority
HIPC	Heavily indebted poor countries
HRM	Human resource management
IDB	Inter-American Development Bank
IEG	Independent Evaluation Group (World Bank)
IFC	International Finance Corporation
IMF	International Monetary Fund
IRTC	Investment-related technical cooperation
ISPC	Imposto simplificado para pequenos contribuintes (Simplified tax for small taxpayers)
IT	Information technology
ITAS	Integrated tax administration services
ITC	International Tax Compact
ITD	International Tax Dialogue
JAS	Joint assistance strategy
JICA	Japan International Cooperation Agency
KfW	Kreditanstalt für Wiederaufbau (German development bank)
KOICA	Korea International Cooperation Agency
LEITI	Liberia Extractive Industries Transparency Initiative
LTTA	Long-term technical assistance
MAE	French Ministry of Foreign Affairs
MCC	Millennium Challenge Corporation
MDBS	Multi-donor budget support
MKUKUTA	Tanzanian poverty reduction strategy
MOU	Memorandum of understanding
MRA	Mozambique Revenue Authority
MSEs	Micro and small enterprises
NGO	Non-government organisation
NORAD	Norwegian Agency for Development Cooperation

ODA	Official development assistance
OECD	Organisation for Economic Cooperation and Development
OED	Operations Evaluation Department (World Bank)
OJT	On-the-job training
OTA	U.S. Treasury Office of Technical Assistance
PAF	Policy assessment framework
PAF	Progress assessment framework
PAM	Performance assessment matrix
PEFA	Public expenditure and financial accountability
PER	Public expenditure review
PFM	Public finance management
PGBS	Partnership general budget support
PRS	Poverty reduction strategy
RA	Revenue administration
REO	Regional economic outlook
RETF	Recipient-executed trust fund
SACU	Southern Africa Customs Union
SADC	Southern Africa Development Community
SARS	South African Revenue Service
SAT	Tax Administration Superintendence (Guatemala)
SBS	Sector budget support
SDP	Sector development programme
SECO	State secretariat for economic affairs of Switzerland
SISTAFE	Mozambique integrated electronic public finance management system
SPA	Special program for Africa
STTA	Short-term technical assistance
TA	Technical assistance
TC	Technical cooperation
TFP	Technical and financial partners
TMP	Tanzania modernisation project
TOR	Terms of reference
TPAR	Tax Policy and Administration Reform project
TRA	Tanzania Revenue Authority
TTF	Topical trust fund
UNDP	United Nations Development Programme
URA	Ugandan Revenue Authority

USAID	U.S. Agency for International Development
VAT	Value added tax
WAEMU	West African Economic and Monetary Union
WGI	World Governance Indicators

Executive Summary

After years of neglect, taxation is increasingly focusing the minds of aid agencies and prompting them to view it as a development assistance priority. Two factors prompt this newfound perception. The first is a groundswell of interest in mobilising domestic resources for sustainable fiscal management and an eventual exit from aid dependency. Second, there is growing awareness that the tax system is a central pillar of state building and good governance. It is against this background that the present study seeks to assess the role of various so-called aid “modalities” (or instruments) in supporting tax systems and recommends practical ways of improving such development assistance. The assessment draws on three sources: a review of the pertinent literature; a survey of aid agency officials; and six case studies that afford a ground-level view of how various modalities work in practice. Given the scope and complexity of the issues at stake, the aim here is not to propose comprehensive solutions, but to contribute to the international dialogue on aid for taxation.

Taxation and governance

The fundamental purpose of taxation is to raise revenue effectively, efficiently, and fairly to finance public goods and services. But donors and development practitioners are equally concerned to promote good governance in tax matters. The governance perspective considers how taxation affects state capacity, responsiveness, and accountability, and looks at the political economy of tax reform. Four themes stand out in the literature on taxation and governance.

First, taxation is a central feature of the state’s role in the social contract as defined by political institutions, influence networks, economic interests, social relationships, and government capabilities in all countries. Second, taxation is itself a core capability in state building and good governance. Third, imposing tax can improve governance by fostering fiscal bargaining, engaging citizens in the political process, and encouraging governments to be responsive, accountable, and efficient. Fourth, linkages also work in the opposite direction, as the quality of governance affects revenue mobilisation through its influence on the “culture of compliance”. This interaction suggests there is a potentially virtuous circle in which improvements in the tax system may lead to better governance, which in turn facilitates revenue mobilisation – yielding better financing for public services and faster progress towards ending aid dependency.

These tax-governance linkages are complex and context-specific, and much of the evidence is anecdotal. Even in the present state of knowledge, though, it is clear that there are strong synergies between tax reforms and governance. In addition, many special concerns from a governance perspective – such as the need for political economy analysis and the importance of public-private dialogue on tax issues – readily complement the traditional “technical” approach to tax reform. Above all, technical and governance perspectives concur on the need to link tax reforms to improvements in public expenditure

management so that citizens see the value of paying tax. These synergies free donor support from trade-offs between the economic and financial objectives of taxation, on one hand, and governance or state-building objectives, on the other hand. In several respects, however, the governance agenda does differ, at least in emphasis, from the economic agenda – for example, in the areas of earmarking and determining thresholds for entering the tax net.

Aid modalities for supporting tax systems

The study examines seven aid modalities for supporting tax programmes: general budget support; sector budget support; basket financing; joint programme or project financing, which includes trust funds; stand-alone bilateral interventions; South-South regional programme funding; and in-kind assistance. For each one, the assessment starts with a short definition and a general description in light of the principles set out in the *Paris Declaration on Aid Effectiveness*. The main objective, though, is to assess the applicability of the seven modalities to tax systems.

General budget support (GBS) is an excellent vehicle for aid effectiveness in countries where conditions of governance and public finance management warrant untied funding to finance ministries to support the government's budget programmes. GBS programmes create both a unified framework for donor financing that is fully aligned with the priorities and systems of host-countries and a joint mechanism for accountability. GBS has an accompanying high-level policy review. It provides a forum that can be used to turn the spotlight on tax performance and create incentives for improving the tax system. By virtue of its breadth of coverage, the GBS framework is especially well suited to addressing interactions between taxation and governance.

At the same time, however, there are concerns that GBS may weaken incentives for revenue mobilisation. Another concern is that the sheer breadth of GBS coverage and donor forbearance when revenue targets are missed may dilute the incentive effects of the policy dialogue. Donors can address this fear in a number of ways. They can ensure that revenue issues are a priority on the GBS agenda; introduce variable tranche mechanisms linked to carefully structured revenue targets; and increase support for strengthening the tax system through other modalities.

Sector budget support (SBS) is very similar to GBS, only it is applied to sector strategies. As a result, SBS yields many of the same benefits as GBS. And although it adds an extra layer of co-ordination and management, it is a major improvement over isolated bilateral arrangements. The special advantage of SBS programmes for public finance management (PFM) is that they create a direct link between budget funding and PFM performance, which includes tax performance. SBS is also a highly effective modality for co-ordinating donor work on revenue issues with reforms to expenditure management. Like GBS, the breadth of PFM sector programmes, however, might weaken the focus on taxation (although this depends on the preferences of the host finance ministry). Again, as with GBS, the use of variable tranches tied to carefully defined revenue-related indicators can address that concern. One novel type of variable tranche is the “cash-on-delivery” (COD) approach, which can be adapted to revenue measures and governance linkages.

Basket financing entails multi-donor pooled funding that is disbursed, not to the host government's general budget, but to a segregated account for a designated purpose, such as a tax programme. By establishing a common fund with a unified arrangement for planning, implementation, and monitoring, the basket modality is eminently well suited to

co-ordinating multi-donor funding for tax programmes. It minimises duplication of efforts and aligns donor support with the recipient's strategy for tax reform.

Compared to GBS or SBS, however, a tax basket is somewhat less closely aligned with host systems, because the funds are earmarked and deposited in a separate account. Nevertheless, most officials interviewed for this study favoured basket funding as a model modality in countries where at least three donors were interested in supporting a common country-defined tax programme. In shaping a tax basket programme, donors and developing countries should seek to include such governance and state-building elements as improved customer services and tax information programmes.

Other multi-donor instruments such as multi-donor trust funds are a channel for supporting tax systems through a co-ordinated platform, especially in countries whose government systems lack the capacity to warrant budget support. Donors can also jointly fund “projectised”¹ assistance for tax programmes, though the basket approach is preferable in countries with adequate capacity for strategic planning and financial management. An additional option is to pursue tax-related activities through joint projects or programmes that are designed for other purposes, such as strengthening Parliament and civil society.

“Stand-alone” bilateral projects or programmes still account for a large share of aid flows. Situations where multiple donors pursue parallel tax projects have maximum potential for fragmentation, inconsistency, and elevated transactions costs. Nonetheless, some aid agencies favour stand-alone arrangements, as do some recipients. Examples such as Rwanda, Mali, and El Salvador show that bilateral tax programmes can be highly effective, if the host country shows strong ownership and leadership. In countries where one bilateral tax programme is dominant, co-ordination is not much of a problem. The larger issue is the need for co-ordination in establishing a coherent division of labour when multiple donors choose to support the tax system.

Donors may also support tax systems by **funding South-South organisations** such as the Inter-American Center of Tax Administrations (CIAT) or the African Tax Administrators Forum (ATAF). Such funding can be a low-cost, high-value channel for networking among regional tax officials, knowledge sharing, and collaborating between regions on cross-border tax issues. South-South organisations merit strong support from the international community, contingent on good management. There are practical limits, though, to their absorptive capacity.

Rather than funding tax systems, some aid agencies deliver technical services and investments directly through **in-kind support**, e.g. twinning arrangements or the secondment of experienced tax officials can be highly responsive to host-country needs.

Cross-cutting issues

Whether provided through a funding instrument or in-kind, **technical assistance** (TA) is a central element in virtually every aid programme on taxation. Key factors include tailoring technical work to local needs and ensuring high quality. Many host-country tax officials favour TA that takes the form of experts who work long-term “in the trenches” to serve as mentors and respond to changing needs. Short-term tax consultants are also often needed to address specific needs, while donor support is highly valued for providing training. In all cases, attention must be paid to sustainable capacity development. Donor programmes, too, can provide broader learning opportunities through twinning arrangements, support for peer networking, and opportunities to attend external short courses, degree programmes, and international tax conferences.

Modern **information technology** (IT) is a central element of strategies to strengthen resource mobilisation, improve taxpayer services, reduce compliance costs, and enhance integrity in tax administration. Because IT systems are complex and expensive, tax authorities in developing countries tend to rely heavily on donors for the provision of hardware and software, along with assistance in re-engineering business systems to take full advantage of efficiency gains from computerisation. The provision of tax-related IT systems is often plagued with problems, including incompatibility across different operations. IT programmes should therefore be carefully planned and co-ordinated within an overall reform strategy. Donors also provide – albeit more rarely – other kinds of communications equipment, office equipment, and vehicles, which can be valuable elements in programmes to strengthen tax collection, enforcement, and administrative efficiency.

Aside from the Paris principles for aid effectiveness, five other cross-cutting issues were raised repeatedly in discussions with both donors and developing countries for this study. First, donors are concerned not only with **how** to finance support for tax systems, but also with **what** to finance, and how to determine **programmatic priorities** for using resources most effectively to improve tax systems. The simple answer is to conduct a country-specific diagnostic analysis. Yet programmatic priorities must still be grounded in basic principles of taxation. They should also draw on well established concepts of good practices in reforming tax policy and administration in developing countries, with special attention to synergies between technical needs and governance dividends.

Second, there is broad support for establishing a **standard diagnostic framework** for assessing tax programmes, styled after the Public Expenditure and Financial Accountability (PEFA) framework that has been widely used for budget assessments. The tax diagnostic should be structured, however, around a “systemic approach” that focuses on the strategic objectives of the host organisation and how parts of the tax system interact. The aim is to determine what matters at the country level, rather than applying a standardised scorecard based on international best practices.

Third, there is a need to identify meaningful **indicators** for revenue performance, especially for GBS programmes. The most common indicator, the ratio of tax revenue to GDP, is subject to technical problems that limit its value as a gauge of performance. A meaningful assessment should include structural benchmarks and operational results, as well as outcome indicators. This book outlines examples.

Fourth, in countries where numerous donors have an interest in supporting the tax system, there is a need to establish an effective **division of labour**. The survey of aid officials carried out for this study found little room for specialisation according to comparative advantage on tax issues, other than in “niche” interventions such as Norway’s support in the taxation of natural resources. The evidence also showed, however, that in-country consultations have been very successful in co-ordinating donor activities.

Finally, given concerns about aid dependency and possible adverse effects of aid on domestic resource mobilisation, the issue of **exiting aid** has special relevance to tax programmes. There is a need for further analysis of an incentive-compatible trajectory for phasing out assistance as well as for realistic rules for disengaging from tax programmes when aid fails to achieve results.

Findings and recommendations for aid modalities to support tax systems

In assessing aid modalities for strengthening tax systems, this book echoes some common themes from the literature on aid effectiveness. But it also addresses many considerations specific to taxation and governance. Some of the principal findings are:

- Host-country ownership and leadership is of paramount importance. Aid can effectively support government programmes to improve the tax system, but it generally cannot “buy” effective and lasting reforms that are not aligned with domestic political incentives.
- Although basic principles of taxation are applicable everywhere, and common themes are widely applicable, there is no “best” approach to tax reform. Donor programmes should be customised to fit country conditions.
- The objective of tax reform is not just to boost the ratio of tax revenue to GDP, but also to establish a tax system that is efficient, growth-oriented, and equitable. **How** revenue gets collected is as important as **how much** gets collected. In the long run, the main benefits of tax reform to favour domestic resource mobilisation will derive from the effects of reform on investment, efficiency, growth, political legitimacy and improved service delivery.
- There are broad areas of synergy between the governance agenda and the standard technical agenda for tax reform. Aid programmes should give special weight to activities that address these synergies.
- The quality of the tax system is itself a central pillar of state building and good governance. But linkages between taxation and governance also involve supporting institutions and organisations outside the revenue system, which includes the justice system, Parliament, and civil society.
- Efforts to widen the tax net and mobilise revenue depend not only on tax reforms, but on broader reforms that influence citizens’ attitudes to the quality of governance.
- Given the importance of ownership, alignment and sustainability, each of the major modalities has a distinct, valuable role to play in promoting more effective tax systems and tax-governance linkages. But there nevertheless remain many ways to improve the effectiveness of the modalities themselves.
- Donor support for fiscal development at the local level can foster a strong link between revenue systems and governance.

Altogether, *Tax and Development: Aid Modalities for Strengthening Tax Systems* identifies some 50 recommendations both for improving the modalities themselves and for strengthening tax-governance linkages. They point to directions for future research in an area of development aid where much is still not fully understood. Nevertheless domestic revenue mobilisation clearly holds promise for sustainable fiscal management and aid-free development in developing countries. The experience of some countries – Liberia and Guatemala are two examples – demonstrates the synergistic relationship between governance and compliance, or state building and taxation. Yet, basic questions remain. The soundness of the main hypotheses relating to taxation and governance needs to be tested. The politics of taxation, too, is a fraught topic: what are the political drivers of tax reform, and what are the obstacles? Taxation looks set to exercise minds in the development assistance community for some time.

Note

1. Many aid activities are structured as a standard project but with multiple donors involved in the financing and often in managing and monitoring the activities. USAID calls this “multi-donor pooled funding: projectized assistance” (USAID 2008, 7).

Chapter 1

Introduction

This introductory chapter first sets the scene for the discussion of aid modalities that donors may use to support tax systems. It states the context, motives, and objectives behind this book and, importantly, considers some definitions of “aid modality”. It seeks to explain why a study of development assistance for tax system is topical – prompted by a surge of interest in domestic revenue raising that has brought taxation out of the shadows of development assistance and made it a mainstream priority target. The chapter then goes on to describe the research methodology underpinning the study, which draws on the literature, a survey, and the experience of selected countries. It then outlines the study’s scope, structure, and objectives.

A growing number of international aid agencies are recognising that taxation is an important mainstream priority for development assistance (International Tax Compact, 2010ab; Michielse and Thuronyi, 2010). Yet, until recently, the issue was neglected. The conditions attaching to the Heavily Indebted Poor Countries (HIPC) initiative, for example, focus on expenditure for poverty reduction. Similarly, the indicators for monitoring progress towards the Millennium Development Goals highlight the provision of social services. According to the OECD, tax programmes accounted for less than 0.1% of overall Official Development Assistance (ODA) in 2009.¹

Two main factors have driven the recent change in attitudes. First, there has been a groundswell of interest in mobilising domestic resources as a foundation for sustainably funding essential public services and eventually exiting aid dependency. The need to raise domestic revenue through efficient tax systems was a fundamental objective of the 2002 *Monterrey Consensus on Financing for Development* (United Nations, 2003). The issue has now received a new lease of life from the fiscal problems that many donor countries themselves are experiencing in the wake of the global financial crisis. The second factor is that the international community is increasingly coming to recognise that the development of an effective, efficient, equitable tax system is a central pillar of state building and good governance.²

These two factors have strongly reinforced the traditional technical tax reform agenda. It focuses firmly on macroeconomic balances and the effects of the tax system on investment, efficiency, job creation, and sustainable growth to reduce poverty and mobilise domestic resources.

1.1. Purpose and scope of the study

The core theme of this study is the need for efficient, effective aid modalities (Box 1.1) to support tax systems in developing countries and promote the twin goals of revenue mobilisation and good governance as the cornerstones of sustainable development.

Box 1.1. What is an “aid modality”?

The term “aid modality” is synonymous with “aid instrument”. No definition is given in the on-line OECD/Development Assistance Committee (DAC) Glossary. However, a Danish glossary cites DAC in defining the term simply as “the way donor support is channelled to the activities to be funded”. This includes: “1) budget support (which is integrated into the national budget of the recipient country ...), 2) parallel support (which is kept separate from the general resources in the national budget ...), and 3) in-kind support (... in the form of goods or services).”

Source: Ministry of Foreign Affairs of Denmark, Aid Management Guidelines Glossary.³

More specifically, the purpose of the study is to review theoretical insights and the lessons of experience in the search for practical recommendations on the use of aid modalities to further revenue mobilisation and good governance. To that end and in line with tasks set out in its terms of reference, the study examines some of the following questions:

- What are the goals and key elements of a governance-focused tax reform agenda?
- What areas should revenue mobilisation programmes prioritise to pay dividends for governance?

- What aid modalities are used to support tax programmes? How can their design be improved? How can their approaches be more closely harmonised and aligned?
- Are there lessons that can be learned so that aid modalities co-operate more closely in supporting programmes to improve tax systems? What are those lessons?
- What are the preconditions and design recommendations for effective use of basket financing?
- How can synergies between donors and approaches be improved?
- What types of activities are most important to fund?
- How do country-specific factors influence or constrain the nature of donor support?
- What is the role of international or regional entities and standards?
- What issues are priorities for further discussion and analysis?

Given the scope and complexity of the issues, this necessarily limited study addresses some aspects more briefly than others. The discussion can, for example, only touch on country-specific factors affecting donor support as a detailed analysis would require separate studies (*e.g.* USAID, 2008). Similarly, although local government revenue systems are extremely important to both the tax and governance agenda (Bahl, 2010; Chambas, 2010), they cannot be addressed in detail here. Among the major topics beyond the scope of the study are the management of natural resource revenues (Daniel *et al.*, 2010) and cross-border tax issues, which are addressed in numerous OECD documents.

This study does not try to re-invent the wheel in evaluating the various aid modalities, technical approaches to tax reform, or the relationship between taxation, governance, and state building. Ample literature is already available. Instead, the focus is on how aid modalities can best be used to support tax systems and enhance the linkages between taxation and governance. The study also seeks to enrich the literature on taxation and governance by distinguishing points of synergy and divergence between the technical and governance agendas for tax reform.

A final point is that there are many variations on each modality theme and a great diversity of country conditions, needs, and solutions. In practice, the “best” approach to virtually every issue is particular to a time and place. The aim, then, is not offer pat solutions, but rather to contribute to the international dialogue on aid modalities to improve tax systems and promote good governance.

1.2. Methodology

This report draws on three sources of information: a review of the literature; a survey of aid agency officials; and selected case studies. The literature review covers recent academic literature and many other documents from multilateral and bilateral organisations (see “References” at the end of each chapter). The review focuses on aid effectiveness, donor modalities for supporting tax systems, the relationship between revenue mobilisation and governance, and tax reform priorities in developing countries.

The study team also sought lessons from experience through a survey of officials who had worked with tax programmes in major bilateral and multilateral organisations, regional entities, and non-governmental organisations. The team conducted their survey through structured interviews to gather information on each organisation’s involvement with tax

issues; areas of programmatic focus or comparative advantage; experience with modalities in harmonising and aligning support for tax systems; governance dividends from tax programmes; conditions for success (or failure); and ideas for further study. Where possible the interviews were face-to-face, but most involved telephone discussions and follow-up by email, as the budget had no provision for field visits.

The study gives special attention to six country cases, based on a review of documents and phone interviews with aid officials and (where possible) government officials who have direct experience in dealing with aid modalities to support the tax system in their country. The chosen countries are Ghana, Guatemala, Liberia, Mali, Mozambique, and Tanzania. The time constraints were such that the case studies have not produced in-depth reports. The aim is, rather, to offer a ground-level view of how various aid modalities work in practice, along with information on tax reform priorities and tax-governance linkages. Indeed, the study's terms of reference state that it is "not an exhaustive assignment" but one that is designed "to provide examples" from various regions and country types. Accordingly, the study team chose the case-study countries against five criteria:

- the potential for learning lessons about effective multi-donor approaches to supporting tax systems;
- the extent of donor support, particularly with multi-donor involvement;
- coverage by region (with a main focus on Africa) and country type (one post-conflict case),
- recommendations from consultation with the German development bank, Kreditanstalt für Wiederaufbau (KfW), and the OECD/DAC GOVNET Taxation and Governance Task Team.
- availability of information.

To broaden the range of experience examined and support the analysis and recommendations, this study also draws on a review of the literature and survey interviews for information on other countries. Text boxes feature insights from Uganda, Afghanistan, Kenya, El Salvador, and South Africa.

Assessments of aid modalities use five benchmarks drawn from the principles of 2005 *Paris Declaration on Aid Effectiveness*: ownership; alignment; harmonisation; managing for results; and mutual accountability. The discussion also explores areas in which the Paris criteria may give rise to trade-offs. For example, where host-country systems are very weak, full alignment would not be the most efficient or effective use of tax system aid. Similarly, in cases where the preferences of senior tax officials are heavily influenced by past practices and institutional inertia, managing for results may require that donors exercise knowledge leadership rather than simply aligning programmes on local priorities. In essence, the Paris principles are guidelines for improving aid effectiveness, not ends in themselves.

1.3. Structure of the study

The report is organised as follows. Chapter 2 provides an overview of the literature on taxation and governance. It highlights the broad areas of synergy between the governance agenda and the standard technical agenda for tax reform, while also looking at some important points of divergence.

Chapter 3 assesses the main modalities used to support tax systems, including budget support programmes and their role in promoting revenue objectives. It proposes a short definition and general description of each modality in accordance with the principles of the *Paris Declaration on Aid Effectiveness*, assesses its applicability for supporting tax systems and tax-governance linkages, then draws conclusions for consideration by donors and host governments.

Chapter 4 briefly discusses the question of **what** to support, as distinct from the main topic of **how** to provide support. It then addresses five implementation issues raised repeatedly during research for the study and which transcend all aid modalities: the identification of programmatic priorities for tax reform; the development of diagnostic tools; the selection of revenue indicators; the division of labour between aid agencies in supporting tax systems; and conditions for exiting from such support. Chapter 5 is devoted to the six country case studies which offer practical illustrations of the aid modalities discussed in the second, third, and fourth chapters. Chapter 6 closes the study with a set of broad conclusions and a summary of the chief findings and recommendations.

Supplementing the study are four annexes. Annex A lists persons interviewed and other contacts who provided information or comments. Annex B presents the survey questionnaire used to obtain feedback on aid modalities and tax-governance linkages, while Annex C summarises the main findings from the survey. Finally, Annex D provides an empirical overview of tax performance in low-income and lower-middle-income countries, along with stylised facts on the relationship between taxation and governance.

Notes

1. Data provided by the OECD to the Tax and Development Task Force Subgroup on Taxation, State-building and Aid, 12 January, 2011. Even within the category of bilateral aid for public administration, economic policy and public sector financial management, tax-related assistance accounted for just 1.7% of total funding in 2005 (OECD, 2008).
2. Another factor is an underlying concern that foreign aid itself may affect the incentives for host governments to raise revenue and accountability to their citizens. The empirical evidence of this hypothesis is inconclusive (Moss *et al.*, 2008; Carter, 2010; von Haldenwang and Ivanyina, 2011), but this does not negate the concern.
3. Source: <http://amg.um.dk/en/servicemenu/Glossary/Glossary.htm>.

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Chapter 2

Taxation and Governance

This chapter looks at the literature on taxation and governance from which it draws four chief themes: 1) the centrality of taxation to the role of the state; 2) taxation as a critical component of state building and governance; 3) the positive effect of taxation on the quality of governance and the government's relationship with the people, particularly in respect of accountability, responsiveness and sound public finance management; 4) the positive effect of good governance on revenue mobilisation and compliance, underpinning which are taxpayers' perceptions of state legitimacy and fairness.

The chapter concludes from the tax-governance linkages which it identifies that donors and governments should leverage them to drive tax reform – though not to the exclusion of the traditional technical modalities. It goes on to discuss areas of convergence and divergence (e.g. earmarking, tax thresholds, informality). It concludes that the technical and governance agendas can be mutually beneficial as part of a carefully co-ordinated reform programme.

The fundamental purpose of taxation is to raise revenue for financing public goods and services. An effective tax system therefore is one that strikes the right balance between public and private needs in order “to achieve national development goals” within the prevailing structural and social conditions and political priorities (EC, 2010). Developing countries, in particular, need to establish tax systems that are not only effective in mobilising resources, but also distribute the tax burden fairly¹ and minimise tax distortions that may deter productive investment, trigger costly resource misallocation, and impair growth. As the OECD (2008) points out, low-income countries face special challenges that affect the feasibility of raising taxes. Such challenges are widespread poverty and illiteracy; hard-to-tax groups in subsistence agriculture and the informal sector; problematic accounting in the private sector; and a lack of tax administration skills (particularly control of international tax leakage).

Beyond these economic fundamentals, donors and development practitioners are deeply concerned to promote “good governance in tax matters” (EC, 2010). The governance perspective focuses on how taxation affects the political drivers of tax reform – state capacity, responsiveness, and accountability – and how governance restricts or enables the effectiveness of donor-supported tax programmes. Yet the traditional approach to tax reform was and is predominantly technical. What, then, is the nature of the relationship between taxation and governance and between the technical and governance-oriented approaches to tax reform?

2.1. A mutually inclusive relationship

Four themes are prominent in the literature on taxation and governance. First, the centrality of taxation to the role of the state in the social contract, as defined by political institutions, influence networks, economic interests, social relationships, and government capabilities. An effective programme to strengthen a country’s tax system has to take into account the commitment of national leaders, the influence of interest groups, the political incentives for sustainable reform, the role of policy dialogue, and the quality of information available to decision makers and stakeholders on the effects of tax decisions. As Prichard (2010) concludes from detailed case studies of Kenya, Ethiopia, and Ghana, domestic political factors ultimately determine the course of tax reform. Aid programmes to support the tax system can work only when reforms are consistent with the domestic political agenda – and they work best when accompanied by high-level political support. Consequently, an understanding of the political economy of reform can be just as important as technical analysis.

A second theme is that taxation itself – along with effective expenditure management – is central to the state-building capability and a fundamental component of good governance. Tax reforms can also be a point of entry for fostering broader improvements in state capacity (Brautigam, 2008). Any serious programme for strengthening revenue performance creates a need for strengthening related functions like budget management, fiscal policy analysis, courts and the judiciary, and the agencies responsible for business and property registration. Similarly, programmes to professionalise tax administration by introducing strategic planning, merit-based personnel management, or modern tax information systems, can set an example that other areas of government will emulate. Among the country cases examined for this report, state-building dividends from tax reforms were reported in both Guatemala and Mali (see Chapter 5).

A third prominent theme is that the imposition of tax is “good for the quality of governance”, in that “being taxed engages citizens in the political process”, while “the

dependence of governments on tax revenue encourages bargaining with taxpayers” (Moore, 2008). Tax obligations can trigger demands for greater responsiveness and accountability, better management of public expenditures, improved public services, more efficient state institutions, and stronger oversight by Parliament and civil society (OECD, 2008; Brautigam *et al.*, 2008; Prichard, 2009 and 2010; Everest-Phillips, 2010). At the same time, reliance on taxes creates incentives for the government to be more open to demands from the public and to engage a broader set of stakeholders in fiscal bargaining. A growing body of historical and contemporary evidence has demonstrated that the payment of tax and the structure of the tax system can deeply influence the relationship between government and its citizens. Further evidence also reveals that the absence of “tax reliance” is often associated with a lack of accountability and responsiveness, especially where governments rely on natural resource rents as a substitute for mobilising revenue from their citizens (OECD, 2008; Everest-Phillips, 2010; Brautigam *et al.*, 2008; van der Ploeg, 2011).

Fourth, there are also important linkages in the opposite direction – namely that the quality of governance can strongly influence revenue mobilisation. For example, dynamic leadership in Liberia has secured remarkable revenue gains in extremely difficult post-conflict conditions (Chapter 5). Besides, tax administrators everywhere know that collection does not depend only on the risks and costs of non-compliance as determined by inspections, audit, enforcement, and penalties. It also hinges on the so-called “culture of compliance”, which is driven by the legitimacy of the government (Box 2.2) and perceptions of fairness in the tax system. Two issues relating to perceptions of fairness are the knotty problems of taxing elites (Box 2.1) and the informal sector (see “Taxing the Informal Sector” later in this chapter). Perhaps the most important factor, though, is the quality of public expenditure management, where citizens’ perceptions of reciprocity are determined by the valued public services they get in return for paying taxes (Bird, 2010; OECD, 2008).

Box 2.1. Taxing elites

The problem of getting elites to pay their fair share of tax is often raised in discussions about tax-governance linkages. Yet constructive solutions in which donors can play a role are hard to find. The interviews for this study produced a few suggestions, namely: limiting exemptions, which often have the unintended effect of creating large loopholes; international information exchange agreements to reduce opportunities for cross-border tax evasion; electronic cross-tabulation of tax data with third-party data; involvement of civil society groups; and media coverage of tax avoidance by the rich.

At a recent OECD meeting on taxation, state-building and aid, a question on the issue evoked an interesting call for three measures against tax evasion and avoidance by elites. First, heads of state and government, finance ministers, and commissioners of the revenue authority must openly pay their taxes. Second, the revenue authority must be truly independent of political influence and its commissioner be a non-political appointee. Third, the revenue authority must embrace a value system emphasising everyone’s responsibility to contribute to national development. It is also essential to have strong audit capabilities and an effective investigative unit, although such technical fixes will not affect the rich and powerful if political will is absent.

Source: OECD, meeting on Taxation, Statebuilding, and Aid.

Box 2.2. Taxation and governance in Kenya

Kenya is a fascinating counterweight to any simplistic interpretation of the standard hypothesis that strong tax collection leads to good governance or that the introduction of major new tax measures stimulates political reaction and tax bargaining. The storyline in Kenya is that the tax ratio has been high for decades, while governance conditions have been poor and overt tax bargaining largely absent. When Daniel Arap Moi began his autocratic, divisive, and corrupt presidency in 1978, domestic revenue was already above 20% of GDP with tax revenue about two percentage points lower (World Bank, various years). In the 1990s, Moi's regime introduced large-scale tax reforms. They included the introduction of value-added tax (VAT); the establishment of the Kenya Revenue Authority, which increased collection of corporate and personal income tax; and a rise in the fuel tax – all with hardly a ripple of public political reaction.

In a detailed case study on taxation and governance in Kenya, Prichard (2010) concludes that “there has been very little public conflict over taxation, and even less evidence of direct tax bargaining between taxpayers and governments”. What Prichard does find, however, is that the “perceived legitimacy of successive Kenyan governments has shaped their ability to raise revenue”. As the regime lost popularity, revenues declined; when the post-Moi transition began, revenues increased. Prichard refers to this resistance to taxation and civil society's gradual shift towards stronger advocacy as “indirect tax bargaining”.

The Kenyan case thus supports the hypothesis of reverse causality: that political legitimacy does help to strengthen fiscal legitimacy and improve tax compliance. The adoption in 2010 of a new Kenyan constitution that ended political impunity will provide an interesting test of this alternative hypothesis.

Source: World Bank (various years); Prichard (2010).

Complex, context-specific linkages

This two-way interaction between taxation and governance suggests that there can be a virtuous circle in which tax reforms lead to improvements in governance which, in turn, facilitate revenue mobilisation – leading to more funding for essential public services, stronger government legitimacy, and faster progress towards ending aid dependency. The technical analysis reported in Annex D confirms that there is a positive and statistically significant relationship in the international data between tax performance and governance as measured by seven governance indicators. Moreover, this result emerges after controlling for the effect of key structural characteristics on each country's capacity to collect taxes. These empirical relationships, however, say nothing about the direction of causation: whether conditions of governance contribute to tax collection or vice versa. Irrespective of causality, governance-focused aid for supporting tax systems should aim to facilitate the interactive relationship between governance and taxation.

In practice, these tax-governance linkages are complex and context-specific. Nor is there anything automatic about them. Repressive governance may persist despite strong tax collection, as in Zimbabwe prior to its economic collapse (OECD, 2008; Everest-Phillips, 2010), and coercive tax collection may fail to spark political reaction, as the history of local taxation in East Africa shows (Fjeldstad and Therkildsen, 2008).

In any case, much of the evidence on tax-governance linkages is anecdotal. Although case study examples in the literature clearly show that the linkages do operate, more systematic analysis is needed to cast light on how particular tax measures yield governance

dividends or how particular governance improvements impact on tax compliance. Additional research – as well as better data on such key variables as collection efficiency, compliance costs, and perceptions of the tax system (Box 2.3) – may provide better guidance for designing aid programmes that actually affect governance dividends from taxation.

Box 2.3. Barometers of public opinion on taxation

One way to gauge citizens' attitudes to tax compliance, tax legitimacy, and the quality of tax services is to ask them. The Latinobarómetro has been carrying out annual opinion surveys on economic, political, and social conditions since 1995, reaching 18 countries in 2010. The AfroBarometer has conducted similar surveys since 1999. The latest round, in 2008-9, covered 19 countries. Both instruments include questions relating to the tax culture.

In its *2010 Report*, Latinobarómetro asked respondents whether tax evasion is ever justifiable: Nicaragua and Guatemala showed the weakest tax compliance. It also asked whether respondents knew anyone who had underpaid tax recently: in Paraguay, 41% said yes. A third question asked for an estimate of how many compatriots (expressed as a percentage) paid what they should: Paraguay again came bottom. There was also a question on corruption in state institutions, but not specifically about tax officials.

Tax questions in the AfroBarometer take a different angle. One is whether Parliament should “ensure that the President explains to the public how his government spends taxpayers' money”. Fewer than half of respondents in Mozambique said “yes”, compared to 75% in Mali in the 2008-9 survey. Another question is whether the tax department “always has the right to make people pay taxes”. Ghana stood out, with 85% saying it should. A third question is whether tax officials are corrupt. In Liberia 91% said “yes”, compared to 51% in Mozambique.

Although questions could be made more direct and compatible, these surveys provide a lens through which to view regional comparisons and country trends. They also yield microeconomic data that can be used to investigate how perceptions of state legitimacy affect attitudes towards taxation. A recent study for AfroBarometer, for example, found that the perception of fairness in state services was a significant factor in explaining readiness to pay tax in Africa (D'Arcy, 2011).

Both of these survey organisations benefit from donor funding, details of which can be found on their websites.

Source: Latinobarómetro (2010), AfroBarometer (2008), D'Arcy (2011).

2.2. Governance-driven and technical approaches to tax reform

Even in the present state of limited knowledge, insights from the literature, case study evidence, and practical experience point to many ways in which tax programmes can also address governance objectives. In this regard, a basic question is how the governance approach to tax reform should differ from the standard technical approach. According to Brautigam (2008), “a reform agenda focused on issues of state-building in the poorest countries would look substantially different” from the standard approach that is “driven by economic and fiscal considerations”. A comparison of the governance and technical literature on tax reform indeed reveals differences in emphasis or prioritisation. But it also points to many areas of synergy. Such synergies create avenues for donor support that entail no trade-offs or inconsistencies between the economic or financial objectives of taxation and its governance or state-building goals.

Points of synergy

Starting with **tax policy**, most reforms that undertake standard technical improvements also pay dividends for governance or state-building. Examples include:

- broadening the tax base and lowering tax rates;
- eliminating or scaling back tax concessions that benefit special interests;
- developing tax expenditure accounts to increase transparency in disclosing the cost of tax breaks;
- establishing simple, fair, presumptive taxes for micro and small enterprises that reduce barriers to formalisation;
- promoting accession to the Extractive Industries Transparency Initiative (EITI);
- developing government capacity for tax policy analysis;
- introducing legal and regulatory reforms to strengthen the statutory foundation for stemming cross-border tax leakages;
- strengthening local government revenue systems in ways that include simplified, more effective use of property taxes and license fees, especially in urban areas.

In the area of **tax administration**, nearly all of the standard technical priorities for tax reform simultaneously yield benefits for governance and state-building. Those priorities include:

- professionalising tax administration through remuneration reforms, merit-based human resource management, and technical and service training;
- strengthening government capacity for revenue forecasting and revenue monitoring;
- introducing more effective integrity and internal audit programmes to control corrupt and abusive practices;
- modernising information technology systems to improve operational efficiency and reduce the scope for discretionary interactions with taxpayers;
- organising tax operations along customer lines to improve customer services and collection efficiency;
- establishing systems for voluntary compliance;
- inculcating a service culture in the tax administration, taxpayer service centres, and service charters;
- making information on the tax system more accessible and conducting public information campaigns on taxpayer rights and responsibilities;
- reducing compliance costs through electronic filing and payments and the simplification of forms and procedures, especially for micro and small enterprises.
- strengthening procedures and institutions for tax appeals and the protection of taxpayer rights;
- improving support institutions such as business and property registries and tax appeals courts.

An outstanding example of how a technical approach to tax reform can and does benefit governance is the South African Revenue Service (SARS). In the mid-2000s it adopted a “theory of compliance”, that transformed it from being a heavy-handed, uninformative enforcement agency to one that is effectively implementing the service concept. The improvement in compliance told its own story.

Box 2.4. Improving compliance by improving services in South Africa

In the new, post-apartheid South Africa, the South African Revenue Service (SARS) realised its legacy approach was unsuitable and counterproductive. It implemented a series of technical measures that emphasised outreach and education, world-class service and enforcement, building them on the responsibility of taxpayers to contribute to the national development agenda. In 2005 SARS adopted a service charter (which it refined in 2009) which spelled out the service criteria that taxpayers could expect. It also embarked on a highly popular education campaign and expanded such communications channels as call centres and electronic services. In addition, SARS implemented a series of administrative reforms to simplify the tax system, reduce compliance costs, and automate business processes.

The results were dramatic. First, there was a huge improvement in public attitudes to SARS services and the importance of paying taxes. Second, collection efficiency was transformed. For example, the percentage of income tax returns filed electronically increased from less than 1% in 2006 to 95% in 2009, while the average time for processing assessments fell from around 50 days to less than two days. These improvements were also evident in the bottom line, as the ratio of revenue to GDP rose from 25.3% in 2004 to 29.4% in 2008. Significantly, SARS designed and implemented these far-reaching reforms itself, without donor assistance.

Source: Presentation by Joseph Rock from SARS to the OECD Tax and Development Task Force Subgroup on Taxation, State-building and Aid, 12 January 2011, Washington, DC. Revenue data from IMF (2010).

There are also significant ways in which the **governance perspective** complements the traditional technical agenda. One such way is by emphasising the importance of:

- conducting political economy assessments to gain a better understanding of the incentives for reform and the political constraints affecting the likelihood of effective, sustainable implementation;²
- fostering and institutionalising public-private dialogue on tax issues;³
- strengthening the capacity of civil society groups, business associations, and the media to engage constructively with the government on tax issues;
- strengthening fiduciary oversight institutions, *e.g.* parliamentary budget and finance committees and the supreme audit body.

But it is above all on the critical need for linking tax reforms with improvements in budget programming and public expenditure management that the technical and governance perspectives concur. Tax compliance is unquestionably influenced by public perceptions of whether the provision of public goods and services is delivering value for money. Besides, there is little point in supporting a stronger tax system in situations where revenues would be wasted or badly used. As a crude test of the proposition that taxation and governance are linked, the survey conducted for this study asked aid officials about the **practical** importance of fifteen possible links. At least one-half of the respondents rated eight options as “strong” or “substantial”: improved business registration; better public-private dialogue; tax IT modernisation as a model for other agencies; increased government accountability; greater government responsiveness; greater representation of civil society and business organisations; improved human resource management in the tax service as a model for other agencies; and improved property registration. In these interviews, though, respondents offered few concrete examples of first-hand experience of linkages.⁴

Points of divergence

In some other respects, the tax agenda in the governance literature does differ from the economic agenda – at least in emphasis. This section discusses one economic principle that is often neglected in governance discussions, namely taxation and growth. It then considers four governance-related questions that diverge from standard tenets of taxation questions – direct vs. indirect tax, taxation in the informal sector, tax net thresholds, tax earmarks – and formulates observations on how tax reforms that are badly planned can have negative effects on governance.

Taxation and growth

The 2010 *African Economic Outlook*, published by the OECD and African Development Bank, observes: “The most effective way of increasing public revenue is through policies that increase the tax base through sustained economic growth.” Thus, the primary benefit of a tax reform programme for resource mobilisation – and also for development – is likely to be its effect on investment, efficiency, and growth (Bird, 2010). Indeed, reform packages are sometimes designed with the aim of improving the economic efficiency of the tax system, while calibrating the measures to achieve (politically expedient) revenue neutrality. Examples include Zambia’s comprehensive tax reform programme in the early 1990s (Hill, 2004), and Jamaica’s well known reforms in the mid-1980s (Bahl, 1997). In such cases, the revenue yield should improve as the economy expands, but a stable tax ratio in the short to medium run is to be expected. This idea is often lost in the governance focus on increasing tax reliance and in the common donor practice of monitoring changes in the tax ratio as a primary indicator of domestic resource mobilisation. Box 2.5 provides a simple example to illustrate the point.

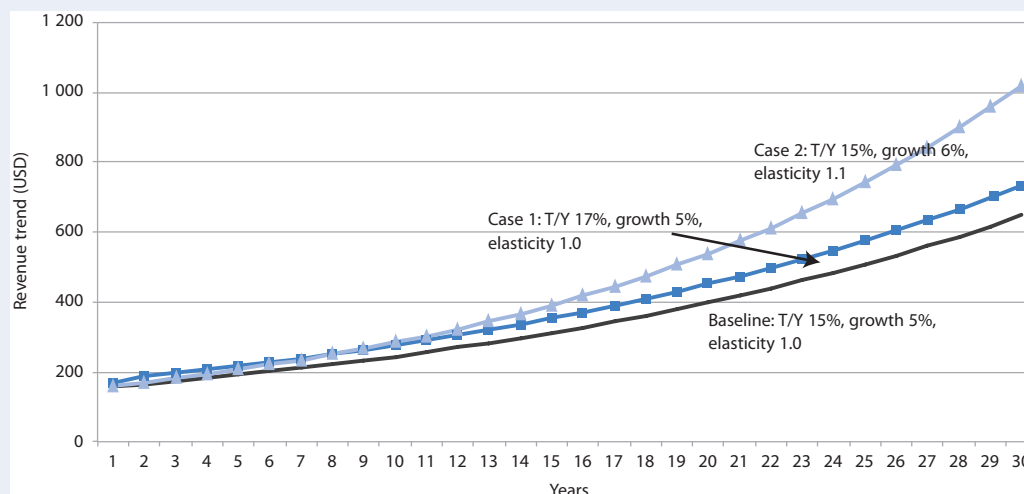
Box 2.5. The arithmetic of tax reform and economic growth

Donor programmes to improve tax systems often focus on boosting the ratio of tax revenue to GDP (T/Y), while also addressing equity concerns and, more recently, governance dividends from tax reform. Economists would add an emphasis on two dynamic considerations. First, the tax system can affect economic growth for better or for worse through its pervasive influence on efficiency, investment, and private sector development. Second, establishing an elastic tax structure will augment the revenue gains from economic growth.

Many tax reform measures afford the happy outcome of improving both the tax ratio and the environment for private sector development. Yet there is always a trade-off here, because governments have the option of spending potential revenue gains on tax cuts that would benefit the private sector. Indeed, major tax reforms often aim at revenue neutrality in the short run as a political tactic to marshal support for changes that are designed to spur economic growth and improve revenue dynamics.

A simple example illustrates the nature of the trade-off in a country with per capita income of USD 1 000, a tax ratio of 15%, and a trend growth rate of 5%. The figure below shows the 30-year trend in tax revenue for three scenarios. The bottom line is the “Baseline” scenario, with the growth rate and tax ratio unchanged over time. The tax elasticity here is 1.0, since T/Y is constant over time. The next line up (“Case 1”) shows the revenue trend resulting from measures that would increase the tax ratio to 17% over two years, with the growth rate remaining at 5% and tax elasticity still at 1.0.

Box 2.5. The arithmetic of tax reform and economic growth (continued)



The upper line (“Case 2”) shows a reform scenario in which revenue gains from a tax reform package are ploughed back into the economy as lower tax rates that succeed in promoting private sector development. For Case 2, the tax ratio stays at 15% but the tax reform boosts the growth rate to 6%, and the tax elasticity increases to 1.1 (meaning that revenues rise by 1.1% for each 1% increase in GDP). These illustrative dynamic effects are not implausible in situations where the initial tax system is highly inefficient.⁵

In the Baseline scenario, with no tax reform, economic growth boosts revenues by 332% over 30 years. In Case 1, revenues would grow by 390% over 30 years due to the higher tax ratio. In Case 2, revenue would expand 580% over the same period. In the short run, Case 1 yields the highest revenue, but the gain is tiny in absolute terms because GDP is tiny. Over the long term, revenue outcomes are determined mainly by the dynamic effects of the tax system, along with other policies to promote growth. Tax programmes therefore need to address seriously the effects on investment, efficiency, and tax elasticity.

Source: Author’s calculations. Model available upon request.

Direct versus indirect tax

A common governance prescription is that direct taxes on income and property are preferred to indirect taxes on transactions (such as VAT, import duties, and excise taxes) because they are more visible and, therefore, more effective in stimulating political engagement. From this perspective the predominance of indirect taxation in most low-income countries is an imbalance to be corrected. In contrast, the technical literature that focuses on collection efficiency and economic efficiency indicates a primary role for broad-based taxes, including VAT and income tax, supplemented by moderate trade taxes and selected excise. Given the technical and administrative complexity of taxing income, the prominence of indirect tax is entirely appropriate.

Prichard (2010, 312) argues that governance dividends stem not from direct tax as such, but from tax visibility. Indeed, many familiar examples of tax-driven political action involve indirect taxes, including the mass protests in Ghana over the introduction of VAT in 1994, as well as the historical case of the Boston Tea Party – a protest over taxes on tea in the pre-Independence United States. Furthermore, tax visibility can be addressed through public information, taxpayer education, and programmes to mobilise civil society and business groups around these issues. It goes without saying that the income tax and property tax are essential elements for an effective tax system and important targets for tax reform; the point here is simply that the governance dividend from tax visibility can be achieved without seeking to rebalance the tax system at the expense of efficiency.

Taxing the informal sector

There is wide agreement that the tax system should minimise barriers to business registration so as to encourage the formalisation of micro and small enterprises (MSEs).⁶ Barriers to formalisation impede growth because unregistered enterprises generally lack access to credit, contracts, and legal protection, and are more vulnerable to abusive so-called “unofficial” taxes. Leaving informal enterprises outside the tax net also creates a perception that the system is unfair, eroding compliance by those who are subject to tax. Competition from untaxed MSEs is a common complaint from formal-sector businesses.⁷ Another factor from the governance literature is the idea that “being taxed engages citizens in the political process”. (Moore, 2008) There are also claims that the revenue foregone from not taxing the informal sector “could amount to 35-55% of total tax revenues in some countries”. (Joshi and Ayee, 2008) These high figures, however, are not well substantiated.⁸ In practice, most efforts to tax very small enterprises in developing countries yield negligible revenue gains, relative to administrative costs.

Viewing these concerns through a governance lens, Everest-Phillips (2009) claims that taxing MSEs effectively is “the biggest challenge in state-building” – a statement that suggests that taxation of the informal sector should be a top priority in programming aid and in the policy dialogue. From both a technical and governance perspective, a more tempered response is appropriate. Terkper (2003) suggests a useful three-way classification: informal enterprises at the subsistence-level are not a major target for taxation; other small enterprises should be subject to a simple presumptive tax; and informal entities with higher incomes are outright tax evaders who should be targeted for vigorous enforcement.

Overall, a balanced approach has three components: first, an emphasis on tax education for MSEs; second establishment of a specialised office for servicing MSEs; and third, development of a simple, cost-effective tax system that encourages MSEs to register and participate in the revenue system. In any case, MSE taxation is unlikely to yield large revenue gains, as Box 2.6 shows in the case of Mozambique.

The issue of taxing the informal sector is a complex one. It can certainly benefit from further research on what has worked best in various conditions and how the costs compare to the revenue gains.

Thresholds for entering the tax net

Paralleling concern with taxing the informal sector, another prescription in the governance literature is the importance of setting a low threshold for entering the tax net to encourage the broadest possible participation in the tax system. Most tax experts, in contrast, advocate setting a threshold that is high enough to exclude those with very low

Box 2.6. Mozambique's simplified tax for small business⁹

On 1 January 2009, a new Simplified Tax for Small Taxpayers (*imposto simplificado para pequenos contribuintes* [ISPC]) came into effect in Mozambique. For the next six months, the Mozambique Revenue Authority (MRA), together with other agencies and private sector organisations, conducted a campaign to inform the public about the ISPC and their obligation to contribute to national development. The aim was to attract new taxpayers into the system by making formalisation less daunting for small enterprises. In June 2009, the Revenue Authority began implementing the ISPC and, by December 2010, the MRA reported (in an interview for this study) that 40 000 new enterprises had registered under the law.

The main features of the ISPC are as follows:

- Enterprises with a turnover of up to 36 times the highest minimum wage in force as of the previous year-end are exempt from tax.
- Enterprises with an annual turnover up to MZN 2.5 million (about USD 78 000 at the current exchange rate) may elect to register under the ISPC. Income subject to ISPC is exempt from VAT and income tax.
- The applicable tax rate is MZN 75 000 per year (about USD 2 300) or 3% of sales volume paid quarterly (taxpayers choose their option).
- For new businesses, the tax is reduced by half for the first year of operations as an enticement to register.

In essence, the ISPC consolidates separate simplified schemes that were already part of the VAT and income tax codes. It also provides a lower tax rate, much simpler procedures, and even simpler formats for official receipt books. In addition, the MRA is extending its geographic outreach by opening offices in new locations and launching mobile tax units, to make it easier for taxpayers to make payments and access services.

According to government sources, the budget programme does not anticipate significant revenues from the ISPC in the near term, and the revenue yield to date has been insignificant. The expectation, though, is that the ISPC will yield a growing stream of revenues over time as the newly formalised small enterprises grow.

Source: Bolnick and Byiers (2009).

incomes. This approach is motivated partly by the concern to minimise the tax burden on the poor in the interests of equity, but also by the pragmatic consideration of efficient revenue mobilisation. In countries with very limited capacity for tax administration, there is a high opportunity cost to allocating personnel and resources to the pursuit of vast numbers of tiny payments from very small taxpayers. The potential governance dividend from setting a low threshold would have to be large and well substantiated to outweigh factors of equity and efficiency.

Tax earmarks

Another point of divergence is the earmarking of revenues for specific uses. The OECD (2010) states that there is “a particularly strong case for using tax earmarking in developing countries” to strengthen the links between taxation and public spending. The strength of the case is attributable in part to the fact that earmarking helps to stabilise funding for priority needs (like road building). However, “more importantly from a governance

perspective”, it helps to build trust, improve monitoring of how taxes are used, and increase public engagement. The OECD document notes that tax earmarking “remains unpopular with fiscal experts”. The reason is that it either reduces flexibility in managing budget allocations or ends up as “political earmarking” with a designated revenue stream allotted to a particular use and no actual change in overall funding for that purpose.¹⁰ This type of political earmarking is anathema to governance and fiscal experts alike.

In the economics literature, user charges are standard textbook fare, justified on efficiency and equity grounds as a benefit tax. The typical example is the earmarking of fuel taxes for expenditure on roads and, more broadly, transportation services. In this context there are debates about whether the tax should be fully or partly earmarked. A more significant disagreement arises when earmarks are applied to general tax revenues or for tying a particular revenue stream to spending that cannot be justified as a user charge. An example given by the OECD (2010) is the decision in Ghana to earmark a mobile phone usage tax to a youth employment scheme. Although this was politically expedient, it is a questionable practice in budget programming. Moreover, in Ghanaian example, the earmark turned out to be more political than real. If the intent is to build trust and increase public engagement, instruments other than earmarking – such as direct public education campaigns to increase tax awareness – are more effective and efficient.

Anti-governance implications

Donor-supported (or donor-driven) tax reforms that are not carefully designed can have negative rather than positive implications for governance. The example that springs most easily to mind is a tax reform agenda with overly ambitious revenue targets that leads to the harassment of taxpayers on the ground – the antithesis of good governance. Several officials interviewed for this study cited an example from Tanzania, where revenue targets in the block management system led to neighbourhood sweeps that produced very little revenue and served mainly to dent trust in government.¹¹ A more frequent grievance, particularly in countries with weak tax administration, stems from the business community which complains about abusive collection practices from tax officers striving to achieve their revenue targets.¹²

Another adverse effect arises from unrealistic timeframes for tax reforms that involve deep organisational, institutional, or behavioural changes. A good example is the modernisation of tax IT systems. A former tax commissioner from Chile told the study team that even with his country’s strong capacity for managing change and dealing with technology, it took six years to implement an IT system. In most developing countries, even six years could be overly ambitious. Donor-funded tax-related IT programmes that seek to move too quickly can lead to inefficient, underused, or inadequately integrated systems, as well as to highly unsatisfactory re-engineering of business processes. Initial efforts to computerise the tax system in Zambia in the early 1990s were a case in point.¹³ Poor donor co-ordination can compound the problem by introducing incompatible systems – as occurred in Mozambique and Ghana. It leads to less effective state building than would be achieved with more patient or better co-ordinated reforms.

Birdsall (2010) lists both impatience with institution building and co-ordination failure among the “seven deadly sins” of foreign aid.¹⁴ Institutional needs to disburse funds and achieve short-term results often create what she calls “wilful naiveté” about the absorptive capacity of host-country institutions.

Another example is a familiar issue in the literature on aid effectiveness: reliance on external funding and the need to deal with donor procedures can compromise government

accountability to the public. Tax programmes are no exception. Transparency in the donor-government relationship and the participation of stakeholders in the policy dialogue and monitoring process can mitigate accountability concerns – a problem inherent to foreign aid (Lawson *et al.*, 2006). For tax programmes in particular, it is also important to ensure that stakeholders have access to adequate information on how intended reforms will affect revenue mobilisation, economic growth, and equity.

Finally, as support for the hypothesis that taxation stimulates public participation in fiscal bargaining, the literature on taxation and governance cites examples where tax measures have provoked a strong political reaction. Many cases, however, could just as well be interpreted as showing that political mobilisation results less from taxation as such than from poor governance of tax measures. To test the hypothesis that taxation enhances political engagement, it would also be useful to identify instances of well designed tax programmes having a positive effect on governance.

Recommendations for governance-driven and technical approaches to tax reform

Growing awareness of the governance dimensions of taxation has been an important stimulus to the international community's concerns over domestic resource mobilisation in developing countries and the effectiveness of aid in supporting tax systems. Although empirical evidence is still rather weak, there are ample examples to show that linkages between taxation and governance can indeed work. Indeed, despite areas of divergence, particularly in taxation and growth, there is a broad range of synergies between the standard technical agenda and the governance agenda for tax reform. They point to other findings that the international community might ponder:

- Taxation is a central pillar of governance and state capacity. The top priority for reaping governance dividends from the tax system is therefore to pursue programmes that improve effectiveness, efficiency, and equity in the tax system itself.
- Governance-focused aid programmes for strengthening tax systems should focus on areas of synergy between the standard technical agenda and the governance-oriented approach. Donors should tread more carefully, however, in supporting measures with possible governance benefits that come at the expense of economic or administrative efficiency in mobilising revenue.
- Tax programmes need to accord as much attention to their effects on private sector development and growth as they do to near-term changes in the tax ratio.
- Technical analysis of the agenda for tax reform should be accompanied by consideration of political incentives for reform: donors cannot “buy” sustainable improvements in the tax system if the government does not fully embrace the agenda.
- Donor support for fiscal development at the local level can foster an important link between revenue systems and governance.
- There is a need for further research into the relationship between taxation and governance. Fruitful areas may be: evidence of governance effects from well designed tax programmes; the experience of various countries in bringing micro and small enterprises into the tax net; and experience with the use of earmarking.
- Useful input for testing the relationship between taxation and governance would be more frequent widespread collection of evidence from surveys on taxpayer

perceptions of the quality of governance, attitudes towards tax compliance, and views on the quality of tax services.

- More systematic and transparent data is also needed on key indicators of administrative efficiency and compliance costs to monitor improvements in the tax system as a pillar of good governance.
- In providing support for tax systems, donors have an obligation to ensure that their support does not impair the host government's accountability to its own citizens on tax issues. This requires building a high degree of transparency into tax programmes and bringing all stakeholders into the dialogue on tax issues.
- Effective stakeholder involvement in the tax reform process calls for adequate public information about the effects of intended reforms for revenue mobilisation, economic growth, and equity.
- It would be useful to establish standards for tax expenditure accounting, which might then be incorporated into donor programmes to support tax systems.

According to unpublished OECD data, less than 0.1% of official development assistance was allocated to identifiable tax activities in 2009.¹⁵ This figure is at odds with the level of international interest in domestic revenue mobilisation and the linkages between taxation and governance, as recently expressed in the EC Communication on Tax and Development (EC, 2010) and the G20 Seoul Summit Agenda for Action (G20, 2010). The time is now right for donors to scale up support for tax reforms and tax modernisation programmes in host countries where tax systems are seriously underdeveloped. To that end, they can use a variety of modalities, which the next chapter examines one by one.

Notes

1. The IMF (2011) points out that the combined impact of the tax system and the government expenditure program is what matters for equity and poverty relief. Nonetheless, an equitable tax system imposes a minimal burden on the poor and ensures that everyone pays their “fair share”.
2. One approach would be a tax-focused adaptation of the Drivers of Change analysis that DFID developed for assessing the political economy of programs for poverty reduction (DFID, 2003).
3. This is a specialty of the Tax Justice Network, an international NGO. See: www.taxjustice.net.
4. Annex C presents further information on the survey findings.
5. Although there is no systematic econometric evidence showing that tax reforms promote growth, investment climate surveys commonly cite tax issues as a leading impediment to private sector development. Furthermore, tax reform programmes are commonly designed with effects on economic efficiency in mind: cases in point include the global trend towards lower marginal tax rates, replacement of single-stage sales taxes with VAT, and reduced reliance on trade taxes.
6. IFC Global Tax Simplification program. International Tax Dialogue Global Conference on Taxation of SMEs, Oct 2007; available at <http://www.itdweb.org/smeconference/Presentations.aspx>.

7. In the World Bank's 2009 Investment Climate Assessment for Mozambique (World Bank, 2009, 13), businesses rated competition from the informal sector as the number one obstacle to growth.
8. The claim about large revenue losses cites Terkper (2003) as the source. Terkper actually says that the underground economy may be 35-55% of GDP in some countries, according to various estimates (which involve problematic methodologies), not that the revenue loss is this large.
9. This box draws heavily on the analysis in Chapter 3 of Bolnick and Byiers (2009).
10. Another concern, raised by some tax officials, is that efforts to "sell" tax payments as a quid pro quo for particular services might have the unintended effect of reducing compliance on general revenue collection.
11. In contrast, Fjeldstad and Heggstad (2011, 40) highlight the Block Management System in Tanzania as being "highly potent for widening the tax base by capturing new taxpayers and evaders." They also acknowledge, though, that there have been problems in implementation.
12. For example, Bolnick (2004) for Mozambique.
13. Sourced from direct observations by the author, as tax advisor in Zambia from 1991 to 1994.
14. The other five "sins" according to Birdsall are failure to evaluate; failure to exit; mistaking participation for ownership; unreliable and stingy funding; and underfunding global and regional public goods.
15. Data provided to the OECD Tax and Development Task Force Subgroup on Taxation, State-building and Aid, January 12, 2011.

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Chapter 3

Aid Modalities for Supporting Tax Systems

The previous chapter considered the thinking behind aid modalities to strengthen tax systems and tax-governance linkages and the approaches that inform their implementation. The focus in this chapter is narrower and more technical: it examines seven individual modalities and assesses how fit they are for purpose. Six are funding modalities: general and sector budget support; basket financing; joint approaches; stand-alone bilateral interventions; and funding for South-South regional programmes. The chapter also discusses a technical assistance modality: in-kind support. Helpfully, it prefaces each assessment with a definition. It then goes on to conclude that each modality makes its own valuable contribution to stronger, fairer tax systems and tighter tax-governance links – as part of a mix that meets host countries' preferences and particular needs.

Although this chapter defines and assesses seven modalities against the Paris principle benchmarks of ownership, alignment, harmonisation, managing for results, and mutual accountability, its prime objective lies elsewhere. It seeks to assess the applicability of each modality to the support of tax systems and to recommend ways they may enhance the effectiveness of aid. Not surprisingly, the basic requirements in the area of taxation echo familiar observations about aid effectiveness in general. The analysis does, however, lead to numerous recommendations that pertain specifically to tax systems.

3.1. General budget support

The OECD/DAC defines general budget support (GBS) as:

“[A] method of financing a partner country’s budget through a transfer of resources from an external financing agency to a partner government’s national treasury. The funds thus transferred are managed in accordance with the recipient’s budget procedures.” (OECD, 2006a)

The EC (2007a), for its part, adds the provision that funds should be transferred after “agreed conditions for payment have been respected”. It also states that GBS should be “accompanied by dialogue on the overall policy and strategy, and on the functioning of public financial management”, through processes that are harmonised with other donors and aligned with government systems. The dialogue and co-ordination process typically centres on a joint policy assessment framework (PAF) that defines programmatic goals, indicators, targets, and triggers for disbursement.

GBS programmes are designed to conform as closely as possible with the Paris principles: they create a unified framework for multiple donors to provide unrestricted financing that is fully aligned with host governments’ priorities and systems through a joint mechanism for accountability and managing for results. Other strengths of the GBS framework are that it incorporates high-level policy dialogues that can address cross-cutting concerns; brings aid funds transparently into the budget; makes line ministries more accountable to the host country’s budget office for accessing aid funds; and finances recurrent expenditures that are often neglected in aid projects. For these reasons, most host governments regard GBS as a preferred aid modality.

In practice, the degree of conformity to the Paris principles varies from case to case. The issues involved are well known (Koeberle *et al.* 2006; OECD, 2006b; EC, 2007b; IDD and Associates, 2006; SPA, 2009). On ownership, for example, the PAF in some countries is based squarely on the government’s poverty reduction strategy (PRS), while in other cases it is based on donor priorities with government consent rather than leadership.¹ And while GBS is fully aligned with host-country budget processes and priorities (because the funds are merged into the treasury’s account), alignment with the budget cycle is frequently weakened by disbursement delays.²

Harmonisation, especially, tends to be far from ideal. Even within a GBS framework, donor agencies are still bound by their own laws and procedures and accountable to their own taxpayers for due diligence. In many countries the GBS process also involves an elaborate matrix of groups and subgroups and high transaction costs (see the Tanzania, Mozambique, and Mali case studies in Chapter 5). These costs ought to be monitored more systematically and transparently. Finally, the advantage of GBS in managing for results and accountability is often diluted by an overload of objectives and targets and, in many cases, a high degree of forbearance when triggers are missed. Indeed, a common theme in the aid

effectiveness literature is that the principles of alignment and predictability are not always compatible with the principle of accountability for results.

Other questions that have been raised with regard to GBS include “the quality, value for money and impact” of budget support (EC, 2010a); fiduciary risks; the effectiveness of policy dialogue; the tendency for disruptive “on-and-off” funding (as recently encountered in Mozambique, Tanzania and Malawi); macroeconomic problems from the sterilisation of foreign exchange inflows from GBS; and potential disincentives for domestic resource mobilisation and domestic accountability (as discussed in the next section, on “GBS and Taxation”).

A joint evaluation study in 2006, commissioned by two dozen aid agencies, concluded that GBS generally produced favourable results and that the process has been improving in most countries. The study also cautioned, however, that improvements “should not be exaggerated,” that results differed by country depending on “underlying political realities”, and that GBS in most contexts does not replace the need for other technical assistance modalities (IDD and Associates, 2006). These conclusions remain fully valid today.

General budget support and taxation

Partnership GBS programmes come complete with high-level policy reviews that can be used to prioritise dialogue on tax issues. In addition, by virtue of its breadth of coverage, the GBS framework is especially well suited to addressing the full scope of interactions between taxation and governance, which includes the development of supporting institutions outside of finance ministries and revenue authorities – if donors deem it as a priority. As a joint framework for monitoring and dialogue, GBS allows a wide range of donors to come together to review reforms to tax policy and administration and related governance issues at minimal transaction cost.

Because it monitors and enables dialogue on revenue performance, the GBS framework often sheds light on discrepancies between tax outcomes and targets, so giving recipient governments the incentive to achieve results on tax reform and collection efficiency. In addition to the incentivising effects of the dialogue, GBS programmes can influence the development of the tax system and complementary institutional reforms through three additional channels: variable tranche mechanisms; links to IMF conditionality; and budgetary effects.

The evidence reviewed for this study suggests that GBS programmes have made only limited use of variable tranche mechanisms to create incentives for revenue mobilisation. The example of Afghanistan is a notable and surprising exception, as Box 3.1 illustrates. Donors may wish to consider applying variable tranche funding more frequently to carefully defined taxation targets. Such targets could include tax collection performance indicators, benchmarks for policy reform, specific improvements in tax administration, or measures involving governance dividends such as the publication of tax expenditure accounts or improvements in parliamentary oversight of the revenue system (see Chapter 4 for a discussion of tax indicators). Performance tranches may be most effective where donors adopt a harmonised approach rather than imposing numerous separate conditions. Here, too, Afghanistan is an excellent example. Whatever the incentive arrangement, success hinges on local ownership: trigger conditions cannot buy lasting improvements in tax performance if the government is not committed to the reforms.

Budget support can also make the revenue targets designated by the IMF as structural benchmarks or performance criteria much more meaningful. Many aid agencies predicate

GBS funding on compliance with IMF programmes, as they did in Mali (Chapter 5). This process has some flexibility in that the IMF regularly approves waivers when there is justification for a lapse in performance – when a revenue gap is caused by an unanticipated change in economic conditions, for example. By the same token, the severity of this sanction, which can be highly disruptive for budget implementation, may put pressure on the IMF to err on the side of issuing waivers. Either way, the host country may face serious risks when GBS funding is closely and rigidly tied to the IMF programme. As widely recognised, more flexible arrangements are needed to avoid on-off funding. Afghanistan is again an interesting case in this respect. Another possible solution is to introduce a delay

Box 3.1. The GBS performance matrix in Afghanistan

The Afghanistan Reconstruction Trust Fund (ARTF) was established in 2002 as a co-ordinated international response to a firm request from the Afghan government for a single source of untied aid. It is administered by the World Bank. As of December 2010, 16 donor agencies took part in the quarterly review process. From the outset, the ARTF has included a recurrent cost window for budget support and an investment window for financing development projects (ScanTeam, 2005).

Back in 2003, Afghanistan's public finance management systems were dysfunctional with the tax ratio under 3% of estimated GDP. The ARTF has had a consistent focus on PFM reform and compliance with (pragmatic) fiduciary standards. Even today, however, the Afghan government is certainly not a paragon of expenditure management virtue.

In July, 2009, ARTF donors and the government established a new incentive programme that will account for a steadily rising share of the recurrent cost window. The programme has two parts: a matching grant tied to revenue performance; and a structural reform scheme (ARTF, July 2009). The matching grant is a variable tranche of budget support linked by formula to revenue collections as a percentage of the IMF programme target and – an important technicality – adjusted for within-year revisions to the IMF target.

The structural reform fund is divided between three “themes”: enhancing domestic revenue generation; improving public sector governance; and enabling private sector development. For each theme, Afghanistan must meet three benchmarks to trigger disbursement. For the revenue theme, they involve specific and verifiable actions relating to customs reforms, revenue transparency, and tax compliance. For example, the customs conditions for 2010-11 involve submitting quarterly reports on a set of performance indicators and rolling out ASYCUDA, the automated system for customs data, to one new customs post.

Revenues have consistently exceeded programme targets since the incentive programme took effect. After languishing between 6% and 7% of GDP for previous four years, revenues reached 8.9% of GDP in 2009-10. Estimates presented at the donor review meeting in December 2010 indicate that collections are expected to reach between 9.3% and 9.5% of GDP in 2010-11.

The donor review attributed the revenue gain to the success of the large and medium taxpayer offices, as well as to more efficient sales tax, income tax and customs collection (World Bank and Islamic Republic of Afghanistan, 2010). Several aid agencies have provided direct support for the structural reforms to enhance revenue performance. As early as 2004, USAID assisted the Ministry of Finance in drafting a new customs law and convening the first public conference on tax issues. USAID has been providing bilateral support with revenue elements since that time. The UK Department for International Development (DFID) is currently running a large project to strengthen tax administration. Additional support has come from other donors, who include the World Bank and the IMF.

Source: ARTF, ScanTeam, World Bank and Islamic Republic of Afghanistan, USAID and interviews for this study.

mechanism for any funding cut-off following a negative IMF review in order to give the host government room for remedial action or an orderly fiscal adjustment.

In countries where tax reform has strong political backing, as in Mozambique (see Chapter 5), budget support may also “buy” improvements in the tax system through the budget itself. However, the extent to which a recipient government really does so depends on the portion of the untied GBS it allots to increased funding for tax administration and tax modernization. It would be useful for GBS donors to monitor and report more systematically on such allocations in order to gauge how positive their budget effect is.

As noted above, one concern with GBS is that unconditional transfers may weaken the incentives for domestic revenue mobilisation and accountability, just as natural resource income may substitute taxation and tax bargaining. One thorough evaluation of GBS “found no obvious diminution of overall tax effort that could be attributed to PGBS [partnership general budget support]” in countries “where revenue-strengthening measures are pursued in parallel with PGBS”. (IDD and Associates, 2006).³ This suggests, however, that adverse effects could arise in the absence of revenue-strengthening measures. That being said, it is difficult to generalise from the IDD finding, which is based on five cases and, as a possible counter-example, research for the present study found some indication that GBS may have diluted incentives for domestic resource mobilisation in Mali.⁴ What is important, though, is that the best safeguard against an adverse incentive effect is to increase support through other modalities that strengthen host-country tax systems and accountability mechanisms and to ensure that revenue issues are a priority in GBS policy discussions.

The incentive effect of high-level dialogue on tax performance may be much weaker in practice than in theory because a GBS review covers a broad set of objectives, ranging from social services to human rights and public finance management. When the policy agenda covers so many issues, lapses in tax performance may result in minimal further consequences. Evidence from interviews and case studies suggests that funding is often unaffected by missed targets – except where there is stark mismanagement, violation of fundamental partnership conditions, or revenue targets for a variable tranche. This forbearance may reflect a laudable intention to avoid hard-edged conditionality or it may stem from pressures for disbursement. Either way, to strengthen the incentive effect of the GBS dialogue on taxation, donors would have to apply sanctions more seriously when faced with lapses in revenue performance. At the very least, they would have to elevate tax issues to top priority in the policy dialogue, especially in countries where aid dependency is high.

The choice of indicators for monitoring revenue performance is a critical issue that is discussed in Chapter 4.5, “Revenue-Related Indicators”. Here, it is important to note that revenue issues are often represented in a policy assessment framework by just one indicator: the ratio of tax revenue to GDP.⁵ Although it may seem an obvious indicator for assessing revenue results, it is not a good performance gauge, as changes in the tax ratio are often caused by factors beyond the government’s control. To determine the reasons for changes in the tax ratio, partnership GBS programmes should establish a regular process for analysing revenue outcomes, not just for monitoring the tax ratio.

Furthermore, aid agencies should be concerned not only with tax collection, but with the quality of tax services, government accountability on tax issues, and broader institutional reforms in support of more effective and responsive taxation. Given its broad coverage, the GBS framework should be parsimonious in the number of indicators chosen for any given sector. If donors regard revenue issues as a high priority, there should be room in the PAF for one or two structural or operational tax indicators in addition to a

revenue outcome measure. However, sector or basket programmes lend themselves more readily than GBS to the specification and monitoring of detailed revenue performance indicators.

Given this mix of pros and cons in using GBS to support tax systems, it is not surprising that the interviews conducted for this study revealed a variety of opinions. Some aid officials gave high marks to GBS because of its conformity to the Paris principles, the efficiency of its joint framework, and the benefits of high-level policy dialogue. Others expressed deep reservations about just how useful GBS is for improving taxation. The main problems cited were, first, that revenue issues are a minor consideration in the multi-sector policy review and, second, that the link between dialogue and action is often weak or missing. Some officials also expressed concerns about financial integrity, attribution, and the link between GBS funding and results – in short: “What do we get for our aid?” There appears, then, to be a tendency among aid agencies to favour more use of “disbursement against results”.

Recommendations for general budget support

General budget support is an excellent modality for improving aid effectiveness in countries where conditions of governance and public finance management warrant direct transfers to the host finance ministry. GBS is also the best available tool for engaging multiple donors in high-level dialogues with host governments on a broad range of such tax-related issues as reforms covering PFM, state audits, the judiciary, and other linkages to governance. Nonetheless, the GBS framework, as practiced in many countries, has been less effective than it might be in buying progress in tax reform and domestic revenue mobilisation. The main reason is that donors also focus on other priorities and performance lapses may not be addressed.

Many of the options for improving GBS as an aid modality are not specific to taxation. These include better harmonisation of donor procedures and requirements; closer alignment of programme targets to host-government priorities; a streamlined process for joint programming and reviewing; more predictable disbursements; better developed measures to monitor GBS transaction costs; greater transparency in GBS programme targets and performance results; and more flexible funding arrangements to provide a graduated response to lapses in key performance indicators. OECD/DAC and the EC have covered these issues well in their guidance on budget support, as have other literature on aid effectiveness.

Looking specifically at the applicability of GBS for supporting tax systems, the analysis suggests the following recommendations for consideration:

- GBS donors should make tax issues a top priority for policy discussion, especially in host countries where aid dependency is high.
- Donors should expand the use of disbursement against results by applying variable tranches to well defined revenue objectives within their GBS agreements.
- To minimise the risk that budget support may create a disincentive for revenue mobilisation, donors should increase direct support for strengthening the tax system through other modalities.
- Donors might structure variable tranche revenue triggers to provide a grace period for corrective action.
- The GBS policy assessment framework should not focus only on the tax ratio as a results indicator, but also on structural and operational tax reform indicators.

- GBS donors should explicitly set forth governance concerns in the policy dialogue on taxation. They could strengthen this focus by requesting reports – as part of the policy review – from the government or an independent civil society group on specific tax-related governance issues.
- In monitoring tax performance, donors and the host government should establish a regular procedure for analysing revenue trends and explaining shortfalls relative to programme targets.
- GBS donors should monitor budget allocations to tax administration and tax modernisation.

3.2. Sector budget support

The OECD’s Development Assistance Committee proposes no definition of sector budget support (SBS) in its guidelines on harmonising donor practices (OECD, 2006b). Instead, it presents the concept of “sector development programme” (SDP), which is “a single comprehensive programme and budget framework” incorporating and co-ordinating government and donor resources in support of a joint sector strategy. The OECD emphasises that aid agencies can participate in an SDP through budget support, basket funding, or projects. From that perspective, SDP is not a separate funding modality.

In contrast, the EC’s general budget support guidelines do treat SBS as a distinct modality, defining it as “a transfer to the national treasury in support of a sector programme, policy and strategy”. (EC, 2007a) The EC explains that “there is no procedural distinction between GBS and SBS”, although their objectives do differ in that SBS supports a sector strategy and GBS a national development strategy.

Since procedures for SBS are the same as for GBS, most of the points discussed in the previous section apply equally here. In particular, SBS conforms closely to the Paris principles for aid effectiveness, although the degree of adherence varies from case to case, depending on donor practices and host-government capacity. One structural difference is that SBS adds a layer to the requirements for aid co-ordination and management because it applies to particular sectors – health, education, agriculture, and roads, for example – as well as PFM. While GBS says, “we will write a large cheque as long as you demonstrate satisfactory overall performance”, SBS says, “we will write several smaller checks based on performance sector by sector”. Nonetheless, SBS is still a major improvement over fragmented bilateral arrangements.

Sector budget support and taxation

Revenue issues usually fall under PFM sector programmes, along with reforms affecting other finance ministry functions such as budget programming, budget execution, electronic financial management systems, debt management, aid management, procurement systems and, in some cases, local government public finance systems. In countries where GBS and SBS programmes both involve revenue elements, it should be essential, standard practice to harmonise the two modalities. Co-ordination can be difficult, however, and there is considerable scope for improving the harmonisation of procedures and requirements.

One distinct advantage of SBS programmes is that they link **funding** directly to aspects of PFM performance that include tax components of the sector programme. Compared to GBS, the SBS modality may offer a greater incentive to take action and account for results in the area of taxation. In addition, by providing budget support at finance ministry level,

donors can readily address connections between taxation, budget programming, budget transparency, and financial management. The importance of this feature, as emphasised in Chapter 2, is that tax reforms are likely to deliver better results if taxpayers see that the complementary PFM reforms are giving them value for money. It is more difficult to deal with these linkages through a direct arrangement with the revenue authority than with a tax basket (see Section 3.3, “Basket Financing”).

In another respect, however, the breadth of an SBS programme at the level of public finance management can be a disadvantage compared to a tax basket. Depending on the priorities of the finance ministry, a focus on expenditure-side reforms might dilute attention to tax matters in the sector policy dialogue. The incentive effects for strengthening tax performance would be further diluted if donors showed the same forbearance in SBS as they often do with GBS. Again, there is a tension between alignment and accountability. And again, the use of variable tranches tied to meaningful revenue indicators is a promising approach for strengthening performance incentives and disbursing against results – without reverting to stringent conditionality.

A novel type of variable tranche that might be used with an SBS arrangement is the cash-on-delivery (COD) approach proposed by researchers at the Center for Global Development. They use aid for education as an example in their proposal. However, donors could also adapt COD to create incentives for implementing revenue measures or further strengthening tax-governance linkages (Box 3.2).

Host-government ownership is the main determinant of success in achieving revenue-side objectives within an SBS programme. Ownership, however, is sometimes a slippery concept, with some officials strongly favouring tax reforms and others being either tepid or opposed to them.⁶ Under these conditions, variable tranche sanctions for revenue performance can strengthen the hand of those who support tax reforms. Transparency in the tax components of an SBS partnership and the engagement of civil society in discussions on the sector programme can also enhance incentives for reform.

Generally speaking, there is a need for careful diagnostic analysis to link the SBS framework to host countries’ strategic objectives for revenue reform. The Public Expenditure and Financial Accountability (PEFA) framework is the most widely used diagnostic tool for assessing PFM performance. It is weak, however, on the revenue side of the budget (see Box 4.1 in Chapter 4).

Finally, it may be noted that SBS funding which incorporates tax provisions may not result in additional funding for revenue activities. This is not an issue of fungibility because budget support, by definition, does not earmark funds for any particular purpose. It is simply that a government might choose not to allocate any of the SBS funds to revenue administration or investment in tax modernisation. There have been cases where donors have tried to use “notional earmarks” to establish an expectation about allocating government budget funds to particular uses. Such an approach, however, is inconsistent with the concept of budget support. If donors want to ensure that their funds are allocated to tax programmes, they may prefer to use such modalities as the basket approach (in which case fungibility does become an issue).

Recommendations for sector budget support

In countries where governance conditions warrant direct transfers to the host treasury, the quality of public finance management is a central concern. A PFM sector programme is therefore a standard component of any budget support arrangement. As the OECD (2006c)

Box 3.2. Cash-on-delivery aid

Researchers at the Center for Global Development (CGD) recently proposed “a new approach to foreign aid” called cash on delivery (COD). There are five core features to COD aid (Birdsall and Savedoff, 2010):

1. Donors negotiate a contract with the host government stipulating fixed payment or payments for achieving a set amount of measurable, verifiable progress towards an agreed outcome.
2. The host government is fully responsible for the achieving the outcome and free to decide how to go about it. Donors do not monitor or intervene in any way.
3. Donors make the payment only when a third party has independently verified that agreed outcome has been achieved.
4. Full transparency is required and contract, its objectives, its terms of agreement, and the results of the independent verification are all publicly disseminated.
5. COD funding could well complement other aid modalities, offering incentives to achieve specific results without reducing other aid flows.

COD aid differs from variable tranches for budget support in that the contract has no disbursement deadline: payment is made once the outcome is delivered. Another difference is the requirement for independent verification. COD aid is also flexible enough to accommodate any number of participating agencies, including non-government organisations.

Can COD aid be applied to revenue issues? As with any trigger mechanism, the trick is to identify practical and meaningful indicators. For example COD payments might be linked to the introduction and usage of electronic tax filing; payments through the banking system; publication of audited “tax expenditure” accounts; verified monthly reports on processing times for customs clearance, VAT refunds, and tax appeals; or the publication of independent surveys on taxpayer perceptions of service quality and corruption in the tax system. In each of these instances, COD aid would target actions that were effectively under the control of the tax authorities and could yield potentially valuable dividends for governance or state-building.

Another intriguing option would be to merge COD aid with recent work on the “tournament approach” for improving aid effectiveness (Zinnes, 2009). The idea here is to use a COD mechanism to run a competition among sub-national jurisdictions – or even countries – to achieve well defined, measurable, and verifiable outcomes. A specified payment could be made to each jurisdiction that meets the COD conditions, or funding could reward the entities that win the race to the top.

Source: Center for Global Development, Birdsall and Savedoff (2010), and Zinnes (2009).

indicates, PFM programmes can be pursued through any modality with SBS as one option. The special role of SBS is to link budget transfers to PFM performance, which includes the performance of its tax components. SBS is also an effective modality for co-ordinating donor involvement in revenue reforms with wider budget governance reform. The following recommendations may help donors make SBS a more effective modality for supporting tax systems:

- Ensure coherence between the revenue objectives and strategies for GBS and SBS and co-ordination between donors involved at both levels.

- Include a strong focus on revenue components in the PFM programme, using indicators that cover structural reforms as well as operational efficiency, customer services, and revenue outcomes.
- Incorporate variable tranches linked to revenue performance or tax reform more frequently into SBS programmes for PFM.
- Experiment with using the COD approach in sector budget support to create special incentives for implementing tax reforms, improving tax administration performance, and strengthening linkages to governance.
- Develop an appropriate diagnostic tool for assessing reform priorities in the revenue system, while paying due regard to political incentives (see Chapter 2.1).
- To strengthen political incentives for tax reform and domestic accountability, ensure transparency in the revenue components of SBS programmes and include public information strategies on taxation as a standard element of the programme.
- Monitor host-government budget allocations to revenue administration and undertake a study to determine the relationship between these budget allocations and SBS funding for the tax system.

3.3. Basket financing

Although the term “basket financing” is widely used, neither OECD/DAC or the EC supply official definitions in their online glossaries of aid terminology. One DAC document describes the modality simply as “a compromise between pure budget support and donor desires for tracking and audit of their funds”. (OECD, 2006a) A USAID note on implementing mechanisms also offers a definition consistent with current usage. It states that the basket modality (also called a “common fund”) entails multi-donor pooled funding that goes not to the host government’s general budget, but to a segregated account or sub-account for designated purposes (USAID, 2008).

As a multi-donor partnership with a government, basket funding closely matches Paris principles for aid effectiveness: it entails a single action plan and an agreement on joint planning, funding, implementation, and monitoring. Compared to GBS or SBS, however, basket financing is less tightly aligned with host countries’ systems and priorities because the funds are deposited in a separate account and earmarked for particular uses. In Mozambique, for example, the tax basket arrangement not only earmarks the funds for use by the Mozambique Revenue Authority (MRA), but requires an agreement on the programme budget for use of the basket funds (see Chapter 5). Although the mechanism is somewhat restrictive, one important advantage is that it helps track and audit funds by creating a “paper trail” that can help to mitigate donor concerns.

Basket financing clearly reduces the fragmentation of numerous bilateral projects. At the same time, it gives rise to greater fragmentation than GBS or SBS because each basket has its own separate agreements and procedures. Basket arrangements also require co-ordination at three levels: between the basket group and the host agency; between donors within the basket group; and between the basket group and higher level SBS and GBS arrangements. For co-ordination to work well, a basket programme has to be well aligned with the recipient’s strategic objectives and plans and harmonised with the overall sector programme and GBS framework. Management of these relationships can involve substantial transaction costs, particularly for the donors.

Basket financing to support the tax system

Basket financing is a relatively new modality for supporting tax systems, and experience is rather limited. Prominent examples, such as the tax baskets in Uganda (Box 3.3) and Mozambique (Chapter 5), show that the arrangement is well suited to co-ordinating multi-donor funding for tax programmes, minimising duplication of effort, and aligning donor support with the recipient's tax reform strategy. In addition, the basket modality is typically a partnership with the host country's revenue body, which is directly responsible for developing strategies and implementing plans to modernise tax administration.

Altogether, the basket arrangement is more suitable than SBS and GBS in addressing “nitty gritty” tax issues and fostering a dialogue on the implementation of administrative reforms, change management, and internal governance within the revenue organisations. On these grounds, most of the aid officials interviewed for this study had very favourable views on basket funding. They saw it as a model modality to use in cases where at least three donors are interested in supporting a common tax programme.

It is less well suited, though, to dealing with policy reforms or supporting institutional reforms outside the realm of the revenue authority. One response might be to make a tax basket available to the finance ministry in order to incorporate – in addition to tax administration measures – policy reforms, capacity building for tax analysis, and revenue elements of the fiscal programme. Still, an arrangement with the finance ministry would require close collaboration with the revenue authorities on tax administration components, where success depends on a combination of technical ownership, leadership and political support.

But whether donors structure a tax basket at agency or ministry level, it is essential they ensure that the programme is coherent with revenue elements of the government's sector programme and the overall GBS framework. And if donors wish to earmark funds to an overall PFM sector programme and have an audit trail, they may use the basket modality

Box 3.3. The basket approach to support the Uganda Revenue Authority

The Uganda Revenue Authority (URA) was established in 1991 as an innovative instrument to rehabilitate a tax system in a state of collapse. With sustained support from DFID and the IMF, Uganda succeeded in boosting the revenue ratio from 6.5% of GDP in 1990 to 12.2% in 1996.⁷ Then revenue performance hit a plateau. In 2006, the URA adopted a five-year modernisation plan to make tax and customs collection more effective and efficient and improve compliance. DFID, the Netherlands, and Belgium supported the plan through a basket fund. The URA is now (early 2011) discussing a new basket arrangement to support reforms for 2011-15.⁸ The agenda is moving from the introduction of new business processes to their consolidation and full use.

Has the basket approach been effective in Uganda? A recent assessment of the 2006-10 programme⁹ (Adam Smith International, 2010) believes it has delivered significant improvements, including a reduction in URA costs from 2.89% to 2.35% of gross revenue. But its effectiveness has been disappointing: as of 2009, the revenue ratio was still just 12.5% (IMF, 2010a). In explaining the reforms' low return on investment, the assessment cites factors outside the URA's control – e.g. tariff reductions required by the East African Community harmonisation process – and the need to improve in four key internal areas: (i) stronger ownership in planning and managing the reform process; (ii) better sequencing of the reforms; (iii) more attention to support functions like procurement and human resources; (iv) the basic challenge of implementing the reform plan while allowing flexibility. Some observers have also pointed to a lack of high-level political backing.

Box 3.3. The basket approach to support the Uganda Revenue Authority (continued)

What can be said, then, about the appropriateness of the basket modality? Discussions on the next phase of reform led to the following conclusions:

- The URA clearly prefers the joint basket approach to multiple individual projects because it simplifies co-ordination; supports a comprehensive, integrated approach; lowers transaction costs; facilitates ownership; and entails more of a hands-off role for the development partners.
- The tax basket approach in Uganda is highly harmonised and almost fully aligned as it has one reform plan, one implementation programme, one monitoring and reporting mechanism, and one financing mechanism (the basket itself).
- But it is a challenge for the URA to align all development partners under the umbrella of one plan and one governance structure. Other bilateral partners outside the basket have continued with small projects, causing coherence and co-ordination to suffer.
- The governance structure within the URA for implementing and monitoring reforms was weak. Strong ownership by URA management and greater involvement from development partners within the governance structure are needed to make the basket approach a success.
- Engagement of a long-term adviser (contracted by international tender) was extremely useful in supporting implementation through the first phase of reform.

Source: Adam Smith International (2010) and interviews conducted for this study.

instead of an SBS arrangement. As with SBS, a basket for public finance management at this level could help coordinate linkages between revenue reforms and public expenditure management reforms.

Tax-related challenges of the basket modality

The Uganda example shows that even with a high degree of harmonisation and alignment under a tax basket, there is no guarantee of significant improvements in revenue performance. This might simply reflect the fact that major institutional changes take time, and that setbacks and delays are to be expected in development programmes. But it can also signal an absence of high-level political support, inadequate programme design, or ineffectual change management. These considerations suggest that it would be useful for basket agreements to include an exit option should aid recipients show a lack of commitment (see Chapter 4.7., “Aid Exit Strategies”).

Although local officials have intimate knowledge of their own tax systems, they often lack the breadth of experience to identify, design, and introduce appropriate new systems and procedures consistent with successful international practices. So, to identify strategic priorities that can really make a difference, donors should build basket programmes on careful diagnostic analyses of technical deficiencies, capacity constraints, and institutional systems, while according due regard to political incentives. IMF missions often conduct this type of analysis at the request of host governments, although individual basket participants do sometimes carry out separate studies. Whoever performs the diagnostic, though, a key concern is to co-ordinate them in order to minimise fragmentation and avoid potentially conflicting approaches.

In working to define a tax basket programme, donors and developing countries should seek to include components that also promote good governance and state building. They could be measures to improve customer services, simplify forms and procedures, reduce compliance costs, conduct public information programmes, or establish international agreements for tax information sharing to prevent cross-border tax leakages. The COD model may again be useful in this respect.

Governance considerations also dictate that the tax basket programme itself should be as transparent as possible and publicly disclose information on the funding arrangement, benchmarks and targets, and the progress of implementation. As with other modalities, donors should ensure the host agency is accountable to citizens, not just to the tax basket group.

Within a tax basket programme, technical assistance can be procured through recipient systems or delivered through parallel projects or in-kind support. Recipient procurement has the advantage of maximising alignment and reducing fragmentation. It also helps develop the host organisation's capacity for project management, despite the opportunity cost of taking revenue personnel away from tax activities to deal with administrative tasks that could be handled by the donors. Furthermore, if local procurement systems are used, it is essential that the donor group appraise the financial risk, preferably through a single joint process. Where parallel technical assistance projects or programmes are part of the mix, the basket agreement should, to preserve co-ordination, include a provision requiring the government to inform the basket group of discussions about prospective programmes.

Case study evidence reveals that, in practice, a tax basket approach involves some of the same operational challenges as budget support. Fragmented procedures and disbursement delays have been common. Co-ordination within the basket group is also a major challenge, because partners often have different views about technical approaches or the justifiable use of funds. For example, donors involved in the tax common fund in Mozambique (see Chapter 5) had trouble agreeing on the extent to which the Mozambique Revenue Authority could use basket funds for IT modernisation. In this respect, some aid officials interviewed for this study felt that the value of bringing many small partners into a common fund was not always worth the additional management effort. One source suggested that partners should commit to a minimum entrance fee before they could join a tax basket.

Donors can also mitigate fragmentation by including in the initial memorandum of understanding a clear leadership plan, a statement of principle for harmonising procedures and requirements, and rules for reconciling views of programme implementation. To inform their agreements, donors would find it extremely useful to build a knowledge base of the challenges encountered and addressed in applying basket financing to tax systems. They could do so through in-depth analysis and discussing tax basket experience in international forums.

To deliver results, tax basket donors should include experts technically qualified in assessing programme design and implementation. Mozambique offers a good example. There, donors funded a quality assurance group to conduct periodic technical reviews in collaboration with tax experts from the IMF. Another approach, used in Uganda, is to fund a resident technical advisor to assist the basket group in monitoring programme implementation.

Finally, considerations of value for money raise the question of fungibility. Although a tax basket programme restricts how funds can be **spent**, their ultimate **use** depends on whether the government reallocates to other uses general budget funds that would otherwise have gone to tax administration. Finance ministries do face severe budget – and other – constraints. Tax basket donors, therefore, have a clear interest in monitoring the

allocation of budget funding for the tax system as part of their partnership arrangements with governments.

Recommendations for basket financing

Basket financing is an excellent instrument for harmonising and aligning multi-donor funding for tax programmes. A well designed tax basket provides joint funding, a unified technical approach, and harmonised procedures for diagnostic analysis, performance assessment, and policy dialogue. The recipe for success starts with a government's technical and political leadership and ownership and a reliable host-country system for managing the common fund. Other fundamental ingredients include: a holistic analysis of strategic requirements (rather than cherry picking technical fixes); an action plan with realistic timing and sequencing that reflect capacity constraints; and an effective management structure for the tax-basket group itself. The following recommendations may help apply basket financing to tax programmes effectively:

- Ensure coherence and co-ordination between the tax basket programme and revenue components of a higher-level sector programme and GBS framework.
- Include in the tax basket agreed conditions for leadership arrangements, rules for harmonising procedures and resolving differences and, if possible, conditions for exit in the event of non-performance.
- Incorporate funding for highly qualified tax experts to support the basket group in monitoring performance. One way is to engage a quality assurance group for periodic assessment visits or hire a resident tax expert to work with the basket group.
- Consider setting a minimum contribution for participation in the tax basket in order to reduce the risk of fragmentation and management problems.
- Ensure that the tax basket programme addresses governance and state-building through improved customer services and public information programmes, for example.
- Include as a basket condition an obligation for a counterpart organisation to inform the basket group of discussions on parallel projects or programmes.
- Incorporate transparency standards in the basket arrangement to ensure domestic accountability.
- Conduct more detailed studies to build up knowledge of challenges encountered and solutions adopted in applying the basket modality to tax programmes.
- Monitor government budget funding of the tax departments in order to spot any possible fungibility effects attributable to this earmarked form of support.

3.4. Other multi-donor instruments

Other multi-donor instruments provide funding outside host-government budgets, although they are generally less closely aligned with country systems than the modalities discussed in this chapter. Nevertheless, some can be highly useful, flexible instruments for multi-donor co-operation, offering the benefits of substantially better harmonisation and coherence than multiple bilateral agreements. In countries where transfers to the government's account involve high fiduciary risks, "other" multi-donor modalities may be the best way to strengthen the tax system. Furthermore, they are a convenient avenue for

smaller donors to support priority tax programmes through “delegated co-operation”. (EC, 2009; EC, 2007) This section examines two widely used options that are applicable to tax systems: trust funds and joint-donor projects.

Trust funds

Trust funds have been used for many years as a vehicle for pooling resources from multiple aid agencies to support a common programme. The basic feature is that one agency – often the World Bank, the UNDP, or the IMF – receives and administers funds on behalf of a group of donors. The *2010 DAC Report on Multilateral Aid* indicates that the World Bank in 2008 handled 2 776 trust funds through its own administrative procedures – such funds are known as “bank-executed trust funds” (BETFs). It managed another 1 503 trust funds for the activities of recipient organisations – “recipient-executed trust funds” (RETFs). The DAC report cites trust funds that target a variety of issues (health, education, climate change, food security, etc.), but not domestic resource mobilisation. Yet the Afghanistan Reconstruction Trust Fund (ARTF) described in Box 3.1 shows that trust funds can address revenue issues. In addition, the International Finance Corporation arm of the World Bank Group uses them to support advisory work, research, and programmes on tax issues that relate to the investment climate, formalisation of micro and small enterprises, and economic growth.

One innovation that the World Bank might consider is to establish a multi-donor trust fund for worldwide technical support on tax issues, modelling it along the lines of its highly successful Financial Sector Reform and Strengthening (FIRST) Initiative. FIRST was established in 2002 to provide grant funding for demand-driven financial sector development activities in 15 programme areas through a panel of consulting firms. It has provided hundreds of grants for short- to medium-term technical assistance and capacity building. The Bank manages FIRST with funding from Canada, the United Kingdom, the Netherlands, Sweden, Germany, and Switzerland in co-operation with the IMF. According to its website, FIRST has been extended to 2012 with USD 100 million in total funding.

The IMF, too, has a long record of using multi-donor trust funds for technical assistance missions, resident advisors, and analytical work on tax matters throughout the world. In addition, it operates a donor-funded network of seven regional centres for technical assistance and training, three of which are in Africa. These centres address tax issues, along with budget management, financial systems, and economic statistics.

In 2010, the Fund introduced a new approach – multi-donor Topical Trust Funds (TTFs), one of which targets tax policy and administration. The tax TTF is to allot approximately USD 30 million over five years to finance IMF tax experts as part of a sustained programme of technical assistance, analytical work, and training for a selection of 15 to 20 low-income and lower-middle-income countries that do not have major donor funding for tax programmes. A donor-chaired steering committee will guide the strategy. Germany and Switzerland are lead donors, with additional support at this time from Belgium, Luxemburg, and the Netherlands (IMF, 2010b).

The tax TTF enlists donor resources to expand the work of IMF tax experts, who are world leaders in helping developing countries to strengthen and modernise their tax systems. The TTF therefore merits full support. However, it also has potential limitations. First, the IMF’s Fiscal Affairs Department has limited capacity, which curbs any scaling up of the TTF approach. Second, although the IMF intends a greater emphasis on long-term programmatic engagements, its track record is predominantly one of short-term assistance. And host countries often do require longer-term technical co-operation to implement strategic reforms. Third, many observers regard the Fund’s approach as being too focused on macroeconomic imbalances, too technocratic, and insufficiently attuned to local conditions.

In this regard it is interesting to see that the TTF programme document has a clear governance orientation. Indeed, it begins by stating that “an effective tax system is a core function of an effective state” and a foundation for “a social contract that underpins social cohesion and helps shape state governance”. The programme also cites support from civil society and communication with stakeholders as keys to success in tax reform, together with political leadership and technical buy-in from the national tax agency (IMF, 2010c). Given that the Fund’s institutional mandate is to address macroeconomic imbalances, it remains to be seen how these governance considerations will play out in practice.

An intriguing variation on the trust fund theme may be of interest in fostering tax-governance linkages. Liberia has experimented with a recipient-managed multi-donor trust fund for the health sector, in which the government manages a pool of funds through government systems, while a private auditor minimises financial risks. The novelty here is that the programme steering committee includes civil society groups, as well as government and donor officials, and uses the funds in part to support non-government organisations (NGOs) in delivering health services. These ideas could be adapted to taxation and governance issues where NGOs and business associations can play a key role. Possible are competitive grants to NGOs to support public information and media campaigns, a private sector tax advisory council, independent tax policy research, independent surveys on taxpayer attitudes and perceptions, and school programmes on rights and responsibilities relating to taxation.

Multi-donor projects or programmes

Many aid activities are structured as standard projects, even though multiple donors are involved in funding them and often in managing and monitoring the activities. USAID calls this “multi-donor pooled funding: projectised assistance”. (USAID, 2008) This approach is less well aligned with government systems than a tax basket, though it could be a preferred option in countries where public systems do not warrant the transfer of funds to a government account. The multi-donor approach also improves on the alternative of bilateral interventions by harmonising the contributions of two or more agencies. In addition, it offers smaller donors a vehicle for participating in programmes without creating fragmentation. At the same time, a multiple donor arrangement can entail higher transactions costs and greater funding uncertainty than a traditional bilateral project, simply because it requires the co-ordination of partners, all with their own processes and requirements.

Jointly funded projects or programmes can be organised in various ways. For example:

- One aid agency may take the lead in identifying, developing, and administering the activity, while other donors contribute funds to share the cost or expand the project’s size and scope. The IMF uses this variant to leverage its internal resources for funding tax missions or resident advisors.
- Multiple aid agencies may pool funds through a World Bank trust agreement, but design a project or programme themselves and establish their own joint arrangement for administering and monitoring its activities. The World Bank typology refers to this kind of fund as a financial intermediary fund.
- Multiple aid agencies can pool funds in a separate account, design a project jointly, and establish a joint arrangement for administering and monitoring the activities. One option is to deposit funds in a segregated government account that is controlled by the partner agency. Unlike basket financing, the use of funds is restricted to objectives, tasks, and deliverables specified in a project contract.

All these options may cover narrow or broad sets of objectives and activities relating to tax system and associated governance issues like as budget management and mechanisms for accountability and transparency. In all cases, agencies in a joint project arrangement have a responsibility to align the programme with the government's tax reform strategy and ensure coherence with tax or revenue elements addressed by other modalities. Participating donors should also, as far as possible, strive to establish common requirements.

The multi-donor-project modality can also be used to support tax-related projects or programmes that are primarily designed for other purposes. In the early 1990s, for example, advisors and short-term experts gave strong support to comprehensive tax reforms in Zambia as part of a macroeconomic policy project funded and administered by Norway, Germany, and the Netherlands through a World Bank trust account. The project was instrumental in establishing a tax policy task force that brought the private sector into the process of determining the tax reform agenda. Its work included introducing VAT and creating the Zambia Revenue Authority. Tax issues could equally well be addressed in other ways such as jointly-funded projects that aim to strengthen Parliament, modernise the judiciary, or foster civil society organisations.

Recommendations for other multi-donor instruments

Multi-donor trust funds are an attractive channel for supporting tax systems through a joint platform. They can also support government programmes in countries where government systems are too weak to warrant budget support. Or they can be used creatively to support non-government initiatives relating to the tax system or tax-governance linkages. Donors can also collaborate through “projectised” assistance for tax programmes – though the tax basket approach is preferable in countries with adequate capacity for strategic planning and financial management. Nevertheless, there is room for improvement:

- The donor community should give its full support to the IMF's Topical Trust Fund (TTF) for Tax Policy and Administration and the Fund's regional technical assistance and training centres.
- The limited size and scope of the IMF's tax TTF calls for a complementary trust fund for world-wide tax support to developing countries, which could be modelled on the World Bank's FIRST Initiative for financial sector reforms.
- Donors should experiment with recipient-managed trust funds that bring together civil society and private sector groups to finance tax-related programmes where non-government stakeholders can play a key role – *e.g.* in the field of public education.
- In countries where financial management systems do not warrant transfers of funds to a budget account, multi-donor projects and programmes should be managed through separate accounts in lieu of a tax basket.
- Seek opportunities to incorporate tax-related initiatives in multi-donor projects or programmes that are designed for other purposes, such as reforming the business environment, fostering civil society, or strengthening parliamentary oversight of the government budget.

3.5. Stand-alone arrangements

The multi-donor modalities discussed so far are grounded in underlying bilateral agreements to formalise the involvement of participating aid agencies. However, a large share of the aid flow to developing countries consists of stand-alone bilateral arrangements. In situations where multiple donors pursue parallel bilateral activities in the same technical area, such arrangements offer maximum potential for fragmentation, inconsistency, and elevated transaction costs.

Nonetheless, a bilateral stand-alone arrangement may have practical advantages in that it simplifies negotiations on the project or programme agenda; avoids the fiduciary risk of budget support; practices the attribution of results to a maximum degree; and gives the donor agency visibility, an asset for maintaining political support at home.

From the recipient's perspective, too, it may be simplest to deal with a single donor rather than negotiating and managing an arrangement involving multiple agencies. A well known case in point is Rwanda, where the government has pursued a comprehensive tax reform programme with long-term assistance from a single donor, DFID, plus analytical input from the IMF. In other instances, a bilateral arrangement can be the preferred path for addressing niche needs, as it was in a recent agreement between Norway and Mozambique to strengthen capacity for taxing natural resource industries.

The example of Rwanda shows that bilateral arrangements can be highly effective when programmes have strong host-country ownership and leadership at both political and technical levels. Indeed, the OECD (2008) has cited the Rwandan example as a model tax reform. One of the DFID programme's achievements was helping to establish the Rwanda Revenue Authority and introduce automated tax systems. Rwanda's reforms led to an increase in domestic revenue from 9% of GDP in 1998 to a peak of 14.9% in 2008 (IMF, 2010a). Other examples of highly effective bilateral tax programmes include USAID's support for tax reforms in El Salvador (Box 3.4) and Canada's PAMORI project in Mali (see Chapter 5).

In countries where a single bilateral donor is the dominant source of support for the tax system, co-ordination and harmonisation issues are not much of a problem. Even then, however, it is essential to align the bilateral support with host government plans¹⁰ and co-ordinate activities in the framework of a PFM sector programme. In this sense, even single-source bilateral aid for improving tax systems should never be stand-alone.

The larger issue is to avoid fragmentation, incoherence, and unduly high transactions costs when multiple donors independently choose to support tax systems in a particular country. Ultimately, of course, it is the responsibility of the host government to ensure co-ordination, as in the case of Guatemala (Chapter 5). In countries where local capacity is limited, donors themselves have a responsibility to establish an effective mechanism for co-ordinating parallel activities to support the tax system. At the very least, agencies should agree on a mutual exchange of information, preferably with regular meetings to discuss their plans and activities. This is commonly done through a PFM sector working group, and should be standard practice.

The best approach, though, is to avoid fragmentation in the first place by pursuing a tax basket or multi-donor project modality. Alternatively, donors can agree on the division of labour at PFM sector level with one agency designated as the lead on tax issues. Mali is again a good example. There the Canadian International Development Agency leads the tax modernisation component of the new PFM sector programme (see Chapter 5). Non-lead donors can also support the tax system through a SBS programme in public finance management or a GBS programme which focuses on revenue objectives.

Finally, it is important to reiterate a finding from the previous section: that interventions meant for other purposes can also address domestic revenue mobilisation and tax-governance linkages. Examples of such interventions are bilateral projects to reform the business environment, build capacity in Parliament, strengthen the legal and judicial system, or support civil society.

Recommendations for stand-alone arrangements

Stand-alone bilateral interventions will continue to be a prominent tool for supporting tax systems in many countries. However, if multiple donors pursue such projects without adequate co-ordination, the result can be worst-case situations of programmatic incoherence and high transaction costs. This observation has familiar implications for effective bilateral aid and prompts the following recommendations:

- Ensure that any bilateral aid to support the tax system is aligned with the government's strategic plans for tax reform and avoid supply-driven approaches.

Box 3.4. Bilateral support for tax reform in El Salvador

In the early 2000s, the tax ratio in El Salvador was stuck at around 11% of GDP and import duty revenues were set to decline as a result of free trade agreements. To increase the revenue yield without increasing tax rates, the government embarked on a series of reforms to modernise tax administration. Chief among reforms were the introduction of IT systems, improving taxpayer services, expanding public information on the tax system, and upgrading professional skills within the tax service.

These reforms improved compliance and reduced evasion, boosting the tax ratio to 14.1% of GDP by 2007. The economic crisis brought the tax ratio down in 2009 – but only to 13% – before it rebounded to 13.8% in 2010. There were also huge improvements in virtually every indicator of collection efficiency. For example, new IT systems reduced the average time for processing an income tax return from 4 hours to just 40 minutes; and the introduction of automated calls to tax delinquents brought in 10 000 additional tax returns in the first four months (Development Alternatives Inc., 2010)

Throughout this period, bilateral assistance from USAID was the predominant source of donor support to the tax authorities. USAID advisors and consultants were involved in all aspects of the reform programme. Indeed, during the period of the Tax Policy and Administration Reform (TPAR) – from 2005 to 2010 – no other donors (apart from intermittent IMF missions) directly supported the tax authorities. At ministry level, though, the Inter-American Development Bank (IADB) provided funding for an integrated tax and customs IT system, while the World Bank supported the tax analysis unit.

Challenges still abound in El Salvador. They include the need to improve the capacity of criminal tax investigation, widen tax education to civil society, expand electronic taxpayer services, and strengthen the capacity for dealing with transfer pricing and the international exchange of tax information.

Source: Development Alternatives Inc., USAID and interviews conducted for this study.

- Establish an arrangement for exchanging information across parallel tax programmes and through regular meetings that bring together participating agencies and the host organisation.
- At donor headquarters level, strive to minimise legal and administrative barriers to the alignment of bilateral aid programmes with host-country systems and the harmonisation of procedures with other donors. This requirement is just as important for bilateral interventions as for multi-donor modalities.
- Look for ways to promote the tax and governance agenda through bilateral projects or programmes that are designed for purposes other than tax support *per se*.

3.6. Support for South-South regional organisations

The discussion so far has dealt with modalities that provide funding through country programmes and multilateral trust funds, like the IMF's tax TTF, which are not tied to a particular recipient. Another approach is to finance tax programmes for groups of developing countries through South-South regional tax organisations.¹¹ They play an especially important role in supporting professional networking among tax officials, promoting South-South knowledge sharing on practical solutions to common problems, strengthening regional collaboration to deal with cross-border tax issues, and liaising between regional tax authorities and international tax forums (OECD, 2008).

As in most aspects of life, advice is most effective when it comes from peers. Thus, a senior tax official in Malawi may readily heed and absorb lessons from the experience of senior officials in Tanzania, but politely resist ideas from an “outside” expert. Peer advice is especially useful when it embodies hard lessons learned through actually managing similar reforms and overcoming similar challenges. One example given in an interview for this study is the practical difficulty of implementing international standards for transfer pricing in an African context due to the lack of regionally appropriate data on arms-length prices. On such issues, peer tax officials may be in a position to offer more useful knowledge than international experts.

These advantages would have little value if regional peers were familiar only with archaic, inefficient tax practices. But today, following decades of technical support, capacity building, and experience of reform, there are highly knowledgeable experts in every region of the world. Peer organisations can therefore play a key role in supporting and facilitating tax reforms in their respective neighbourhoods. Two prominent examples are the Inter-American Center of Tax Administrations (CIAT), and the recently established African Tax Administrators Forum (ATAF).

CIAT, which has headquarters in Panama, has been in operation since 1967, and currently has 40 member countries. It is a major vehicle for regional co-operation and dialogue, training (both classroom and on-line), and technical assistance to strengthen and modernise tax administration throughout Latin America.

ATAF was established in November 2009, and already has 33 members. The organisation's mandate is to “articulate African tax priorities, anchor good practices, and build capacity in African tax policy and administration through peer learning and knowledge development”. ATAF's objectives include not only technical progress in strengthening resource mobilisation, combating tax evasion, and building professionalism in tax administration, but also enhancing tax dialogue with stakeholders and civil society

in African member countries.¹² Initially, ATAF is not anticipating involvement with customs work, though it might add such work to its agenda in the future.

The interviews conducted for this study revealed unanimous agreement on the growing importance of regional organisations in the international network that works to promote efficient, effective tax systems and enhance governance through revenue system reform. This endorsement, though, needs to be qualified. There are practical limits to regional bodies' absorptive capacity and those involved in tax programmes would not all be strong candidates for support. Donors decide whom and what to fund on the basis of organisations' strategies and plans, management capability, financial controls, and evidence of effectiveness. Third, the Paris principles apply as much to South-South arrangements as to any other modality. Some of the challenges that ATAF faced as a start-up evidently involved the familiar problems of fragmentation and disbursement delays in donor funding.

Recommendation for support for South-South organisations

Regional tax organisations are small but vital players in providing low-cost, high-value support for improving tax systems in developing countries. These organisations merit strong support from the international community – be it financial or in-kind (see next section) – that is contingent on good management and strong programmes. For this modality, as for any other, it is important for donors to develop procedures for maximising harmonisation, minimising transaction costs, and ensuring the timely disbursement of funding.

3.7. In-kind support

The funding modalities discussed above are widely used to provide technical assistance, training, equipment, and (less often) physical infrastructure for strengthening host-country tax systems. Some aid agencies, however, deliver assistance as **in-kind** support to host governments. Apart from capital investments, in-kind assistance generally falls within the definition of “technical cooperation” (Box 3.5). Nearly all the activities of Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), for example, take the form of in-kind technical cooperation. In-kind support is also the main modality for tax assistance provided by the IMF's Fiscal Affairs Department and the United States Treasury Office of Technical Assistance. Other forms of in-kind support are twinning arrangements or the secondment of tax officials. The interviews conducted for this study suggest that tax authorities in low-income countries are especially interested in the engagement of experienced tax officials from other countries. In-kind modalities may be government-to-government or take place through regional peer organisations such as CIAT and ATAF (discussed in section 3.6).

This direct form of support can be easier to implement than the provision of comparable services through a funding modality. One reason is that tax experts who work for donor government revenue agencies are generally unavailable as consultants for hire in the market. Also, the procedures for procuring technical assistance under a funding arrangement can involve extra layers of complexity that in-kind assistance averts. With suitable arrangements, in-kind support can be provided flexibly and at short notice to address wide-ranging or narrowly focused objectives relating to the tax system and tax-governance linkages.

As an example of broad coverage, the Good Financial Governance (GFG) programme in Ghana, led by GIZ and Switzerland's State Secretariat for Economic Affairs (SECO), provides technical co-operation that addresses not only tax administration and tax policy,

but also budget management, accountability to Parliament and society, and transparent revenues from extractive industries (see Chapter 5).

One possible downside of in-kind support is that it may operate outside of host country systems. There are also potential pitfalls (shared by other modalities) such as inadequate buy-in from local clients, fragmented technical approaches, and weak quality control. With regard to managing for results, the World Bank Independent Evaluation Group (2008) found that many in-kind support programmes were poor at evaluating the effectiveness of interventions.

Recommendations for in-kind support

The direct provision of in-kind technical assistance, training, and equipment clearly has a place on the menu of aid modalities for strengthening tax systems and enhancing tax-governance linkages. Through twinning agreements or secondments, in-kind aid can play a special role in providing expert support that might be difficult to obtain through a funding

Box 3.5. Defining technical co-operation and technical assistance

The DAC glossary of aid terminology states that technical cooperation (TC):

“Includes both (a) grants to nationals of aid recipient countries receiving education or training at home or abroad, and (b) payments to consultants, advisors and similar personnel, as well as teachers and administrators serving in recipient countries (including the cost of associated equipment and materials).” (OECD, 2006c)

The DAC further distinguishes between **free-standing** technical co-operation (FTC) and **investment-related** technical co-operation (IRTC). FTC denotes technical cooperation applied to capacity building, while IRTC affords similar support in the context of capital projects.¹³ The DAC Glossary does not give a separate definition of technical assistance (TA), though some OECD documents use the term as a synonym for part “b” of the definition of technical co-operation quoted above.

The European Commission similarly defines TC as “actions aimed at strengthening individual and organisational capacity by providing expertise (short and long term TA ...), training and related learning opportunities ... and equipment”. It defines TA, in turn, as referring to “the personnel involved in the implementation and the management of technical cooperation services”. (EC, 2008) The World Bank further distinguishes between direct technical assistance and economic and sector work (ESW), with the latter term referring to analytical studies.

An unofficial perspectives note prepared at the OECD emphasises that TC is “more than technical” in that it involves “a broader relationship between donors and country partners” with the common objective of capacity building (Hradsky *et al.*, 2010). The German government likewise highlights partnership and capacity building, emphasising that TC involves not just the provision of technical services but joint and interactive planning, flexible implementation and capacity building (GTZ [now GIZ], 2008).

“Technical cooperation serves the purpose of upgrading the skills of people, organisations and societies ...and enabling them to realise their own goals through effective, efficient and sustainable use of resources.” (BMZ 2008)

Source: OECD, European Commission, German Technical Co-operation Agency, German Federal Ministry of Economic Cooperation and Development.

modality. In other cases, in-kind support is a viable alternative to financial support – in providing long-term resident tax advisors or modern computer systems, for example.

Donors providing in-kind support for tax programmes have a responsibility to collaborate closely with host-country officials in identifying priority needs, designing the interventions, and ensuring quality control. Co-ordination across aid agencies and aid modalities is also essential to harmonising technical approaches, establishing a coherent division of labour, and minimising transaction costs and procedural fragmentation (Hradsky *et al.*, 2010; EC, 2008, 2009, 2010b).

3.8. Concluding word on tax system aid modalities

The chief conclusion here is that each modality can play a distinct, valuable role in supporting tax systems and enhancing linkages between taxation and governance. At the same time, all the modalities have the inherent shortcomings which often gives rise to problems in practice. Taking into account the strengths and weaknesses of the various instruments, donors should seek to determine the right mix for each host country, tailoring it to domestic government preferences and the conditions which prevail in that country.

Following this one-by-one assessment of aid modalities, Chapter 4 broadens the perspective. It briefly discusses the types of assistance which the various aid modalities support, then explores five cross-cutting concerns that affect all of them: programmatic priorities; diagnostic tools; tax-related indicators; the division of labour among donors; and conditions for donor exits.

Notes

1. In some countries the PRS is itself laden with donor fingerprints. “Mistaking participation for ownership” is another of the “seven deadly sins” that Birdsall (2008) observes as a recurring problem in foreign aid.
2. A 2008 survey of budget support programs by the Strategic Partnership with Africa found that 35% of the respondents encountered disbursement difficulties due to government failure to meet conditions. But this figure includes difficulties involving within-year funding delays and slippage to the following budget year. No information is given on the extent of non-disbursement or partial disbursement of variable tranches due to underperformance (SPA 2009, 39-40).
3. The “P” here refers to the *partnership* model of general budget support.
4. The empirical literature on how aid transfers affect tax effort has produced mixed results. For example, IMF studies by S. Gupta *et al.* (2003) and by A. Gupta (2007) reach opposite conclusions on this issue. Knack (2008) finds a strong negative effect of aid on the *quality* of tax administration, as gauged by the World Bank’s Country Policy and Institutional Assessments. Carter (2010) concludes that statistical studies are unlikely to produce stable and reliable results due to problems with the methodology and data. See also Moss *et al.* (2008), and Gambaro *et al.* (2007).
5. KfW (2010a, 5) lists proposed revenue indicators in German-funded budget support programs for seven countries. The tax ratio is proposed for all seven cases, and it is the only indicator listed in five of the cases.

6. A corollary to this observation is that local “ownership” should be rooted in institutional strategies and plans, and not just in the preferences of individual reform “champions.” On two occasions the author has personally been involved in tax-related projects that were seriously affected by the unexpected exit of a reform “champion.”
7. Soest (2008), 24-25.
8. URA, Managing Compliance Programme 2011-2015. Draft, Dec. 2010.
9. Adam Smith International. Sept. 2010. *Project Completion Report*. Produced on behalf of URA and DFID. Review Team: Elizabeth Gresty, Abdur Rahman Khan, David Watt.
10. The author was once involved in a bilateral tax administration project where the lead counterpart, at the first meeting, told the team leader that the project Scope of Work is not what his department needed. This was an egregious example of lack of alignment.
11. Regional organizations run by the IMF or other international entities were covered, albeit very briefly, in the section on multi-donor trust funds. This section focuses on south-south organisations.
12. Other regional also have tax-related activities, including tax harmonization programs. In Africa, the list includes the West African Economic and Monetary Union (WAEMU), the Southern Africa Development Community (SADC), and the East African Community (EAC), among others. For present purposes, though, the focus is on regional peer organisations like CIAT and ATAF with taxation as the central mandate.
13. In DAC statistics on aid flows, only FTC is categorised as Technical Cooperation; IRTC is instead included in the data on program and project expenditure.

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Chapter 4

Technical Assistance and Cross-Cutting Issues

While Chapter 3 looked separately at seven aid modalities, assessing their individual strengths, weaknesses, and applicability, this chapter examines what they have in common. It first discusses two broad categories of aid that are central planks of any aid programme to strengthen and modernise tax systems and improve the efficiency of revenue collection: technical assistance and training and information technology (IT). The chapter then broadens its sweep to five concerns that cut across all aid modalities: programmatic priorities; diagnostic tools; tax-related indicators; the division of labour among donors; and conditions for donor exit. It rounds off its consideration of technical assistance and IT with a series of recommendations and does the same again for the cross-cutting issues it has identified.

This chapter briefly outlines the types of tax assistance supported by various aid modalities – the question of “what” rather than “how”. It then addresses five issues repeatedly encountered in conducting this study and which apply to all the aid modalities that support tax systems: the determination of programmatic priorities; the development of a diagnostic tool for assessing revenue systems; the selection of revenue indicators; the division of labour among donors; and considerations for exiting from support for tax programmes. Each topic merits a separate study in its own right. The aim here, though, is simply to highlight the issues as input into the dialogue on aid effectiveness for strengthening tax systems.

4.1. Technical assistance and information technology

Technical assistance

Whether provided in-kind or through the various funding modalities, technical assistance (TA) is a central element of virtually every aid programme for strengthening tax systems. A recent study by the World Bank’s Independent Evaluation Group (IEG) explained that the objective of TA is “to assist in policy implementation, strengthen institutions, and facilitate knowledge exchange”. The IEG went on to add that accompanying economic and sector work (ESW) aims “to inform lending, inform government policy, build client capacity, stimulate public debate, and influence the development community”. (World Bank IEG, 2008) The study found that most of the Bank’s technical assistance and economic and sector work had met those objectives as judged by users in the client countries. Such assistance had contributed to improving the design of Bank loans and delivered wider benefits for local policy makers, investors, researchers and other stakeholders. Key factors included tailoring the technical work to local needs, collaborating with clients, securing local buy-in, and ensuring high quality and objectivity.

The IEG study did not address revenue issues explicitly, but its findings clearly applied to tax programmes.¹ In addition, an earlier Bank evaluation of capacity building in Africa singled out tax administration as an area of “greatest success” among other public sector development programmes. The reason given was that tax programmes often involve “issues that are technical or reforms that enjoy broad political support”. It is noteworthy that there is a broad technical consensus on the basic concepts behind strengthening tax administration and reforming tax policy in developing countries (see “Programmatic Priorities”, Chapter 4.3). The IEG (2008) also found that governance-related assistance was more prone to “deeply rooted institutional constraints”. This observation underscores the need for donors to be especially creative and collaborative in developing TA programmes that address the interface between taxation, governance, and politics. Given the importance of these linkages for development effectiveness, there is an underlying need to gain a better understanding of institutional and political constraints and to customise programmes that address them.

Short-term vs. long-term technical assistance

A related issue that has long been a matter of debate is the relative value of short-term versus long-term technical assistance (STTA vs. LTТА). In fact, both approaches can be highly effective components of a comprehensive strategy for supporting tax reforms. An assessment by the IMF’s Independent Evaluation Office (IEO) in 2005 concluded that the choice between the two approaches depended on country circumstances. This may seem obvious, yet it was a marked departure from a previous IMF assessment that endorsed

STTA because of the high cost of fielding resident advisors in the long-term option. The 2005 IEO evaluation found, instead, that the benefits of a “hands-on” relationship would far outweigh the added costs and that resident experts could be especially productive in countries with weak institutional capacity. The IEO also noted that host-country counterparts sometimes found STTA reports to be, among other things, inappropriate to local circumstances and/or out of line with country priorities.

Acting on those insights, the IEO recommended a “life cycle model” for technical assistance as part of a long-term framework for institutional capacity development. The model cast LTTA as a key modality in countries with weak capacity, which included post-conflict states. Then, as capacity improved, LTTA would be phased out in favour of short-term missions and training.

Host-country tax officials interviewed for the present study echoed the IEO conclusion. They expressed a unanimous preference for flexible technical co-operation arrangements providing long-term experts who serve “in the trenches” as mentors, respond to changing needs, and offer continuity in supporting institutional development for tax administration. This approach is also consistent with the EC’s “backbone strategy” for reforming technical co-operation (EC, 2008) and with the assessment of client preferences in the World Bank’s evaluation of TA and ESW (World Bank IEG, 2008). All of these results place a premium not only on long-term TA, but also on flexible TA support involving advisors who work directly within the client organisations, as distinct from project experts who are housed in a separate management unit and charged with a pre-determined menu of tasks.

All programmes to provide long-term technical assistance, however, should come with a warning label about the risk of capacity substitution (gap filling) in place of capacity development (gap closing). Donors should therefore design their technical co-operation programmes with a clear agenda for building sustainable local capacity in an environment that may be constrained by a lack of required skills, inadequate conditions of service, high rates of personnel attrition, and possible political interference.²

Although there is a general preference for long-term resident advisors, short-term consultants and tax missions can be very productive in addressing special needs like diagnostic analysis, studies on well defined issues, and the drafting of legislation. Indeed, resident tax advisors often need to call on short-term or medium-term consultants to deal with issues or training needs requiring specialised skills. Even project-based technical assistance has often proven to be a very effective instrument for supporting the implementation of tax policy or tax administration reform programmes. The project modality is particularly well suited to managing for results because it carries out set tasks that involve a clear completion point. In addition, because they include services to other state organisations and non-state stakeholders, technical assistance projects can support policy or governance reforms in a way that resident advisors who work within a revenue authority cannot. Similarly, technical assistance at the level of the ministry of finance is particularly important in strengthening tax analysis capacity and the interaction between revenue mobilisation and budget programming.

The critical need for training

Every revenue agency has a critical need for training and human resource development to build the technical and management skills needed to administer tax laws fairly and effectively. Ongoing training enables administration personnel to obtain professional advancement and keep pace with the dynamics of organisational growth, staff turnover, modernisation of procedures, and changes in the legal framework governing the tax

system. Donor assistance is therefore highly valued in helping with the design and delivery of tax training.

Training support should begin with a collaborative diagnosis of training needs and the development of a comprehensive training strategy, embodying local vision and leadership. Such strategy has to dovetail with plans for organisational restructuring, human resource management, and business process re-engineering in conjunction with the modernisation of tax IT systems. Donor-funded training activities should advance the overall strategy by complementing and enhancing local training capacity, which requires developing training materials and training local trainers. On-the-job training (OJT) and mentoring are at least as effective as the classroom for imparting an operational understanding of required skills and methods. Donors can also provide broader learning opportunities for tax officials by supporting participation in external short courses, professional degree programmes (including management education), and international tax conferences. As discussed in Chapter 3.7, “In-Kind Support”, twinning arrangements are another valuable form of support for enhancing host-country tax skills. Whatever the design, training support should be framed within an evaluation plan that includes serious efforts to assess outcomes, rather than simply reporting a headcount of numbers trained.

Finally, it is important to note that capacity development involves more than the provision of training and learning opportunities. According to OECD guidelines, capacity can be defined as “the ability of people, organisations and society as a whole to manage their affairs successfully”. (OECD, 2006) Capacity development therefore entails change at the three levels: of individual the organisation, and the enabling environment. These changes occur in a complex institutional setting that influences incentives and constrains the scope for sustainable improvements (Hradsky, 2010). Efforts that focus narrowly on imparting technical knowledge to tax officials may therefore have little effect in an organisation that is not supportive of change or an environment that lacks incentives for applying new knowledge and practices. Thus, in-kind support to develop capacity in the tax system is closely interconnected with governance reforms and donor programmes that address complementary needs. Such an agenda includes training support for organisations beyond the tax authority – *e.g.* the court system, state audit, and the business registry, all of which contribute to a stronger tax system.

Information technology and equipment

Modern information technology is a central element of any programme to strengthen domestic resource mobilisation and improve administrative efficiency, taxpayer services, tax compliance and tax transparency. It is also an important tool for enhancing integrity in tax administration in that it can limit the scope for discretionary negotiations on tax liabilities and trace improper assessment adjustments.

However, tax IT systems are complex and expensive, requiring careful attention to system architecture, hardware and software procurements, network connections, integration across sub-systems, and system maintenance. Additional factors are concomitant process re-engineering, the re-training of staff throughout the organisation, and the development of management information systems. Even in a small country like Liberia the government has estimated that a new system of integrated tax administration services (ITAS) is likely to cost USD 11 million (and overruns would surprise no one). For these reasons, tax programmes in developing countries tend to rely heavily on donor provision of IT equipment and associated technical assistance. Indeed, in a survey of 15 revenue authorities in sub-Saharan Africa, the International Tax Dialogue (ITD) found

that self-financing of IT investment in most countries accounted for less than 2% of total administrative expenditures.

Although IT systems are critically important for tax administration, supplying them is a form of support that is often plagued with problems.³ One major issue has been fragmentation – where, for example, one donor introduces an IT system for customs that is incompatible with another donor-furnished system for income tax or VAT. Among the six case study countries examined for this study, IT incompatibilities of this sort occurred in Mozambique, Tanzania, and Ghana. Once the systems are in place, it takes years to untangle the knot and transition to an integrated information system. The recent trend has been to introduce fully integrated IT systems covering all the revenue streams handled by a country's revenue authority (including customs) and all the related business processes. Examples of that approach include Mozambique, Ghana, Rwanda, Liberia, and Guyana. A comparative assessment of the efficiency and effectiveness of these ambitious tax-IT programmes would be very welcome.

Multiple challenges of tax-IT donor support

Another issue is the introduction of computers without due regard to process re-engineering which helps take full advantage of efficiency gains from the modernisation of IT systems. Other challenges include managing IT procurements, ensuring the accuracy of data entry (reportedly a serious problem in Mali), customising systems to fully suit local requirements, navigating the concomitant change management, maintaining and adapting the system over time, and ensuring that all local tax officials are trained and motivated to use the new system. Unfortunately, many tax officials find it is in their interest to resist the new technology. And senior officials often face an incentive structure that favours short-term fixes. They might therefore seek donor support for hardware and software upgrades while neglecting more fundamental problems of institutional modernisation and change management that ought to be addressed in the process of upgrading the IT systems. There are also instances of donors falling into the trap of supporting inefficient IT development in order to lay claim to short-term “success stories.”

In view of these frequent difficulties, donor support in the form of IT equipment has to be carefully and comprehensively planned, sequenced over an appropriate time frame, integrated into the client's overall strategy for tax reform and, above all, fully embraced by host government authorities. It is also a good idea to incorporate a separate quality assurance team into the programme design, as was done in Mozambique, (see Chapter 5). An interesting ploy for bypassing some of these problems is to outsource data functions to a private contractor. According to one expert interviewed for the study, this idea is under consideration in India and has been suggested for Bangladesh and Uganda. Interestingly, the ITD (2010) found that several revenue authorities in Africa are already outsourcing IT maintenance.

In addition to IT systems, many tax agencies have also solicited donor assistance for communications equipment, office equipment other than computers, and vehicles. In Guyana, for example, the revenue authority in 2006 sought support (that was ultimately not forthcoming) from the MCC for speed boats for use by border control officers. Although donors often do not accede to such requests, they can be eminently sensible in the context of well conceived programmes to strengthen tax collection, enforcement, investigation, audit, and administrative efficiency. Nevertheless, donors should weigh up the likely benefits and costs as part of the government's overall reform programme.

The final form of equipment-related assistance is support for physical infrastructure investments for the tax and customs authorities. This type of support is usually delivered through a funding modality, though it can also be structured as in-kind support. (This is effectively what China does in Africa when Chinese companies implement loan-financed infrastructure investments then forgive the loan.) Possible examples include the construction of one-stop customs posts to facilitate trade transactions; new training facilities for tax and customs officers; new tax offices to extend geographic coverage of the tax services; or customer service centres in major metropolitan areas. Each of these examples could pay dividends for state building and good governance, in addition to improving tax administration. Or they could be wasteful boondoggles. Here, too, context-specific analysis is required to determine the efficiency and cost-effectiveness of any such support.

Recommendations for technical assistance and information technology

Technical assistance is a critical component of almost all capacity-building aid programmes and has proven particularly successful in programmes to strengthen tax systems. However, whether it takes the form of funding, training, or the supply of IT or other equipment, it should be creative and delivered through collaboration with local partners and beneficiaries as governance-related assistance is prone to “deeply rooted institutional constraints”. Organisations may not support change, environments may lack the incentive to new understanding and practices, and donors may have vested interests in resisting change or going for short-term fixes.

Donors’ first step should be a diagnostic analysis of local needs and circumstances. They should factor local instructional and political constraints into their programmes and design them to deliver tangible, commonly agreed outcomes. Only then can they make TA effective and avoid the pitfall of conventional, merely quantifiable aid.

Short-term technical assistance (STTA), for example, was widely preferred to long-term technical assistance (LTTA) until the mid-2000s because it was cheaper. An IMF evaluation then found that the hands-on approach of fielding long-term resident advisors was far more cost-effective than mere STTA – a conclusion that echoed host-country preferences. Indeed, STTA and LTTA should be viewed as complementary parts of a flexible aid approach in which hands-on, practical LTTA builds capacity, with STTA topping it up through short-term missions and training. Training, precisely, is a modality that epitomises the need for careful preparation, customised delivery, and practical outcomes.

It should begin with a comprehensive, collaborative needs diagnosis with local leaders being seen to buy in. Donor-funded work should complement local training capacity and help drive the overall training strategy by developing materials and training trainers. Again the hands-on approach is particularly effective. On-the-job training and mentoring are meaningful ways of imparting operational understanding of skills and methods. Donors can then round off such understanding with short-term opportunities for broader learning through external courses and tax conferences. It is critical that training support should not be narrow or overly technical. Because strengthening tax systems is so closely bound up with governance reform, training support should take in institutions like the court system and state auditing which, though not part of the tax system, contribute to making it stronger.

Donor support in the form of IT equipment, too, has to contend with numerous challenges that arise from the complexity and cost of IT systems. Again, a holistic approach that meets practical needs on the ground is critical. The main problem is one of fragmentation arising from incompatibility with other donor-supplied systems. Another challenge is managing change and overcoming resistance to new technology, vested

interests, and short-termism among senior tax officials. Donors must prepare their support carefully and comprehensively, sequencing it over time, and integrating it into the overall tax reform strategy. It could, for example, dovetail with training in business process re-engineering as part of tax-IT system modernisation. The most crucial factor, though, is that the host government buy in.

IT improves revenue mobilisation, administrative efficiency, tax services, compliance, transparency, and, importantly, the integrity of tax administration. But if tax-IT support is to yield such benefits, it must – like other forms of technical assistance – seek to build capacity at the three levels of the individual, the organisation, and the enabling environment.

4.2. Cross-cutting issues

Programmatic priorities

What can be said about programmatic priorities for advancing a governance-focused tax reform agenda? Or, more to the point: how can priorities be determined? A basic lesson from international experience is that there is no cookbook recipe for success with economic reforms. Donors should not therefore determine their priorities against a mere checklist of best practices. Instead, they should analyse key problems and opportunities in the light of host-country priorities and the economic, cultural and political conditions in each country. Thus, there is a simple answer to the question on priorities: conduct a diagnostic analysis (see the next section, “Diagnostic tools”).

Nonetheless, programmatic priorities must still be grounded in basic principles of taxation and well established concepts about good practices for tax policy and tax administration in developing countries.⁴ In this regard, a recent IMF paper reviewed lessons learned from the Fund’s long experience as a leader in advising developing countries on tax issues. The review emphasises that raising revenue is the basic purpose of taxation, but that it also serves other vital development objectives through its effects on economic efficiency and growth, distributional equity, and state building. Although conditions differ significantly among developing countries, the Fund points out that they face “common tax challenges” – weak revenue administration; a culture of non-compliance; weak governance; large segments of “hard-to-tax” activities; pressures on revenue from trade liberalisation; and problems dealing with cross-border transactions, especially with multinational enterprises (IMF, 2011).

In view of these shared objectives and common challenges, strategies for tax reform in developing countries often incorporate similar elements. Broadly speaking, the fundamental **tax policy issue** is to establish a tax system that relies primarily on broad-based taxes at moderate rates. Other policy priorities include a reliance on self-assessment; tax simplification; reduction or elimination of tax preferences; rationalisation of customs duties; strengthening the fiscal base for local governments; introduction of streamlined tax regimes for micro, small and medium-sized enterprises; and building capacity for tax policy analysis.

In the area of **tax administration**, which is a primary concern in many countries, major themes for reform include establishing an integrated management structure organised along functional and customer lines; strengthening the strategic planning process; modernising information systems and business processes; improving human resource development; and developing a culture of customer service. Vazquez-Caro and Bird (2011) view the development of a “co-operative compliance model” and a strong “customer orientation” as the “polar star” for guiding tax administration reforms.

Another common priority is strengthening internal audit and institutional integrity. The case study of Liberia (Chapter 5) reveals an unusual and innovative priority: establishing a system to encourage whistle-blowers who report tax cheats. Interestingly, a recent survey of 15 revenue organisations in sub-Saharan Africa (ITD, 2010) found that many countries have implemented or are now pursuing similar “good practice” reforms. Some examples are the creation of a unified revenue authority organised by function and customer segment; the adoption of strategic plans; the introduction of modern IT systems; the development of an ethics code and service delivery standards; and the introduction of taxpayer surveys.

As emphasised in Chapter 2, there are many areas of synergy between the standard technical agenda for tax reform and the governance agenda for strengthening tax systems. In the interest of state-building, the assessment of priorities for donor support should therefore accord special consideration to programmatic activities that can deliver governance dividends. By the same token, activities to strengthen related institutions outside the revenue system itself – tax courts, state audit organisations, parliamentary oversight committees, and civil society groups involved in tax issues, etc. – also warrant special attention in the design of tax programmes. In contrast, programmatic options for which governance concerns might conflict with equity, efficiency, or effectiveness in the tax system are more difficult to justify as priorities, especially if other approaches could be used to promote similar governance outcomes.

Diagnostic tools

Despite the proliferation of donor interest in strengthening tax systems and improving revenue mobilisation, no common framework has emerged for analysing performance gaps or strategic priorities on the revenue side of the budget. The governments of high-capacity countries can undertake the analysis themselves and present their programme to donors for support. Elsewhere, IMF tax missions do the job. In addition, donors and multilateral agencies regularly engage their own tax experts to conduct *ad hoc* diagnostic studies to inform the design of their interventions. As far as possible, donors and multilaterals should co-ordinate their diagnostic work to ensure a consistent set of priorities. Such co-ordination is far from universal, but it is becoming more common – especially with multi-donor financing arrangements like sector budget support and tax baskets (Chapter 3). Possible arrangements include joint missions, as conducted in 2010 for the design of the new tax basket in Uganda (see Box 3.3), or delegating responsibility to a lead partner – often the IMF. In addition to improving co-ordination, donors should also involve host-country experts in the diagnostic studies, consult with local stakeholders, and disseminate findings to facilitate public-private dialogue on the agenda for tax reform.

Several agencies have developed tools specifically for assessing tax systems. The examples cited below are the World Bank, the EC, and USAID.

- A World Bank paper in 2003 drew up a two-stage framework for diagnosing weaknesses in revenue administration (RA) and options for reform in developing countries (Gill, 2003). Stage one is a preliminary examination of indicators identifying the nature of RA operations and the administration’s effectiveness and efficiency. The second stage is a more detailed diagnosis using a comprehensive conceptual framework, rather than a checklist of indicators.
- The European Commission first developed its Fiscal Blueprint in 1999, followed by a revised version in 2005. Its purpose is to evaluate revenue systems in candidate countries for EU accession (EC, 2007a). The tool applies a gap and needs analysis to determine a change management plan and priorities for technical assistance.

Analysis involves scoring designated indicators for 15 objectives in the following five categories: the overall framework and structure for revenue administration; human resources; operational systems; taxpayer services; and support functions. Although this tool was not designed for low-income developing countries, it has been adapted to this purpose.

- USAID in 2004 developed a diagnostic tool using international benchmarking for assessing tax administration (Gallagher, 2004). This approach identifies points of weakness relative to regional and comparable country standards. It does by using 57 indicators in the following eight categories: tax structure; enforcement; payments and collections; automated systems; planning and co-ordination; human resources; sanctions and penalties; and organisation, institutional credibility and public confidence. USAID has also developed a diagnostic tool for customs systems (Nathan Associates, 2009).⁵

Public expenditure and financial accountability

In practice, donors have not used such diagnostic tools to assess tax programmes in low-income or lower-middle-income countries. This is in marked contrast to the situation on the expenditure side of the budget, where donors have applied the Public Expenditure and Financial Accountability (PEFA) framework to more than 110 countries for assessing PFM conditions, identifying priorities for reform and capacity building, and tracking performance changes over time (Box 4.1).⁶ The widespread application of the PEFA tool reflects the special attention given to PFM issues by the international community over the past decade.

On the revenue side of the budget, the PEFA framework includes four “high-level performance indicators”: (1) aggregate revenue out-turn compared to original approved budget; (2) transparency of taxpayer obligations and liabilities; (3) effectiveness of measures

Box 4.1. The Public Expenditure and Financial Accountability model for assessing public finance management

The Public Expenditure and Financial Accountability (PEFA) programme was established in 2001 by a multi-donor group including the World Bank, the EC, the IMF, and aid agencies from the United Kingdom, Switzerland, France, and Norway. In 2005 the PEFA group completed the development of a diagnostic framework that donors and recipient countries have used to harmonise the assessment of PFM systems and co-ordinate the design of PFM programmes. The PEFA Secretariat is housed at the World Bank and supervised by a joint steering committee of participating agencies. The Secretariat has developed guidance notes and training materials for assessors, organised PEFA training events, supported regional networks for peer learning, and established quality assurance arrangements for the conduct of PEFA assessments.

The PEFA framework was initially developed for application in sub-Saharan Africa and other post-HIPC countries. By mid-2010, more than 175 PEFA assessments had been conducted in over 110 countries, often in conjunction with budget support reviews. The tool has been used in 42 countries in sub-Saharan Africa. It has also been adapted for use at the sub-national level; 55 such assessments have been carried out. A recent study by the PEFA Secretariat (2010) found that the PEFA funding partners are using these assessments as common-source input into their internal processes – e.g. the fiduciary risk assessments, determining criteria for budget support eligibility, and planning country programmes.

Source: PEFA Secretariat (2010).

for taxpayer registration and tax assessment; and (4) effectiveness of tax payments. The last three are composites, each with three “dimensions”. For example, the transparency indicator consists of scores for the clarity and comprehensiveness of tax liabilities, taxpayer access to information, and the mechanism for tax appeals. In turn, the score for each dimension addresses several specific attributes.

Nonetheless, the PEFA framework does not provide comprehensive coverage of the revenue system, nor was it designed to. Now that the international community is focusing on revenue mobilisation and tax-governance linkages, it would be very useful to have a diagnostic framework styled after PEFA to harmonise revenue assessments and co-ordinate aid programmes for stronger tax systems. The interviews conducted for this study revealed wide support for this idea, though a few voices of dissent suggested that a tool like PEFA is too generic and donor-driven.

Along these lines, Vazquez-Caro and Bird (2011) recently criticised much of the work to date on benchmarking the quality of tax administration in developing countries.⁷ They argue the case for a more “systemic approach” that focuses on the strategic objectives of the host organisation and how the parts of a system interact as a whole in the legal, operational and political environment of each country. The idea is to determine “what matters” at the country level, not to apply a standardised scorecard based on international best practices.

Vazquez-Caro and Bird do not question the value of diagnostic benchmarking to identify symptoms of weakness in the tax system as a guide for reform. They argue, rather, that to be most useful, it should also probe into the technical and management causes for key problems and afford insights into how to improve the system. Equally important, they stress the need to engage with the responsible officials and ensure that recommended remedies enjoy their support. Crandall (2010a) similarly emphasises the importance of aligning performance measures with the organisation’s goals and objectives.

The study team who prepared this report learned that the World Bank and IMF were developing a diagnostic benchmarking tool that drew on guidelines and illustrative examples in Crandall (2010a). Both the content and the organisational arrangements are under discussion. The organisational issue is whether a new “systemic” diagnostic tool should be administered through an expanded PEFA Secretariat, managed by a new multi-donor entity, or even handled by regional tax organisations such as ATAF and CIAT with multi-donor support and involvement. In principle, the regional approach is attractive as a vehicle for strengthening South-South learning and support networks. The PEFA model, though, has been highly successful in fostering donors’ and recipients’ widespread use and acceptance of the tool and ensuring quality control. These are all paramount considerations. Also, as with PEFA, a centralised structure does not preclude the mobilisation of regional networks.

Revenue-related indicators

Dozens of revenue-related indicators have been used in diagnostic studies and programme matrices to identify performance gaps, determine eligibility for budget support, monitor progress in improving tax systems, and trigger decisions on funding. Some indicators focus on revenue yield or collection efficiency, some on policy reforms or legal foundations for taxation, and still others on organisational or structural reforms. Furthermore, some indicators are qualitative, others quantitative. Indicators also differ in the way they address outputs, intermediate results, and outcomes. To be useful, any indicator should be “specific, measurable, achievable, relevant, and timed” and “obtainable at a reasonable cost”. (Crandall 2010b, 11)

The choice of indicators depends, of course, on context and purpose. For general budget support programmes, which cover a broad range of issues, there is usually room for only a few revenue indicators in the overall performance assessment matrix. Aid agencies can, however, introduce other revenue indicators as triggers for variable tranches in their GBS support. At the sector level, a PFM programme can accommodate more detailed revenue indicators, customised to the programme objectives of the host government and donors. With tax baskets or technical co-operation agreements, aid agencies can drill down to an even more granular level in defining appropriate revenue indicators for each country context.

At the GBS level, some country programmes have omitted revenue indicators altogether (see the Ghana case study in Chapter 5). With the international community now focusing attention on revenue issues, there is clearly a need to identify meaningful indicators for monitoring tax performance. To date, the most common indicator is the ratio of tax revenue or total revenue to GDP. This direct measure of domestic revenue mobilisation can be useful in identifying performance that is critically deficient or especially strong. In general, though, it is not a discerning gauge of performance. The main problem is that the ratio is affected by factors beyond the control of government. Such factors are business cycles, world commodity prices, movements in the exchange rate, rainfall, or even major revisions to the GDP statistic itself (e.g. Ghana).⁸

Another shortcoming of the tax ratio is that many important reforms to the revenue system are not intended to show up as an increase in the tax ratio. Some major tax reforms are designed for revenue neutrality in the short run by combining base-broadening measures with lower tax rates to improve the efficiency and equity. Other reforms are designed to reduce compliance costs or to speed up procedures for VAT refunds or the settlement of tax appeals. Even a major reform to simplify the tax system for MSEs in Mozambique would not show up in the tax ratio, because it yields very little revenue in the short run (Box 2.6).

A better gauge would be to target revenue outcomes against targets adjusted for changing economic conditions. One example is Afghanistan, where the GBS revenue indicator is defined relative to the IMF programme target, taking into account within-year revisions (Box 3.1). Another approach is to use indicators for intermediate results, reflecting aspects of collection performance, like reducing the number of stop-filers or later-filers, which should be under the control of the revenue authorities.

As noted in earlier chapters, what matters is not just how much tax is collected but also how it is collected – and how the tax system affects development performance.⁹ A meaningful assessment of revenue performance should therefore include structural benchmarks and operational results as well as outcome indicators. The diagnostic tools cited above offer a large menu of options. Box 4.2 outlines some examples.¹⁰

Other types of indicator

Many indicators not directly related to revenue can also be used to monitor synergies between taxation and governance. For example, a recent IADB sector programme for fiscal policy and tax equity in Panama includes indicators pertaining to the creation of a tax administration tribunal; the formal incorporation of tax expenditure analysis in the national budget; and targets for signing bilateral tax treaties with data exchange provisions to help limit cross-border revenue leakages (IADB, 2010). Other examples with significant implications for governance and state-building include:

- the number of tax appeals that have been outstanding more than one year;
- publication of taxpayer satisfaction surveys or compliance cost surveys;

- the introduction of computer-assisted mass appraisal systems for municipal property taxes;
- the number of asset declarations by revenue authorities' employees verified;¹¹
- extent of electronic filing or tax payments through banks;
- monthly publication of data on customs clearance times;
- implementation of real-time IT links between business and tax registration;
- joining the Extractive Industries Transparency Initiative;
- the number of parliamentary hearings on tax issues.

In selecting revenue indicators for any aid modality, donors have to be careful about possible unintended consequences. Some superficially attractive indicators can be double-edged swords. The tax ratio is a prominent case in point in that overambitious targets can lead to abusive collection practices at the expense of fiscal legitimacy. Similar adverse outcomes can result from ambitious targets for increasing the number of tax registrations by small businesses, as occurred in Tanzania (see Chapter 5). Another type of side effect can arise when quantity targets invite responses that sacrifices quality. For example, setting a high target for the number of audits carried out could lead to faster but less effective procedures. In all cases, thinking through the incentives created by an indicator can point to more refined or supplementary measures for monitoring and guarding against adverse side effects.

Lastly, the 2005 Paris Declaration on Aid Effectiveness established 12 indicators for monitoring the progress of various donors in adhering to its stated principles. The OECD/DAC periodically tracks them (OECD, 2009a). Donors should also develop indicators at the host-country level for tracking performance on their side of the development partnership. This includes regular public reports on the timeliness of disbursements, a fragmentation ratio (OECD, 2009b), and transaction cost indicators like the number of meetings per year with government officials on aid issues, or the number of documents required by donors from outside the government's own systems each year. To this end, Birdsall (2010) calls for donor programmes to include grants for independent watchdog groups who can monitor the donors themselves. These concepts apply to tax support as much as to other aid programmes.

Division of labour

The division of labour among donor agencies, or “complementarity,” has been a prominent theme in discussions about co-ordination to improve aid effectiveness. The EC *Code of Conduct on Division of Labour in Development Policy* neatly summarises the issue as: “who does what?” (EC, 2007b). The EC Code identifies five dimensions of complementarity: in-country; cross-country; cross-sector; vertical (ranging from sub-national to global initiatives); and cross-modality. The Code also sets out 10 principles for the division of labour. They include: concentrate on a few focal sectors within each partner country; redeploy involvement in other sectors through lead donors or delegated cooperation; and pursue vertical and cross-modality complementarity.

In 2009, an EC Communication on aid effectiveness assessed progress in applying the division of labour principle to reducing fragmentation. The communication reported that most EC member states had moved towards more selectivity and that a majority were participating in joint programming or multi-donor funds. In contrast, the OECD's 2009

Box 4.2. Illustrative indicators for assessing tax performance

For any aid modality the selection of indicators has to be customised to the context in order to shed light on progress towards priority objectives for improving the tax system. In some countries, like Afghanistan or Liberia, programmes may focus on very basic measures, while in more advanced countries like Guatemala or the Philippines more sophisticated indicators would be appropriate. With that caveat in mind, some illustrative indicators are listed below for outputs, results, and outcomes. This list is drawn from the literature on diagnostic tools for tax assessment, survey interviews, and country programme examples. As noted in the text, many of these indicators have implications for governance and state-building as well as tax performance.

Benchmarks/milestones (output indicators)

- passage of key tax laws or regulations;
- posting of tax laws and regulations on the Internet;
- establishment of taxpayer service centres;
- publication of monthly reports on revenue out-turns;
- publication of a taxpayer service charter;
- publication of tax expenditure accounts;
- number of tax treaties/agreements signed, with standard information exchange provisions;
- establishment of electronic master files for each taxpayer, with risk profiles;
- number of post-clearance audits for customs control;
- number of internal audit investigations on the conduct of tax officials.

Operational performance (results)

- debt collection ratio, by year;
- voluntary compliance rate (% of registered taxpayers filing and paying on time, by month);
- percentage of VAT refunds or income tax refunds paid within [30] days;
- percentage of large and medium taxpayers filing electronically;
- revenue assessed and collected from audits and inspections;
- percentage of commercial imports using green lane through Authorised Economic Operator programme;
- cost of tax registration and compliance for micro or small businesses;
- cases of tax evasion, customs fraud or smuggling successfully prosecuted, by year;
- cost of tax administration as percentage of revenues collected.

Revenue performance (outcomes)

- percentage of revenue targets achieved, adjusted for economic conditions;
- VAT efficiency ratio;
- tax gap as a percentage of revenue collected;¹²
- increase in own-source revenue for local governments.

Report on Division of Labour compiled two measures of aid concentration and found “no progress since the adoption of the Paris Declaration”. Indeed, the report found that “fragmentation is worsening” in low income countries which have “the least institutional capacity to cope with the costs”. Suggested remedies include reallocating funding to focus on the most significant relationships and having smaller donors channel resources through other agencies.

Drawing on a survey of donor agencies, the 2009 EC Communication also summarised impediments to the division of labour. They included the home-country preference for remaining engaged in politically important sectors; home-country legal or administrative barriers; lack of visibility in delegated co-operation arrangements; transaction costs of establishing elaborate complementarity arrangements; and hesitation about overly concentrating involvement in a narrow range of areas, which could limit host-country ownership and flexibility. As a result, fragmentation remains high. For example, despite an elaborate division of labour arrangement in Mozambique, many working groups and subgroups have 10 members or more, and over a dozen donors are involved in at least 15 groups (Chapter 5). Although the arrangement is far from streamlined, it does function and the various sector programmes are reasonably well co-ordinated.

In the field of taxation, complementarity has become increasingly important as more donors gain interest in domestic resource mobilisation and the relationship between taxation, governance, and state building. Yet the survey conducted for this study found limited scope for aid agencies to specialise based on a comparative advantage in tax-related expertise. From a menu of tax issues, almost all the major aid agencies cite at least five areas of “major focus” or “frequent involvement”, of which “comprehensive tax reform programmes” is a favourite. For only one issue, fiduciary oversight, did the survey find self-selectivity among the respondents. The survey also revealed an overlap of preferences with regard to types of support. From this angle, specialisation was apparent only for capital investment – mainly the province of the development banks – and for twinning arrangements for tax training.

No “best” division of labour option

One clear feature in the division of labour on taxation is that the IMF very often has a special role in providing upstream assistance in the form of diagnostic studies, analytical work, assistance in designing tax reforms, and reforming the legal framework (IMF/IEO, 2005). Agencies other than the IMF usually take responsibility for providing downstream support for implementation activities. At this operational level, there is no “best” way to establish the division of labour for tax programmes. Where multiple donors are involved, the “tax basket” approach is an efficient way of achieving co-ordination and coherence, though joint projects can also be effective. In some cases, like Rwanda and El Salvador, a bilateral arrangement with a lead tax donor has worked well. In addition, there is room for smaller donors playing to their special strengths to support niche activities. Two examples are Norway’s support for mining taxation in Mozambique and the auditing of large taxpayers in Tanzania. Such interventions should be co-ordinated closely with other donor action in support of the tax system.

Happily, the survey results and case studies also indicate that efforts to establish in-country consultation and co-ordination can succeed in establishing a coherent division of labour among donor agencies working in tax programmes. In addition, cross-modality complementarity provides a mechanism for smaller donors to be involved in tax issues through general or sector budget support programmes without creating fragmentation at the operational level.

Furthermore, there is ample scope for cross-country division of labour in supporting tax programmes, especially given the option donors face in many host countries of using budget support for that purpose. The 2010 tax and development mapping survey produced by the International Tax Compact (ITC) found that most developing countries had no more than three aid agencies, including multilaterals, directly involved in taxation activities. At this low level of donor density, it should not be difficult to deal with co-ordination problems in the field.

Finally, although the decisions on “who does what” in each country are largely driven by donor-country motives, host governments need to play an active role in shaping the division of labour among international partner agencies. The evidence suggests, on the contrary, that many host governments welcome donor support from nearly any source, sometimes even soliciting fragmented arrangements. Greater selectivity, as in Rwanda’s bilateral relationship with DFID, makes for less cumbersome arrangements, greater domestic ownership of the process, and outcomes that are just as effective.

Aid exit strategies

In the context of supporting tax systems, the issue of aid exit has several special dimensions. A fundamental concern in providing support for domestic revenue mobilisation is to help recipient countries make progress towards an eventual exit from aid dependency. While awareness of the issue is widespread, there does not appear to be much systematic thinking about an appropriate, incentive-compatible trajectory for phasing out development assistance as per capita incomes and revenue performance improve.

A more immediate exit issue involves the effectiveness of aid in helping host countries to improve their revenue systems and promote governance dividends from taxation. Should donors exit if the programmes are not showing results? Birdsall (2010) points out that donors have been too unwilling to disengage when aid is ineffective. She suggests that continued funding under unfavourable conditions may be due to “misguided optimism” or a preference to “do something,” impelled by organisational pressures for disbursement. Another, more benign, motive for aid continuity is a genuine concern on the part of donors for ownership, alignment, and predictability in funding. As discussed earlier, however, these principles are not always consistent with accountability for results. If there has to be a trade-off, then it is appropriate to resolve it in favour of accountability for results.

But the problem runs deeper. Improvements in the revenue system are multi-dimensional, and there are many shades of gray between satisfactory results and clearly inadequate performance. Except where lapses are egregious, it is difficult to set down clear rules on when to exercise the exit option in programmes to support the tax system. Here, once more, decisions must be made case by case. Nevertheless, there is room for two or three general observations.

First, expectations should be realistic. Institutional transformations have a gestation period that can take five to ten years or more, and progress is not always monotonic. In fragile or post-conflict states, World Bank research indicates that “even the fastest-transforming countries can take from 15 to 30 years to establish well functioning institutions” (World Bank, 2010). Donors should therefore look at the long term in assessing whether or not to continue funding revenue programmes.

Second, a graduated response mechanism can help to balance predictability and accountability. This can be achieved through variable tranches or incentive funds (as in Afghanistan) that are based on revenue indicators. A similar option is to draw up specific

exit criteria as part of a programme agreement in order to create incentives for the host country to remedy problems with revenue performance. One idea might be for donors to focus exit criteria on fundamental indicators of government commitment, such as audit and transparency conditions, rather than specific quantitative targets.¹³ Unless lapses are severe, exit should be predictable and aligned with the host-country budget cycle. Thus, a decision in year “T” to cut off support should take effect in “T+1”, or even be phased over several years. Such an approach averts abrupt disruption and allows recipients a grace period in which to demonstrate their resolve to address problems.

Third, an exit from funding through one modality need not mean disengagement (Birdsall, 2010). For example, lack of revenue performance may drive even a donor who is seriously committed to seeing revenue improvements to end budget support or a major technical co-operation agreement. However, the donor may reprogramme some funds for initiatives that aim to deliver revenue benefits over time, such as analytical work, tax training, or support for civil society participation in dialogue on the fiscal contract.

Recommendations for cross-cutting issues

Donors should not determine priority areas for support against a mere checklist of best practices. They should analyse key problems and opportunities in the light of host-country priorities and the economic, cultural and political conditions in each country. In other words, while grounding their programmatic priorities in basic principles of tax policy and administration in developing countries, they should always conduct diagnostic analyses. These should, in the interest of state-building, accord special consideration to programmatic activities that can deliver governance dividends.

Despite the clear need to establish priorities, there is no common framework for analysing performance gaps or strategic priorities on the revenue side of the budget. In the absence of such a framework, donors and multilaterals are increasingly co-ordinating diagnostic work to ensure a consistent set of priorities. On the expenditure side of the tax system there is a common, widely used tool – PEFA. Despite some criticism that PEFA is too generic and donor-driven, it would be useful to build a revenue-raising framework along the lines of the PEFA to harmonise revenue assessments and co-ordinate aid programmes for stronger tax systems

Dozens of revenue-related indicators are used to identify performance gaps, determine eligibility for budget support, monitor progress in improving tax systems, and trigger decisions on funding. The one finally chosen should depend on the aid modality and its objective. GBS, for example, may use very few indicators (some GBS programmes use none), while and tax basket arrangements apply indicators down to the minutest granular level. The most widely used is the ratio of tax or total revenue to GDP. It helps determine whether tax performance is good or bad, but is no more discerning than that. A meaningful assessment of revenue performance should therefore include structural benchmarks and operational results as well as outcome indicators. Donors should also be wary of the unintended consequences of some indicators. The tax ratio can lead to abusive collection at the expense of fiscal legitimacy. Thinking through the incentives created by an indicator can point to more refined or supplementary measures for monitoring and guarding against adverse side effects. Donors should also develop indicators at the host-country level for tracking performance on their side of the development partnership.

Carefully assessed and targeted tax assistance objectives should be supported by donor complementarity or “division of labour” – *i.e.* it should be clear “who does what”. In the field of taxation, complementarity has become increasingly important as more donors

show interest in domestic resource mobilisation and the relationship between taxation, governance, and state building. Yet few aid agencies have special tax-related expertise, with many big agencies citing “comprehensive tax reform programmes” as their speciality. There is no single “best” way to ensure complementarity in donor tax aid provision. Ultimately, however, host governments should be more active in determining the division of labour among partner aid agencies, which should be made easier by the fact that most developing countries worked with no more than three agencies in the field of taxation.

What, though, if programmes fail to show results? Should donors exit or not? They are often unwilling to pull out through “misguided optimism” and concern for alignment, ownership, and predictability. Their prime concern should be accountability for results although they should not be too unbending in this respect. Their expectations should be realistic, as programmes may take decades to bear fruit. They should also write into programme contracts specific exit criteria in order to strike a balance between predictability and accountability. A final point is that ending funding for one modality does not mean that a donor necessarily pulls out of a country altogether.

Examples of exit options, donor division of labour, and the diagnostic and monitoring indicators used to determine priorities can all be found in the next chapter. It presents six case studies that illustrate the tax aid modalities at work. The selected countries exemplify tax assistance issues and actions, successes and failings, and point up linkages between taxation and governance.

Notes

1. Another World Bank evaluation, on Public Sector Reforms (PSR), found that tax administration programs have generally been successful, and that performance ratings for these programs were higher, on average, than for programs in public expenditure management, civil service reform, or anticorruption and transparency. The findings, however, refer to lending programs; the study explains that the IMF generally leads on TA and ESW in the area of taxation and that the Bank lacks staff expertise on tax issues (World Bank IEG, formerly OEC [Operations Evaluation Department], 2008).
2. TA projects often have the opposite effect of exacerbating the skills gap when they “poach” top local experts from government organizations. Sometimes this is a price that has to be paid for effective capacity building, but other staffing options should always have priority.
3. The ITD survey also found that a majority of tax administrations in sub-Saharan Africa are dissatisfied with their IT systems (ITD, 2010). See Bird and Zolt (2008).
4. See, for example Bird (2010) and IMF (2010) and libraries of material on taxation and development available on-line through the International Tax Dialogue (www.itdweb.org) and USAID’s Fiscal Reform website (www.fiscalreform.net). Neither the literature review nor the interviews conducted for this study shed useful light on the sequencing of reform measures. This issue also needs to be examined as part of the country-specific diagnostic analysis.
5. The World Customs Organization (WCO), under its Columbus Programme, has applied a Diagnostic Framework tool for customs administration in more than 100 developing countries. This tool covers best practices for customs administration, but the focus is on WCO Standards to Secure and Facilitate Global Trade (the SAFE Framework) rather than revenue mobilization.

6. Data on the number of PEFA applications is from the June 2010 PEFA Newsletter, which is available at www.pefa.org. Also see PEFA Secretariat (2005), Eckardt and Schickinger (2011) and other information on the PEFA website.
7. For example, they refer to the EU Blueprint as benchmarking good practices “carried to an extreme.” They also criticize the EU scoring methodology as a “(superficially) scientific guise” for evaluation that actually “depends entirely on subjective judgment in several key respects” (Vazquez-Caro and Bird 2011, 6-7).
8. The same problems afflict use of year-by-year changes in an index of “tax effort” (see Annex D). This index compares the tax ratio to a predicted value, controlling for major structural characteristics affecting the capacity to collect taxes in each country. Another problem with this indicator is that the predicted values are subject to large standard errors.
9. Some other widely cited tax indicators are also problematic, but not discussed here for lack of space and time. These include the IFC’s Doing Business scores for Paying Taxes, and tax ratings in the World Bank’s Investment Climate Assessment reports.
10. Among other sources, the illustrative indicators cited here draw on Annex 2 of the International Tax Dialogue (2010), which summarizes strategic objectives and targets of the revenue authorities in eight African countries.
11. This interesting indicator has been adopted by the Mauritius Revenue Authority under their strategic objective for “ensuring integrity and fairness” (ITD 2010, 113).
12. The IMF recommends the tax gap as a Key Indicator of performance in tax administration (IMF/FAD 2011, 19). But Fuest and Redell (2009) provide a compelling analysis of methodological problems in estimating tax gaps in developing countries. They suggest that better estimates might be obtained using microeconomic data from audit results; this approach, however, would miss out on non-filers.
13. Thanks to Will Prichard of University of Toronto for this suggestion.

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Chapter 5

Six Case Studies¹

This chapter presents the experience of six countries, all recipients of tax assistance provided through the modalities which the previous chapter addressed. The countries are: Ghana, Guatemala, Liberia, Mali, Mozambique, and Tanzania. The case studies offer ground-level views of the aid modalities used to strengthen the tax system and the interface between taxation and governance. The main concern has been to understand how the modalities and linkages actually work, the nature of problems and issues encountered, and how to improve the modalities from the insights gained. For each country, the study team reviewed documents and conducted face-to-face and telephone interviews or exchanged emails with officials who had direct experience of dealing with tax programmes on both donor and government sides. In essence, the case studies are designed to inform analysis, not as comprehensive reviews in their own right.

5.1. Ghana

Since the mid-1980s, Ghana has pursued several institutional arrangements to strengthen domestic resource mobilisation and implemented a comprehensive set of tax policy reforms. Currently (in 2011), though, the fiscal environment is very challenging. The government has run up huge budget deficits and the debt outlook is clouded by state enterprise losses from underpricing energy. The tax ratio has increased over the past ten years and, at 21% of GDP, appears very high by regional standards. But this picture is deceptive.

A recent re-basing of national accounts found that GDP had been seriously underestimated. New and more reliable statistics show that tax revenues amount to only about 13% of GDP. In addition, the government is still heavily dependent on donor funding, which accounted for over one-half of the capital budget in 2010 and about one-sixth of total revenue. So, notwithstanding imminent oil revenues, the government's position calls for further developing internally generated revenue.

In 2009, the government established the Ghana Revenue Authority (GRA) as an apex body tasked with improving taxpayer services, modernising tax and customs processes, strengthening taxpayer compliance, widening the tax base, and generally making tax administration fairer and more transparent, accountable, and accessible. The entire tax environment is expected to change, with automation as the central – and costly – factor that would bring the revenue departments into the 21st century. At the same time, the government put in place a transparent, rule-based framework for managing oil and gas revenues.

Since 2002, a multi-donor budget support (MDBS) programme has provided funding to supplement domestic revenues. The MDBS programme is derived from Ghana's national strategy for poverty reduction and economic growth. Donors base funding on a holistic annual review of performance. The government supports its domestic revenue mobilisation indirectly in the base tranche in accordance with the principle of maintaining sound economic policies. Given the recent budget deficits, it has evidently applied the principle loosely. There is also a performance tranche, but without revenue triggers.

The MBDS programme has a progress assessment framework (PAF) with several structural indicators for revenue and transparency. For 2010 they were: commencement of integration of departments in the GRA and selection of criteria for allocating taxpayers to the large, medium, and small taxpayer offices. The programme met both benchmarks. The 2011 indicator calls for the completion of the Taxpayer Identification Number and registration modules for the new tax IT system. Indicators for 2012 are still to be determined.

Under the MDBS programme, the Ministry of Finance and Economic Planning spearheads revenue mobilisation. The ministry operates under aegis of the Public Financial Management (Revenue and Expenditure) Steering Group and through the Information Management Working Group (automation). The government is concerned to limit the number of committees to what is essential. A GRA Reform and Implementation Committee, chaired by the Commissioner General, supports the governance structure for revenue mobilisation. Given the importance of revenue mobilisation and the need for support to the GRA, this committee could form the nucleus for a donor revenue committee or the establishment of a revenue basket.

Currently, direct support for domestic revenue mobilisation comes from the IMF, GIZ, and SECO. The World Bank supplies additional support for automation through the

eGhana project. GIZ is the main bilateral agency in this area. It works through the Good Financial Governance (GFG) Programme in co-operation with SECO. Tax administration and tax policy is one focus of GFG, along with budgeting and budget implementation, accountability to Parliament and society, and the transparency of revenues from extractive industries.

In addition to the GRA reforms and transparency initiatives, a major link between the revenue system and governance is support for local authorities. Local governments are traditionally funded by central government through a set-aside common fund. But their capacity is still very limited. A programme for decentralising reforms is designed to build capacity in the regional governments, with significant German support from both the German Ministry for Development (now merged with GTZ into GIZ) and KfW. In addition, a large World Bank operation is scheduled for approval.

One way in which the central government is actively seeking to increase local capacity is through a programme of having GRA officers work with and train local government revenue officers. This initiative is being tried in particular with property tax, which is a local government responsibility.

Ghana's experience points to the following key findings and recommendations:

- A merger of tax administration under one authority is most effective if the reform is fully owned by both the government and Parliament – not imposed by donors. Donor support is welcome, but it should not interfere in ownership.
- The multi-donor budget support programme is the government's preferred modality in the delivery of aid. It allows the government to determine the allocation of funds received from development partners and increases its ownership of the process.
- The mechanism has increased the predictability of donor funding, helped to improve PFM systems, and facilitated policy dialogue between government and development partners, while lowering the transaction costs associated with the management of aid on both sides.
- "To catch fish, you need to use fish." In other words, revenue modernisation needs adequate funding to succeed. Considerable donor support for the revenue programme will be needed through the medium-term. The amount will be based a fully costed corporate plan that the government is completing.
- Putting in place basket financing to support the tax system may offer the advantage of increasing the pool of funds available specifically for revenue programmes and ensuring alignment with government priorities.
- However, the government of Ghana (GoG) appears satisfied with the current donor governance framework and is reluctant to add additional layers unless it deems it essential.
- One way for central government to enhance the revenue capacity of local governments is to assign officers from the revenue authority to work with and train local government revenue officers. Strengthening the property tax is particularly important for local governments in Ghana.
- It is important for the donor community to provide support to improve the management of non-tax as well as tax revenues, especially in light of the future oil revenues.

- Good governance requires consultation with and education and training for all stakeholders with respect to the changes in policies and systems and their procedures.
- There is a need to anticipate institutional rivalries amongst the revenue departments and agencies and to provide adequate, timely resources for staff recruitment and training. In short, there is a need for skills in change management.

5.2. Guatemala

In the aftermath of a 36-year civil war that ended in 1996, Guatemala has made significant progress in achieving macroeconomic and democratic stability, strengthening public institutions, and introducing reforms to improve governance and transparency. The country faces major challenges, though, in tackling poverty, corruption, and criminal violence. In addition, Guatemala was hard hit by the global financial crisis, with growth falling to 0.6% in 2009. Despite the challenges, the IMF considers the macroeconomic outlook to be favourable, though the country needs to make significant policy efforts, which include tax reform. More specifically, stronger domestic resource mobilisation is essential for debt sustainability and fiscal adjustment with increased funding for priority expenditures.

In the early 1990s, tax revenue in Guatemala averaged less than 8% of GDP. To strengthen tax administration, the government set up the Tax Administration Superintendence (SAT) in 1998 to collect central government taxes, including customs duty. Modelled on the Peruvian and Tanzanian revenue authorities, the SAT was endowed with functional, economic, financial, technical, and administrative autonomy. In practice, performance has varied with the political environment. Among other issues, political interference created considerable instability in top management during the first years of operation, leading to inconsistent internal policies and programmes. In addition, the Ministry of Finance has generally allotted the SAT less funding than the 2% of revenues stipulated by law.

Since 2002 the tax yield has stagnated around an average of 10.5% of GDP – against a goal of 13.2%. Even that goal would be well below the regional benchmark for lower-middle-income countries. The weak performance is attributable to outdated tax laws, tax expenditures, the effects of trade liberalisation on customs revenues, and widespread tax evasion. Corruption in the SAT is not considered a significant factor. Priority areas for improving tax collection include: strengthening the regulatory framework; improving core business processes developing human resources; infrastructure and equipment for modernisation; ethics and transparency programmes; and capacity building to audit multinational taxpayers.

The SAT initially received substantial funding and technical assistance from the World Bank, and subsequently received modest support from a very wide range of agencies. The current agenda includes activities or projects with the IMF, CIAT, IADB, World Bank, GIZ, the Korea International Cooperation Agency (KOICA), and the U.S. Treasury Office of Technical Assistance (OTA). Unusually for Latin America, the SAT has a management unit in charge of donor co-ordination and broader international co-operation issues. The unit meets one-on-one with donors to reach agreements based on its corporate plan and assessments conducted by each partner agency in developing proposals for support. The SAT considers that this arrangement is effective for managing all aspects of donor co-ordination and preventing duplication, albeit with high transaction costs.

In addition to direct aid to the SAT, major donors, particularly the World Bank, the IADB, and the Central American Bank for Integration (CABEI) provide general budget support. Government officials regard this flexible funding as extremely beneficial. But there is no formal development partnership forum, and no specific arrangements for sector support. Donors prepare their own strategies as part of a co-ordinated effort with the government and consultation with the private sector and civil society. Both government officials and donor representatives state that this informal system works well. It is notable, though that the World Bank recently held up disbursements for the Third Programmatic Fiscal and Institutional Development Policy Loan (provisionally USD 350 million) for lack of progress, specifically on taxation.

The concept of basket funds is not well known in Guatemala, but once it was explained to them, officials felt that it would offer advantages in keeping players on the same page, preventing duplication, and reducing transaction costs for government.

Guatemala's experience points to the following key findings and recommendations:

- Regional organisations and South-South co-operation on taxation are especially useful in sharing best practices and experience. Learning and mentoring from peers is more effective.
- Nonetheless, support from foreign experts is also valuable. Decision makers often pay more attention to them than to local experts.
- Guatemala needs medium- and long-term donor support programmes aimed at specific outcomes. For this purpose, the tax authorities need consultants who work in the country either full-time or over long periods, so that they may build relationships, come to understand the local culture and environment, and provide sustained support through training and mentoring.
- But current donor projects are very small, and transactions costs are high in meeting different reporting and timing requirements. It can also be difficult and time consuming to find support for completing an activity that was begun by one donor but not fully implemented.
- The government would like to see donors work together to aggregate their support, establish a joint process for co-ordination, conduct a common diagnostic studies, and agree at the outset on the course of action, priorities, and a division of responsibilities. Development co-operation is about synergies, not competition among donors.
- A key lesson from interviews for Guatemala is the emphasis on the political dimension of taxation and that political factors can be major impediments to improving revenue administration. The implication is that the international community should engage at the political level, not just at the technical level, in assessing opportunities for and obstacles to serious tax reform.
- One key factor for success in fostering governance dividends from programmes to strengthen tax systems is to deal with pressure groups in a positive manner, increasing collaboration with them and making them part of a solution in which the country as a whole will benefit.
- An asymmetry in resources between large companies and the public sector underpins the importance of independent policy research to support government policies and provide outreach education to the media, civil society, and business groups. Huge benefits are to be gained from broader understanding of tax issues.

- The clearest example of a tax-related governance dividend in Guatemala is a recent IDB operation to provide small-business taxpayers with software to aid them in tax compliance.
- Anecdotal evidence suggests that the SAT, like Guatemala's Central Bank, has shown a positive example which the government and private sector are seeking to emulate in their business and management practices. Spillovers for computer literacy from on-line filing (now up to 95%) are a notable case in point.

5.3. Liberia

Since 2003, when a peace accord ended 14 years of devastating civil war, Liberia has achieved great progress in the face of serious difficulties and risks. In 2006, democratic elections brought to power a strongly reformist government that moved decisively to start the lengthy process of re-establishing public financial management systems, delivering essential public services, and laying the foundations for local government systems. The country still faces monumental challenges in all areas.

Despite extreme capacity constraints and a large share of non-monetised economic activity, revenue performance has been remarkable. In 2010, total revenues (excluding grants) reached nearly 30% of estimated GDP. In its initial fiscal recovery effort, the government focused on overcoming corruption in customs and gaining quick wins by re-negotiating concessions for forestry, flagships, mining (mainly iron ore), and more recently, palm oil. In 2010, concession revenue yielded 11% of GDP. The government has also sold offshore oil exploration rights to a major company. To ensure transparency, the government enacted the Liberia Extractive Industries Transparency Initiative (LEITI) Act in 2009. It encompassed forestry and agriculture as well as the extractive industries. The EITI Board commended Liberia as the “Best EITI Implementing Country” in 2009.

The second quick win was in customs revenue, which amounted to nearly 10% of GDP in 2010. This performance was driven by an early decision to enforce a pre-shipment inspection regime, streamline systems for paying import duties, and improve port management. Income tax has also performed well, supported by a tax awareness campaign, a whistle-blower law to reward those who report false tax declarations, and the introduction of an automated payment module. Nonetheless, tax administration is hindered by inadequate and poorly paid staff and lack of reliable data, especially from the large informal sector.

The government accords a high priority to strengthening revenue collection and modernising revenue administration. Far-reaching changes in tax policy and tax administration are underway, as well as improvements in public financial management. Key reforms under consideration include the establishment of a revenue authority; the introduction of VAT (in compliance with the standards of the Economic Community of West African States [ECOWAS]); a comprehensive human resource management programme; and implementation of LEITI to ensure full disclosure of revenues from mining, petroleum and forestry.

Liberia remains extremely dependent on aid. Since the end of hostilities, official grants have exceeded GDP each year, though this figure is steadily declining. The government manages aid through the Liberia Reconstruction and Development Committee, which provides a platform of working committees for co-ordinating, monitoring, and evaluating projects and programmes, and reporting on progress. Liberia also receives significant funding from private foundations. Donor co-ordination overall is well-structured and harmonious.

Revenue reforms have been driven by the government itself, with only moderate donor support. One example was the principal multi-donor agreement on the Governance and Economic Management Assistance Programme (GEMAP) which started in 2005 and was run by USAID. It did not significantly address tax issues, aside from some assistance with customs reforms and training of revenue (and expenditure) staff. The IMF also has been providing technical assistance since 2006, including a resident tax advisor posted in May 2010. Support for revenue mobilisation has been growing, though, including assistance from the African Development Bank (AfDB), ECOWAS, the EU, the French Government, the US Treasury Department, the World Bank, and the IFC.

One critical activity is the introduction of an integrated tax administration services (ITAS) system to cover all aspects of tax administration. It is estimated to cost USD 11 million, of which USD 2 million are provided as part of a World Bank project. The project was launched in August 2010 and encountered some early problems such as the absence of a prior mapping of business processes, difficulties in staff retention, and a need to scale back the modules to fit the funding. The current focus is on taxpayer identification numbers.

Looking ahead, Liberia's revenue modernisation will need extensive financial and non-financial support over the next decade. The government has developed a strategic plan for revenue and customs, and will be seeking donor support in the range of USD 35-40 million. There is no doubt that Liberia's revenue modernisation will need extensive financial and non-financial support, and that donor co-ordination on the ground is imperative.

Liberia's experience points to the following key findings and recommendations:

- Even in a post-conflict setting with near total collapse of governance systems, strong and dynamic leadership from a reformist President, Minister of Finance, and Deputy Minister for Revenue can produce rapid improvements in revenue mobilisation.
- Liberia's experience confirms the relative ease of collecting import taxes in a post-conflict setting – if the government is serious about it.
- Successful negotiation of natural resource concessions has been a major factor in the rapid increase in revenues. Also notable is Liberia's early entry into the EITI to ensure full disclosure of revenues from mining, petroleum, and forestry.
- Liberia's experience with introducing IT systems for tax administration underscores the need for careful planning and costing, with support from the international community.
- Government officials stressed the need for advisors to remain on the ground through the medium term to work alongside and mentor local staff, as well as provide training.
- The government's decision to establish a whistle-blowing act as an integral part of the revenue programme can have dividends in other sectors, and be a model for other developing countries.
- There has been a considerable loss of tax personnel, lured to the private sector after they received training. Decent salaries are an important factor in state-building. Under post-conflict conditions, donor-funded top-ups can be warranted as an interim measure.

5.4. Mali

Over the decade from 2000 to 2010, Mali's growth rate averaged over 5% per year, lifting per capita income from UD 663 in 2000 to an estimated USD 1 207 (in purchasing power parity). But it is still one of the poorest nations in the world and remains heavily dependent on foreign aid. In 2009, foreign grants and net loans totalled 7% of GDP, while external financing covered 60% of the capital budget.

The government has been pursuing major tax reforms since the Directorate General for Taxes (DGI) was established in 2002 with a mandate to modernise tax administration, improve taxpayer services, broaden the tax base, and strengthen revenue mobilisation. But revenue performance is still fairly weak. In 2009, tax collections amounted to 14.8% of GDP – below the tax ratio in 2005. One factor contributing to the lack of improvement has been a relative decline in customs revenue attributable to trade liberalisation. Other factors include extensive exemptions that apply to many large companies; tax evasion by elites; lack of political backing for strengthening the urban property tax; corrupt practices in the revenue service; and a general lack of tax compliance.

The issues of harmonisation and alignment are highly salient ones in Mali, where a large number of technical and financial partners (TFPs) operate. The government and the TFPs have established a Joint Assistance Strategy (JAS) with 10 thematic groups, three cross-cutting groups, and numerous sub-groups. Participants view the mechanism as working reasonably well. The JAS provides for joint dialogue, joint work plans, joint review procedures; joint monitoring, and effective division of responsibilities. Nonetheless, there is still fragmentation as different TFPs respond to their own administrative and political requisites, and often have distinct priorities and approaches.

In 2010, nine TFPs funded GBS, totalling about 2% of GDP. The World Bank is the largest contributor. The GBS performance matrix had 39 “triggers” with 60 indicators, including a target for the tax ratio (which was not achieved). The public finance management subgroup co-ordinates the government's PFM programme, known by the acronym PAGAM II. Its runs from 2011 to 2015 and has four strategic objectives: efficient and effective revenue mobilisation; budget preparation and execution; transparency and responsiveness; and fiscal de-concentration and decentralisation. PAGAM II has set four intermediate revenue-related objectives – predictability; revenue mobilisation; the appropriate issuance of domestic debt; and harmonisation between local and state revenue systems. A total of 20 indicators measure the four targets. Support for PAGAM II is channelled through bilateral projects and programmes. It is not a common fund.

From 1997 to 2005 a programme run by the Canadian International Development Agency (CIDA) called PAMORI was the flagship donor scheme for strengthening and modernising tax administration. It was supplemented by IMF tax missions. Although PAMORI achieved substantial success, progress has been slow since 2005.

Planning for PAMORI II began in 2007, again as a CIDA project, but the implementation has been very slow to materialise. Meanwhile, CIDA has provided intermittent assistance and the IMF has continued short-term missions and training, mainly through its technical assistance centre for West Africa (AFRITAC-West Africa). The French Ministry of Foreign Affairs has also been providing training, advising, and technical support through one official in the Directorate General for Taxes (DGI) and one in the Customs Directorate (DGD).

The PAMORI project yielded considerable improvements in governance up to 2005. It established a strategic planning process, professionalised tax administration, and streamlined business processes. These reforms were central achievements that have benefited every

citizen who comes into contact with the tax system, even if problems remain. One informed source indicated that the programme in the DGI has motivated reform in other ministries, particularly in strategic planning, results-based management, and remuneration reforms. PAMORI also helped the government to strengthen tax information outreach to the public and facilitated consultations with the business community. Finally, in tandem with reforms to improve the revenue system, the government and its international partners have also been working to improve budget management and strengthen public finance systems at the community level to finance local economic development.

Mali's experience points to the following key findings and recommendations:

- The JAS process has been highly effective in co-ordinating aid programmes at all levels and establishing a workable division of labour among donors.
- The GBS programme is very attractive when benchmarked against the Paris Declaration principles and as a framework for high-level policy dialogue. But it has not created effective incentives for domestic resource mobilisation. Performance reviews have been characterised by a high degree of forbearance on certain triggers and the broad set of indicators dilutes the incentive value of each one. In addition, there is still significant fragmentation below the surface of JAS.
- The PAGAM II sector programme is an excellent framework for co-ordinating donor and government activities, and embedding revenue reforms in a broader PFM framework. But the sector programme does not involve any common fund or SBS arrangement. Donor activities are mainly bilateral arrangements which have no harmonised systems or procedures.
- One strength of PAGAM II is its focus on integrating local and national finance systems within the sector programme as a way of strengthen fiscal decentralisation.
- The monthly meetings of the PFM subgroup are a helpful mechanism for regularly reviewing budget and revenue issues and co-ordinating donor activities.
- The bilateral PAMORI project was very effective in supporting tax reforms and boosting revenue performance. According to one participant, the project was “such a success that I wouldn't want to change the recipe!” But the sluggish progress since 2005 shows the value of having a predictable funding mechanism such as a tax basket rather than relying on bilateral support.
- The IMF's Regional Technical Assistance Center for West Africa (Afrítac-West) has provided effective technical assistance and training, with multi-donor funding. However, the Center does not have the capacity for comprehensive involvement.

5.5. Mozambique

Since 1998 the government of Mozambique has been pursuing a well sequenced programme of fundamental reforms to the tax system. They include the creation of the Mozambique Revenue Authority (MRA) in 2006 and the introduction of a highly simplified tax regime for micro and small enterprises in 2009. On the policy side, the current tax code largely conforms to international good practice for a developing country, with primary reliance on broad-based consumption and income taxes. The MRA has been highly successful in widening the tax base and achieving ambitious targets for revenue mobilisation. The revenue ratio has increased from 14.1% of GDP in 2005 to an estimated 18.8% in 2010, despite reduced import duty rates and the effects of preferential trade

arrangements on revenue from trade taxes. Mozambique's revenue ratio is now well above the median for low-income countries in sub-Saharan Africa and low-income countries globally.

Mozambique has been one of the most aid-dependent countries in the world. In 2009, net aid flows amounted to 14.5% of GDP, and two-thirds of the government's capital budget was externally financed. Support for the tax system has evolved on four levels. The main modality is a multi-donor common fund, or tax basket, providing approximately USD 6 million per year in direct support to the MRA. Revenue issues are also addressed in a common fund at the Ministry of Finance level for implementing an integrated electronic public finance management system (SISTAFE). Third, the performance matrix developed for the 19-agency GBS programme includes the ratio of government revenue to GDP as a revenue indicator. The PFM co-ordination group (and the tax basket group) assess revenue performance. Fourth, several bilateral and multilateral agencies have provided assistance to the government in modernising and strengthen the revenue system.

Mozambique's tax basket, which now has five members, is widely regarded as a model for multi-donor co-ordination in supporting tax systems. The basket has a single joint programme, and a single process for dialogue, monitoring, and quality control. It also has achieved a high degree of alignment with host-country systems and priorities, and capacity development for the MRA. Furthermore, the MRA has exercised leadership in the common fund dialogue and ownership of the reform agenda. The co-ordination process, however, has been difficult and time-consuming for the lead agencies, and there is still fragmentation in donor requirements, involving problems with the timing of disbursements. In addition, the basket agreement has some restrictions on the use of funds.

The foremost governance benefit from tax reforms in Mozambique has been in strengthening the tax system itself and boosting domestic resource mobilisation to finance public expenditures. Achievements have included sustained efforts to improve the efficiency and effectiveness of tax administration; new legislation clarifying taxpayer rights and responsibilities; steady progress in professionalising tax and customs personnel; upgrading internal IT systems; widening the tax base; improving taxpayer services; simplifying procedures; and providing better public information on the tax system. Another development in governance is that the MRA will be undertaking the first survey of taxpayers' attitudes in 2011.

The Mozambican government has also been pursuing related governance reforms, such as concerted efforts to modernise public finance management; the establishment of tax and customs courts; revenue transparency through the EITI process; and improvements in public-private dialogue on tax issues. Donors and multilateral agencies play an important role in working with the government in all of these areas.

Mozambique's experience points to the following key findings and recommendations:

- The tax basket is a major improvement over fragmented bilateral projects. However, it can be difficult to manage and has some inherent and context-specific limitations.
- While strong local leadership and ownership are essential to the success of the tax basket, there is also a need for technical support to help shape the reform agenda. In Mozambique, the IMF in particular has played a critical role.
- There is also a need for careful attention to detail in the tax basket memorandum of understanding on procurement, audit, use of funds, and an *ex ante* framework for dealing with unexpected problems.

- The GBS programme has not had much of an impact on domestic revenue mobilisation. This is partly because the government has done an excellent job of meeting the revenue targets, but also because donors are not applying serious sanctions for missed targets.
- With the SISTAFE common fund including tax elements, co-ordination with the tax basket is essential if multiple processes, budgets, and technical approaches are to be avoided. In practice, however, this co-ordination is very good.
- Even with active, effective multi-donor programmes in place and funding budgets at several levels, there is still a place for technical co-operation to address implementation and capacity development needs. Government-to-government peer support would be especially welcome.
- It is essential, however, to have systems for co-ordinating technical cooperation arrangements within a coherent overall programme for tax reform, and to simplify and harmonise procedures for technical assistance programmes as much as possible.
- There have been important tax-governance linkages in Mozambique, driven by the government, with international partners in supporting role.

5.6. Tanzania

In 1994, Tanzania embarked on a major programme of tax reforms to increase domestic resource mobilisation and reduce aid dependency. The key initiative was to establish the Tanzania Revenue Authority (TRA) in 1995 with the aim of strengthening tax administration; reducing widespread tax evasion; limiting political interference in tax administration; and freeing the tax agency from civil service constraints. A second major reform was the introduction of VAT in 1998. VAT now generates nearly one-third of total revenue collected. The reforms contributed to commendable growth in revenue from under 10% of GDP in 1992-93 to a peak of 15% in 2008-9. Despite these improvements, revenue growth has not matched the rise in expenditure, so Tanzania is still highly dependent on foreign assistance.

Opportunities to improve domestic revenues echo some of the original objectives of the TRA was set in 1995. These include strengthening compliance; widening the tax net to include emerging sectors; controlling abuse of still pervasive exemptions; and addressing the small business tax environment. In addition, human resources remain problematic: internal corruption and taxpayer fraud are still serious issues; taxpayer trust is not yet well developed; and tax legislation itself, which is not within the TRA's mandate, requires further simplification. Non-tax revenues are another source of potential revenue gains; they have averaged about 1% of GDP, but there are significant leakages through illegal logging, mining, poaching, and fishing. The government is particularly seeking to increase revenues from the mining sector, which are not collected by the TRA. In 2009 the government also moved to join the Extractive Industries Transparency Initiative (EITI).

For financial year (FY) 2009-10, grants and concessional loans totalled approximately 9.4% of GDP – approximately USD 2.4 billion – and funded 62% of total development expenditures. Budget support amounted to 5.5% of GDP, including 1.5% of GDP allocated through the budget to sector “basket” programmes (IMF, 2010e). Project aid amounts to just under 4% of GDP.

Some 40 agencies have been providing support. A development partners group (DPG) works with the government and domestic stakeholders through a complex joint assistance strategy (JAS) that was developed in 2006 to increase aid effectiveness. The JAS draws on the country's poverty reduction strategy (MKUKUTA) and provides a framework for joint dialogue at four levels: a high-level joint co-ordinating group for discussing overarching issues of policy and aid co-ordination; a public expenditure review (PER) group; three cluster working groups; and numerous sector and thematic groups that work with relevant ministries.

Since 1995, assistance for revenue mobilisation has amounted to an estimated USD 120 million.² Funding has targeted business process re-engineering; IT systems; customs border posts; equipment; building renovation; stronger tax laws and the judiciary; improved taxpayers services; capacity building; studies and training; and support to the policy unit in the Ministry of Finance and the Auditor General's office.

In 2006 the World Bank and DFID initiated the Tanzania Modernisation Project (TMP), providing funds of USD 7.6 million and GBP 16.6 million respectively. A donor tax basket that supports TMP brings together the World Bank (as lead donor), DFID and the Danish International Development Agency (DANIDA) – all funding donors. The IMF and the Norwegian Agency for Development Cooperation (NORAD) provide technical assistance in requested areas. Donors all take part in biannual project implementation missions to assess progress towards development objectives.

While some donors regard the tax basket as the most successful sector fund in Tanzania, others consider progress on tax modernisation to be slow and are concerned about revenue performance. In fact, in May 2010, the 14-member GBS group reduced their pledges for the financial year 2010-11 by over USD 200 million, citing continuing large government deficits as a primary concern. Also, for the first quarter of FY2010-11, the TRA missed its programme target for revenue collection by 12%. Although it improved its performance slightly in the second quarter, it missed its half-year target by 8%.³

Tanzania's experience points to the following key findings and recommendations:

- The tax basket has been very successful in harmonising and aligning multiple donor contributions for the revenue modernisation programme - but strong government ownership and leadership, including high-level political support, are also critical to successful outcomes.
- It is often claimed that there are too many donors working in Tanzania with too many separate ideas. the result is a very complicated co-ordination process. Consideration might be given to requiring a minimum contribution for participation in a tax basket programme.
- Better co-ordination of project aid is needed to ensure appropriate, timely funding of government priorities.
- Despite all the support that has been provided to the TRA, problems with the underlying tax policy regime undermine progress in domestic resource mobilisation.
- Indicators like the tax-to-GDP ratio can divert staff from longer-term goals to focus on monthly targets. More effective and meaningful would be measures like revenue collection efficiency or the tax effort.
- Tanzania's block management system for tax collection illustrates the potential for conflict between revenue collection, governance, and administrative efficiency. The system's costs are high relative to revenue, while the process is invasive and probably counter-productive. There are better ways to widen the net.

- A lack of awareness and knowledge among tax payers is an obstacle to compliance and the fight against corruption.
- The TRA prefers longer-term to short-term technical assistance to favour hands-on coaching and mentoring.
- The TRA especially welcomes assistance from sister organisations through regional mechanisms like ATAF. But support from foreign experts is also valuable because decision makers often pay more attention to them.

Notes

1. Each case study considers tax reform highlights in the country as of early 2011 and concludes with a set of key findings.
2. Informal IMF and author estimates.
3. TRA monthly revenue collection reports for September and December, 2010. (Source: communication from TRA official.)

References

International Monetary Fund (2010), United Republic of Tanzania: First Review under the Policy Support Instrument, Country Report 10/231, IMF, Washington, DC., December.

Chapter 6

Findings and Recommendations for Stronger Tax and Development Aid

This chapter concludes the study of aid modalities for strengthening tax systems. It draws together the different thematic strands discussed in each chapter to state the key findings and make practical recommendations for tax-related development assistance. Running throughout is the theme of tax-governance linkage and its implications for tax reform and state building. To close the study, the chapter restates the most important of the 50 or so practical recommendations advanced in the course of this study and closes with some pointers to future directions for research.

This study has examined the effectiveness of various aid modalities as instruments for improving tax systems in developing countries and sought to identify practical recommendations on the appropriate use of each modality for addressing this goal. Although donors have been providing support for tax reforms and tax modernisation programmes for decades, tax issues have gained new prominence in recent years as a result of increased concern in the international community about the need for domestic resource mobilisation in recipient countries, combined with a growing awareness of the linkages between taxation, governance, and state building. For this reason, the study has examined not only technical reforms for more effective taxation, but considerations of political economy and the governance dividends that tax reform may reap. It drew on three sources to address these issues: a review of the relevant literature; a survey of officials who have been dealing with tax and governance issues at major bilateral, multilateral, and regional agencies; and six country case studies that provide a ground-level view of how different approaches work in practice.

6.1. Main findings for programmes to strengthen tax systems and tax-governance linkages

Many of the question examined here echo common themes in the literature on aid effectiveness, while others are more specific to aid programmes for supporting tax systems and enhancing tax-governance linkages. Some of the principal findings are:

- Host country ownership and leadership are of paramount importance. Aid can effectively support government programmes to improve the tax system and technical assistance can influence local views on tax reform priorities. Yet aid cannot “buy” effective and lasting reforms that are not aligned with domestic political incentives.
- Basic principles of taxation are applicable everywhere and many developing countries share common challenges in mobilising revenue. But there is no “best” approach to tax reform; donor programmes should be customised to fit country-specific economic, structural, cultural, and political conditions.
- The objective of tax reform is not just to boost the ratio of tax revenue to GDP, but also to establish a tax system that is equitable, efficient, and growth oriented. **How** revenue gets collected is therefore as important as **how much** gets collected. Indeed, in the long run, the greatest benefit for domestic resource mobilisation may be through the effects of tax reform on investment, efficiency, and growth.
- There are broad areas of synergy between the governance agenda and the standard technical agenda for tax reform. In identifying priorities, aid programmes should give special weight to activities that address these synergies in order to achieve governance dividends along with improvements in the tax system.
- The quality of the tax system—both tax policy and tax administration—is itself a central pillar of state-building and good governance. Addressing linkages between taxation and governance also requires working with supporting institutions and organisations outside the revenue system, including the justice system, Parliament, and civil society.
- Efforts to widen the tax net and mobilise revenue depend not only on tax reforms, but on broader governance reforms that influence citizen’s attitudes to the quality of governance and value for money in paying taxes.
- Donor support for fiscal development at the local level can foster a major link between revenue systems and governance.

6.2. Strengths and weaknesses of chief aid modalities

As for aid modalities themselves, the main finding is that each one, if well planned and carefully managed, has a distinct and valuable role to play in promoting more effective tax systems and tax-governance linkages. It is not possible to say that one instrument works best or that any of them should be discarded from the toolkit for supporting tax systems. Instead, the analysis indicates that a multi-tiered framework is entirely warranted, though it does require careful attention to coherence and co-ordination across modalities. The study also found that each modality has its own difficulties. They include the practical problems of adhering to the principles of alignment, harmonisation, the predictability of disbursement, and accountability for results.

Donors themselves must determine the appropriate mix of modalities in light of their strengths and weakness, home government preferences, and the conditions that prevail in each host country. Broadly speaking:

- General budget support (GBS) conforms most closely to the principles of aid effectiveness in countries where conditions of governance and public finance management warrant direct transfers to the finance ministry. GBS is also the best tool for high-level dialogue that addresses a broad range of public expenditure management and governance issues linked to the tax system. The same breadth of scope, however, leaves little room for detailed assessment of tax issues in the high-level dialogue. And it dilutes the effectiveness of GBS in terms of accountability for revenue results.
- Sector budget support (SBS) offers many of the same advantages as GBS from the viewpoint of compliance with the Paris Declaration principles. Indeed, sector-level programmes for public finance management (PFM) are an indispensable part of any budget support arrangement. SBS has a distinct edge over GBS programmes in that it creates a direct link between budget funding and PFM performance, which includes tax performance. It is also the most effective modality for co-ordinating revenue reforms with improvements in budget governance.
- Basket financing is eminently well suited to co-ordinating multi-donor funding for developing capacity and modernisation in tax administration, aligning donor support with the recipient's strategy for tax administration reform, and creating a dialogue that is sharply focused on the effective implementation of "nitty-gritty" reforms. A well designed tax basket creates joint funding for a unified programme with common procedures for diagnostic analysis, performance assessment, and policy dialogue in strategic tax issues. From the governance perspective, donors should seek to include taxpayer services, tax information programmes, and public-private dialogue on tax issues as integral elements of any tax basket programme.
- Multi-donor projects or programmes can be used in place of basket financing in countries where fiduciary risks caution against direct transfers to a government budget account. This approach can also be used as an alternative to bilateral arrangements in situations where multiple donors agree to pool funds for a specific set of tax-related activities, or where a lead donor develops a project and accepts (or solicits) participation from other partners.
- Bilateral interventions still account for a large share of aid flows to most recipient countries. This partly reflects institutional inertia, but some donors clearly do favour the bilateral approach. As do some recipients. In addition, demand-driven bilateral arrangements that align with recipient priorities can be very effective.

Consequently, bilateral aid will continue to be an important modality for supporting tax systems. In countries where multiple donors choose to get involved with tax programmes, however, the transaction costs and co-ordination problems with bilateral aid will be increasingly problematic.

- Multi-donor or bilateral tax projects can be designed to include non-tax agencies and non-state actors in order to enhance governance dividends from tax reform. Conversely, donors can incorporate tax-related activities in projects designed for other purposes, such as business environment reform, parliamentary capacity building, or strengthening civil society and the media.
- Regional organisations can provide low-cost and high-value support for improving tax systems in many developing countries. Such organisations are especially important for supporting peer networking among tax officials, promoting South-South knowledge sharing on practical solutions to common tax problems, strengthening regional collaboration to deal with cross-border tax issues, and liaising with international tax forums.
- The various funding modalities often support the provision of technical assistance, training, equipment, or infrastructure support for tax systems. Some donors provide this support in kind as a distinct aid modality. Host governments especially value in-kind support involving long-term resident advisors as mentors and the provision of training programmes.

6.3. Recommendations for donors

In the course of assessing different aid modalities, the analysis identified nearly 50 specific recommendations. Some of chief considerations for the international community are:

- The overall amount of aid allocated to tax programmes has been extremely low. Taxation and its linkages to governance and state-building are such important concerns that they merit greater focus in the policy dialogue and stronger funding support.
- Donors should make more, and more creative, use of graduated funding mechanisms with revenue-related triggers, such as variable tranches or cash-on-delivery arrangements.
- There is high demand for a standard diagnostic tool to assess revenue systems, similar to the PEFA framework that donors have used in more than 110 countries for assessing public finance management systems.
- The principles of ownership and alignment should not override accountability for results. Donors should, therefore, be prepared to disengage when aid for tax support does not achieve results. However, they should have realistic expectations and avoid suddenly cutting off support unless there are egregious problems with revenue performance.
- Regardless of the tax system support modality they employ, donors have an obligation to ensure maximum transparency within the recipient country to reduce the risk of aid undermining the recipient's domestic accountability on tax issues.
- Every donor-funded tax programme should, if possible, incorporate programmes for public information, tax education programmes, and public-private dialogue.

- Sustainable institutional development should be at the heart of any technical assistance programme in order to reduce the risk of it resulting in capacity substitution instead of capacity development.

6.4. Directions for future research

The findings and recommendations addressed in this book (and listed above) point to directions for further research. Some key areas are:

- more systematic testing of the main hypotheses relating to taxation and governance;
- the effectiveness and efficiency of the different aid modalities for supporting tax systems;
- the effectiveness of various tax measures, including both policy reforms and administrative reforms, to determine what works, what doesn't, and under what conditions;
- the politics of taxation, including drivers of tax reform and political impediments to reform;
- the design of tax systems to support more inclusive and pro-poor growth;
- the use of revenue performance indicators in aid programmes;
- evaluation of the transaction costs for both donors and recipients of multi-donor modalities;
- comparative studies on different approaches to taxation of micro and small enterprises;
- the use of earmarking as a political economy device to facilitate tax reforms;
- guidelines for phasing out budget support and technical co-operation and appropriate conditions for exiting from tax support programmes.

Altogether *Tax and Development: Aid Modalities for Strengthening Tax Systems* identifies some 50 recommendations both for improving the modalities themselves and for strengthening tax-governance linkages. They point to directions for future research in an area of development aid where much is still not fully understood. Nevertheless, domestic revenue mobilisation clearly holds promise for sustainable fiscal management and aid-free development in developing countries. The experience of some countries – Liberia and Guatemala are two examples – demonstrates the synergistic relationship between governance and compliance, or state building and taxation. Yet, basic questions remain. This study notes, for example, that the soundness of the main hypotheses relating to taxation and governance needs to be tested. The politics of taxation, too, is a fraught topic: what are the political drivers of tax reform, and what are the obstacles? Taxation looks set to exercise minds in the development assistance community for some time.

Annex A

Officials and Experts who Provided Information for the Study

Survey interviews

Carmen Schickinger	KfW - German Development Bank
David Kloeden	International Monetary Fund
Raul Junquera Varela	World Bank
Frans Ronsholt	Public Expenditure and Financial Accountability
Richard Stern	International Finance Corporation
Alberto Barreix	Inter-American Development Bank
David Dod	U.S. Agency for International Development
Matthias Witt	GIZ – German Technical Cooperation
Sandra Nicholl	Asian Development Bank
Socorro Velazquez	Inter-American Center for Tax Administrations
Logan Wort	African Tax Administration Forum
John Christensen	Tax Justice Network
Mick Moore	Institute for Development Studies, Sussex, and International Centre for Tax and Development
Eric Desquesses	French Development Cooperation
William Remington	U.S. Treasury Office of Technical Assistance
Tanja Ustved	Norwegian Agency for Development Cooperation
Tassil von Droste zu Huelshoff	European Commissions
Ubaldo Gonzalez	OECD – Centre for Tax Policy and Administration
Mirco Gourdiaan	Netherlands Development Cooperation

Other survey respondents

Francesco Paolo Cannito	Italian MFA
Juan Pablo Jimenez	Economic Commission for Latin America and the Caribbean

Ai Imai	Japan International Cooperation Agency
Maria Villanueva Serrano	Spain – FIIAPP Twinning Programme – General Directorate of Planning and Development Policy Evaluation
Michael Lennard	UN Department of Economic and Social Affairs

Contacts for case studies

Ghana

Harald Kueppers	GIZ/Ghana
Edward Odame Larbi-Siaw	GIZ/Ghana and Ghana Revenue Authority
Maurice Ochieng	GIZ/Ghana
Seth Terkper	Ministry of Finance

Guatemala

Juan Albert Fuentes Knight	Formerly Ministry of Finance
Ricardo Barrientos	Formerly Ministry of Finance
Manfredo Alvarado Chocano,	Tax Administration Superintendence (SAT)
Michael Gould	World Bank

Liberia

Elfreda Tamba	Ministry of Finance
Sebastian James	International Finance Corporation
Eric Nelson	Consultant, formerly World Bank/Liberia

Mali

Guenter Roos	Germany – KfW/Mali
Gerard Gagnon	Consultant, formerly Canadian International Development Agency/Mali
Olivier Benon	IMF/Afritac-West Africa

Mozambique

Emelie Bosten	IMF/Mozambique
Ralf Orlik	Germany – KfW/Mozambique
Marit Strand	Norway – NORAD/Mozambique
Herminio Sueia	Mozambique Revenue Authority

Tanzania

Harry Kitillya	Tanzania Revenue Authority
Olav Lundstol	NORAD
Frank Holtmeier	German Development Cooperation
Niels Knudsen	Development Partners Group Secretariat

Other contacts

Ben Dickinson	OECD
Juan Toro	IMF Fiscal Affairs Department
Vicki Perry	IMF Fiscal Affairs Department
Will Prichard	University of Toronto and ICTD
Emil Sunley	IMF Fiscal Affairs Department (retired)
Rubino Sugana	Duke Center for International Development
Enrique Giraldo	Consultant, formerly with Development Alternatives International (DAI)/El Salvador

Annex B

Survey Questionnaire

As an information input to the study, a questionnaire was sent to representatives from 33 organisations – 19 bilateral agencies, 10 multilateral organisations, 2 regional tax organisations (CIAT and ATAF), and 2 non-government organisations (the Tax Justice Network, and the International Centre for Tax and Development). In consultation with KfW and the OECD (sponsors for this study), 20 of these organisations were identified as priorities for a direct interview, based on their involvement with tax and development issues. In the end, 17 interviews were completed, using the questionnaire as a framework for discussion; one other respondent replied in writing rather than doing an interview. For the organisations that were not targeted for interview, the study team invited designated representatives to respond by email, especially when only quick answers were required. For this group the response rate was very low, with 4 questionnaires received.

The full questionnaire is reproduced below.

Survey questionnaire for donor organisation interviews

This questionnaire is part of a study on *Aid Modalities for Supporting Tax Systems*, which is being conducted on behalf of the International Tax Compact (ITC) organised by KfW German Development Bank, and the OECD/DAC Tax and Governance Task Force (GOVNET). The purpose of the study is to identify efficient aid modalities to strengthen tax systems *and* promote good governance, as cornerstones for sustainable development. (For this purpose, “tax systems” include customs and local government financing.)

To this end, we seek your assistance in providing information on five issues:

- The scope of your organisation’s involvement with programmes to strengthen tax systems in developing countries (to supplement work on the Tax Mapping conducted by the ITC).
- Lessons from experience with various modalities for supporting tax systems, including insights on the design of the modalities, particularly where multiple donors are involved in one country.
- Insights on how tax programmes can yield dividends or create externalities for governance and state-building.
- Insights on conditions for success or failure of programmes to strengthen tax systems *and* promote good governance.
- Related considerations such as the role of regional and international entities and priorities for further dialogue or research.

This information will be a major source of evidence leading to practical recommendations for donors and partner countries on appropriate aid modalities and linkages between taxation and governance. The results and recommendations will be presented to the OECD/GOVNET as well as to the ITC in 2011.

The interview should take about 45 to 60 minutes. To expedite the discussion, **questions marked ** may be completed and returned in advance.** (For questions with boxes to check, it is easy to replace the boxes with an “x” as appropriate.)

Please be assured that responses will be fully confidential. Interviews outside Washington, DC. will be conducted by phone. We will contact you by email or phone to arrange a suitable date and time. Kindly let us know in advance, though, if someone else from your organisation is in a better position to discuss these questions.

We welcome your assistance with this study, as a contribution to the international dialogue on improving aid effectiveness in the areas of taxation and governance. Thank you.

Yours sincerely,

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Survey questionnaire on aid modalities for supporting tax systems

Questions marked ** may be completed and returned in advance, to expedite the interview.

1. ** Contact information

Organisation: _____
Name: _____
Title: _____
Phone: _____
Email: _____

Section A. Involvement in supporting tax systems

2. ** Within the overall scope of your organisation's development agenda today:

a. How would you rate the priority of concern with the development of tax systems?

High priority – substantial support in many countries ☐

Moderate concern – substantial support in some countries ☐

Low priority – minor aspect of most programmes ☐

Comments:

b. If taxation is a high or moderate priority, is this a relatively recent development or a long-standing priority?

c. Is your organisation planning to expand its support for tax programmes, either in funding or country coverage? If so, please explain briefly.

3. ** In approximately how many developing countries does your organisation support either bilateral or multilateral programmes with significant tax components? Please include cases of budget support, if it has significant tax triggers or performance indicators.

	2010 <u>also</u> :	2005	2015 (est.)
Less than 5	☐	☐	☐
5 to 10	☐	☐	☐
10 to 20	☐	☐	☐
More than 20	☐	☐	☐

4. ** Approximately how much financing does your organisation provide in an average year in either bilateral or multilateral programmes with significant tax components? Again, please include budget support if it has significant tax triggers or performance indicators.

	2010 <u>also</u> :	2005	2015 (est.)
Less than \$10 million	☐	☐	☐
\$10 - \$50 million	☐	☐	☐
\$50 - \$100 million	☐	☐	☐
\$100 - \$500 million	☐	☐	☐
More than \$500 million	☐	☐	☐

5. ** How do you rate each of the following areas of assistance in terms of the programmatic focus for your organisation? Please rate each option on an ascending scale where: 1 = none/negligible; 2 = some involvement; 3 = often involved; 4 = major focus.

	1	2	3	4
a. Comprehensive tax reform programmes	☐	☐	☐	☐
b. Tax policy/tax law	☐	☐	☐	☐
c. Tax administration process re-engineering	☐	☐	☐	☐
d. Tax administration organisational reform	☐	☐	☐	☐
e. Information systems/e-taxation	☐	☐	☐	☐
f. Taxpayer services/public information	☐	☐	☐	☐
g. Customs reform	☐	☐	☐	☐
h. Local government fiscal systems	☐	☐	☐	☐
i. Accountability/anti-corruption	☐	☐	☐	☐
j. Judicial reform/strengthening	☐	☐	☐	☐
k. Fiduciary oversight (Parliament, audit)	☐	☐	☐	☐
l. Strengthening stakeholder or media organisations	☐	☐	☐	☐
m. Other focus areas? Please specify:				

6. ** Please provide up to three (3) examples of countries in which your organisation has major programmes to support the development of tax systems (including customs and local government finance), either current or recent.

Country: _____

Country: _____

Country: _____

Section B. Aid modalities

7. ** How extensively does your organisation provide each of the following types of assistance? Please rate each option on an ascending scale where: 1 = none/negligible; 2 = sometimes used; 3 = often used; 4 = widely used.

	1	2	3	4
a. Short-term technical assistance	☐	☐	☐	☐
b. Long-term technical assistance/cooperation	☐	☐	☐	☐
c. Tax training programmes	☐	☐	☐	☐
d. Provision of hardware/software	☐	☐	☐	☐
e. Other capital investments	☐	☐	☐	☐
f. Analytical work/research	☐	☐	☐	☐
g. Twinning arrangements for training	☐	☐	☐	☐
h. Other major types of assistance? Please specify:				

8. ** How extensively does your organisation use each of the following modalities to finance support for tax systems in developing countries? Please rate each option on an ascending scale where: 1 = none/negligible; 2 = sometimes used; 3 = often used; 4 = widely used – preferred modality.

	1	2	3	4
a. Budget support	☐	☐	☐	☐
b. Policy/sector/programme based financing	☐	☐	☐	☐
c. Basket financing/pooled programmes with other agencies	☐	☐	☐	☐
d. Funding through multilateral trust funds	☐	☐	☐	☐
e. Direct bilateral project funding	☐	☐	☐	☐
f. Cash on delivery (C.O.D.) results-based financing	☐	☐	☐	☐
g. Other major financing modalities? Please specify:				

9. Focusing on **budget support** programmes that involve tax triggers or revenue targets:
- What do you see as the advantages of and problems with this aid modality for strengthening tax systems?
 - In your view, how can this modality be improved as an effective approach for

promoting tax reforms, harmonising donor interventions, and aligning aid to partner-country priorities and systems?

- c. What are the preconditions for providing budget support and disbursing such funds?
10. Focusing on **policy/sector/programme based financing** to support tax systems:
 - a. What do you see as the advantages of and problems with this aid modality for strengthening tax systems?
 - b. In your view, how can this modality be improved as an effective approach for promoting tax reforms, harmonising donor interventions, and aligning aid to partner-country priorities and systems?
 - c. What are preconditions for financing a sector programme and disbursing such funds?
 11. Focusing on **basket financing** to support tax systems:
 - a. What do you see as the advantages of and problems with this aid modality for strengthening tax systems?
 - b. In your view, how can this modality be improved as an effective approach for promoting tax reforms, harmonising donor interventions, and aligning aid to partner-country priorities and systems?
 - c. What are the preconditions for basket financing, and disbursing such funds?
 12. What key indicators for revenue performance have been used as triggers or performance indicators for budget support or sector support programmes? What other revenue indicators might be useful?
 13. In your experience, what are the most effective practices used by your organisation for harmonising with other donors and aligning efficiently with host government priorities and systems:
 - a. In funding support for tax programmes?
 - b. In planning and designing support for tax programmes?
 - c. In implementing support for tax programmes?
 - d. In monitoring and evaluating support for tax programmes?
 14. What are the main problems in harmonising your programmes with those of other donors in supporting tax programmes?
 15. What are the main problems in aligning your programmes with host country priorities, structures and use of country systems?

16. What is the best modality that you have encountered or heard about for donor co-ordination or for a joint donor approach in supporting tax systems in developing countries? Please describe briefly.
17. How would your organisation like to contribute to make donor support for tax programmes more effective?

Section C. Taxation and governance

18. ** There is increasing awareness of links between strengthening revenue mobilisation and improving governance, in the broad sense of encompassing transparency, accountability, integrity and state-building. Based on your agency's experience, how significant in practice are the following governance dividends from tax programmes? Please rate each option on an ascending scale, where: 1 = negligible; 2 = some effect; 3 = substantial effect; 4 = strong effect.

	1	2	3	4
a. Strengthening central government accountability	☐	☐	☐	☐
b. Strengthening central government responsiveness	☐	☐	☐	☐
c. Improving transparency in the budget process	☐	☐	☐	☐
d. Model for modernising IT systems in other government agencies	☐	☐	☐	☐
e. Modernising human resource management in other agencies	☐	☐	☐	☐
f. Modernising financial management in other agencies	☐	☐	☐	☐
g. Reducing corruption, beyond the revenue departments	☐	☐	☐	☐
h. Improving public-private dialogue on economic issues	☐	☐	☐	☐
i. Strengthening local government capabilities	☐	☐	☐	☐
j. Strengthening Parliamentary oversight of revenue performance	☐	☐	☐	☐
k. Strengthening state audit of revenue performance	☐	☐	☐	☐
l. Strengthening representation, civil society and business associations	☐	☐	☐	☐
m. Strengthening media coverage of revenue issues	☐	☐	☐	☐
n. Improving business registration	☐	☐	☐	☐
o. Improving property registration and assessment	☐	☐	☐	☐
p. Other? Please specify:				

19. In your view, which of the possible governance dividends listed above should be top priorities in terms of the potential impact from donor programmes to strengthen tax systems?
20. Do you see any negative consequences for governance from donor-funded programmes aimed at strengthening tax performance? Explain briefly.

21. One major tax issue that is strongly linked to governance is the problem of getting elites to pay taxes fairly. In your view, how can this be done? Explain briefly.

Section D. Conditions for success or failure

22. Based on your experience, what are the key factors for successful donor support to strengthen revenue systems?
23. What are the key factors for success in fostering governance dividends from programmes to strengthen tax systems?
24. What are the key factors for success in supporting programmes to strengthen local government finance?
25. In each of the following special situations, should the approach to supporting tax systems differ in any significant way from standard practices? Please explain briefly.
- a. Fragile or post-conflict conditions?
 - b. States with very high levels of aid dependency
 - c. Resource rich states?
 - d. Authoritarian states?

Section E. Related considerations

26. Briefly, what is your assessment of the role for regional organisations and south-south cooperation in strengthening tax systems? How can this support best be linked to donor support for tax programmes?
27. What is your view on the idea of establishing an umbrella entity to co-ordinate, guide and evaluate support for strengthening tax systems in developing countries, along the lines of the Public Expenditure and Financial Accountability (PEFA) programme or the Global Development Learning Network?
28. What priorities would you suggest for further research on links between taxation and governance?
29. Finally, do you have any final thoughts on donor modalities and governance dividends from programmes to strengthen tax systems in developing countries?

Thank you very much for your kind assistance with this survey.

If you have any further information or thoughts or suggestions, please contact Bruce Bolnick at BBolnick@Nathaninc.com or Sandra Hadler at shadler@seraconsult.com.

Annex C

Survey Findings

This annex presents a synopsis of findings from the survey of bilateral and multilateral agency officials that was undertaken as an input to the study (see Annex B). The survey asked respondents for information in five areas:

- the organisation's involvement with programmes to strengthen tax systems in developing countries;
- lessons from experience with various modalities for supporting tax systems;
- dividends or externalities for governance and state-building;
- conditions for success of programmes to strengthen tax systems and promote good governance;
- related considerations such as the role of regional entities and priorities for further research.

Four caveats should be noted about the findings. First, the sample is selective and the information generally reflects the individual views of the respondents drawing on their personal knowledge. Second, the questionnaire invited open-ended responses on many of the issues, but the duration of each interview often limited the depth and scope of discussion. Third, respondents were promised confidentiality in order to prompt their candid views, so the presentation here does not identify sources for qualitative opinions. Finally, for the sake of space, the summary focuses on findings of most interest.

Scope of involvement

The first module sought approximate information about the size and scope of each agency's involvement with tax-related programmes, and some idea of the respective areas of concentration or comparative advantage. Responses from multilateral agency representatives were uniform in rating tax systems as a high priority concern. None of the bilateral respondents did so. They mostly viewed it as a moderate but growing priority, though several of the agencies still regard revenue mobilisation as a low priority. Eight of the responding agencies indicated that they have tax-related programmes in more than 10 countries, and three of the larger ones have programmes in more than 20 countries. Only three respondents indicated an increase in their country coverage for programmes involving tax systems over the past five years; and only one indicated an expectation of increasing coverage over the next five. The international financial institutions are by far the primary source of funding for tax programmes. The World Bank is the largest with more than USD 500 million invested in programmes involving taxation, while the IADB has investments in excess of USD 100 million. Other respondents are all below

USD 50 million, and most are below USD 10 million. KfW is the only agency indicating a substantial scaling-up of funding for tax systems over the past five years, and also the only one anticipating a substantial increase over the next five.

Turning to areas of focus on taxation, the questionnaire offered a menu of 12 technical options. Tabulating the responses by agency, little evidence emerges of specialisation or comparative advantage. Almost all of the major respondents cite at least five technical areas (including comprehensive tax reform programmes) as a “major focus” or an area of “frequent involvement.” If the response “some involvement” is included, technical coverage is even more widely dispersed. Only one item, fiduciary oversight (by Parliament or the supreme audit body) shows considerable selectivity; but even this finding largely fades when the response “some involvement” is included.

A similar picture of overlapping interests emerges on involvement with various forms of implementation support. Among seven modalities for supporting tax systems, only two appear to involve significant specialisation across agencies. In particular, capital investments are mainly the province of the development banks, and only two of respondents identified twinning arrangements for tax training as a frequent or widely used modality.

The responses showed more specialisation in funding modalities. For example, the European Commission (EC) and the World Bank express a strong preference for general budget support or sector programmes, though the Bank also widely uses multi-donor trust funds. In contrast, USAID uses bilateral project financing as the principal modality. Only one respondent, the EC, reported frequent use of cash-on-delivery results-based financing, presumably reflecting the its practice of including variable tranches in budget support programmes.

Aid modalities

This second module asked respondents to draw on their experience to discuss the advantages and disadvantages of different aid modalities, approaches for improving aid effectiveness in this area, especially in the context of co-ordinating multi-donor involvement. Although the questionnaire focused on tax programmes, the responses largely confirmed familiar insights from the general literature on aid effectiveness.

Four general comments stood out from the interviews. First, host-country ownership and leadership is essential for every modality, so donors should resist the temptation to push supply-led solutions. Second, tax programmes should be determined in the context of a comprehensive, country-specific analysis of needs and priorities. Third, in countries where multiple donors are involved in supporting tax programmes, field-level consultation, co-ordination and division of labour works well enough through a variety of different mechanisms. Fourth, progress on harmonisation and alignment has been slow. Just as host-country revenue authorities need to re-engineer business processes to use IT systems efficiently, donors also need to re-engineer their processes to improve co-ordination and reduce transactions costs. In practice, though, this is difficult to achieve because donors have their own approaches, interests, and requirements for ensuring that aid funds are used effectively.

Opinions on general budget support (GBS) varied widely. Some respondents strongly favoured GBS because it conforms most closely to the Paris principles and provides the best leverage for high-level policy dialogue. But many concerns were expressed about the utility of GBS for improving tax systems. The main problem is that revenue issues usually play only a minor role in a multi-sector policy review – though this can be remedied. In any case, the connection between dialogue and action is often weak or missing. Many donors

are concerned, too, about financial integrity, attribution, and the link between funding and results, or in short: “What do we get for our aid?” In addition, governance within the GBS framework can be complicated and time-consuming. And in the end, GBS funds are often disbursed even when performance is weak (as long as it is not critically bad), which dilutes incentives for reform. There appears, then, to be a tendency to favour more widespread use of “disbursement against results”.

Most of the remarks about GBS apply equally to sector budget support (SBS) programmes for public finance management (PFM). There is agreement, though, that SBS programmes are more easily targeted at tax issues and can have more precise tax-related triggers. But several respondents expressed concern that, even at the sector level, tax issues may not be a focus of attention for ministries of finance, which handle a much broader agenda.

Modalities that focus directly on taxation were clearly favoured as the most effective form of support. The tax basket, in particular, is widely viewed as a model for improving co-ordination and minimising duplication in cases where at least three donors are interested in supporting a common tax programme. The big advantage is that a basket approach involves one joint plan with the government, and an agreement on joint planning, funding, implementation, and monitoring. Ingredients for success include strong leadership and ownership by the government, adequate absorptive capacity, and a clearly designated lead partner for the basket group. This view of the basket modality was not universal, though. A counterview was that tax baskets are more difficult to manage than a flexible technical cooperation agreement, and the involvement of numerous partners does not add value. In addition, tax baskets have had problems with poorly co-ordinated payments, different opinions on procedures and priorities, fragmented donor processes, and disbursement pressures that reduce accountability for results.

Views on technical cooperation were similarly mixed. These interventions can be highly productive, but often have a tendency to be supply driven, and not well co-ordinated. Several respondents also cited difficulties in ensuring the quality of technical assistance personnel and a lack of procedures for dealing with this problem when it arises.

Respondents were also asked about performance indicators. The general opinion is that many tax indicators are highly problematic. Respondents were uniform in their distaste for the tax ratio as a useful outcome measure. The number of tax registrations was also singled out for criticism as a results indicator. The only consensus was on the need for careful attention to the definition of tax indicators, including structural benchmarks, as well as measures for results and outcomes. Very few positive suggestions came out of the interviews.

Governance and state-building

The third module solicited information on linkages between revenue mobilisation and governance. A theme that emerged consistently in the interviews is that the tax system itself is a central feature of state-building and good governance. Other general comments included caution about the lack of empirical testing of the governance hypotheses, and concern about whether donors can do much in practice to strengthen the linkages. Another concern was that donor funding for tax programmes could have an adverse effect on the recipient’s accountability to the public, suggesting a need for donors to address this issue in designing and implementing tax programmes.

Respondents were asked about 15 specific links between revenue reforms and governance. As shown in Table C.1, eight options were rated as substantial or strong linkages by at least one-half of the 17 respondents to this question: improvement in business registrations;

improved public-private dialogue; IT modernisation as a model for other agencies; strengthened government accountability; strengthened responsiveness; strengthened representation by civil society and business organisations; establishing a model for modernising human resource management; and improving property registration.

Table C.1. **Ratings of the practical importance of tax-governance linkages**

Governance Dividend	Average Rating, on a scale of 1 to 4, where 4 = strong linkage effect	No. of agencies (out of 17) rating this item '3' or '4'
Strengthening Central Government Accountability	3.1	10
Strengthening Central Government Responsiveness	2.8	10
Improving transparency in the budget process	2.8	8
Model for modernizing IT systems in other government agencies	2.7	10
Modernizing human resource management in other agencies	2.7	9
Modernizing financial management in other agencies	2.6	6
Reducing corruption, beyond the revenue departments	2.9	8
Improving public-private dialogue on economic issues	2.9	11
Strengthening local government capabilities	2.4	6
Strengthening Parliamentary oversight of revenue performance	2.5	6
Strengthening state audit of revenue performance	2.8	7
Strengthening representation, civil society and business associations	2.7	10
Strengthening media coverage of revenue issues	2.6	7
Improving business registration	3.1	12
Improving property registration and assessment	2.6	9

Source: Results of the survey discussed in the report, designed and administered by Bruce Bolnick and Sandra Hadler of Nathan Associates.

The choices that were cited least often as significant linkages were: strengthened local government capabilities, and improved parliamentary oversight. In the interviews, respondents offered few concrete examples of linkages they had seen first hand, although all had clear opinions on priorities. Interestingly, one respondent cited SME taxation as a first priority, while another suggested that this idea may be irrational, both politically and economically.

Another governance issue that was highlighted repeatedly in start-up discussions for the study was the need for political analysis of the incentives for tax reform, including the problem of getting elites to pay their fair share of tax. The questionnaire asked about this directly. Most respondents either had no answer or replied, in effect, that it was an exercise in futility unless national leaders at the highest level push the agenda. But there were also some constructive responses, as set out in Box 2.2 in Chapter 2.

Conditions for success

The questionnaire also inquired about conditions for success in providing aid to strengthen revenue systems and foster governance dividends. The responses largely reflected familiar themes in the literature. The most resounding response was that genuine country ownership (not just procedural concurrence) is the heart of the matter. This includes ownership of the agenda by national leaders as well as officials at the technical level. Every other issue is secondary. Several respondents pointed to Liberia as a case where dynamic leadership produced remarkable results for revenue performance under extremely difficult post-conflict conditions and very modest donor support. The implication here is that tools are needed for assessing local ownership on tax issues, which are inherently political. One possibility would be an adaptation of the Drivers of Change Analysis that DFID developed for assessing the political economy of programmes for poverty reduction (DFID, 2003).

Three other major requirements were cited repeatedly: first, the need to customise prescriptions for revenue reform, taking into account international lessons on successful tax practices; second, the importance of a holistic framework for reform, rather than cherry picking technical fixes; and third, the benefits for tax compliance from fiscal legitimacy through improved public expenditure management and accountability for use of funds.

Another question probed special challenges in strengthening revenue systems in fragile and post-conflict states, resource-rich countries, aid-dependent countries, and authoritarian states. Most of the interviews dealt with this issue superficially, due to lack of time for a thorough discussion. In addition, only a few respondents had extensive experience dealing with these special cases. Given these limitations, the principal findings were as follows:

- For resource rich states: focus on participation in the Extractive Industries Transparency Initiative; negotiate revenue agreements allowing the host country to benefit from a major share of the resource rents; and develop skills and international information exchanges to deal with sophisticated accounting systems of large multinational corporations.
- For fragile states: take a more selective and limited approach, focusing on core state functions; avoid overloading the agenda, and ensure a realistic time frame.
- For post conflict states: scale down expectations as to what can be achieved in the short run; look for opportunities to move quickly on generating revenue from sources that are relatively easy to collect, mainly import taxes and resource

concession revenues; mobilise diplomatic pressure; and avoid wasting resources on unresponsive clients.

- For aid dependent countries: scale up efforts to support the tax system, with a medium to long term strategy, not a short-run focus on the tax ratio.
- For authoritarian states: major improvements in the revenue system can be achieved when working with benevolent authoritarian leaders; but gains can be quickly lost as such regimes can be brittle.

Related considerations

The final module asked about the role of regional organisations and South-South cooperation; the value of establishing a co-ordinated approach for evaluation of tax systems; and priorities for further research.

Respondents were unanimous in assigning regional tax organisations like CIAT and ATAF a key role in fostering South-South peer learning on tax issues, and serving as a focal point for dialogue on cross-border tax cooperation. These specialised organisations can provide a low-cost and high-impact option for donors to contribute to strengthening tax systems in multiple countries. But there are several reasons to doubt that this can be a major modality. First, there is not much room for large commitments because the total amounts involved are relatively small. Also, the organisations prefer a large degree of self-sufficiency through member contributions.

Respondents were also asked whether they favoured the idea of having an international entity like the PEFA Secretariat (Box 4.1 in Chapter 4) establish a standard for co-ordinating, guiding and evaluating support for strengthening tax systems. In retrospect, the question was not well worded, but two results stand out anyway. First, most respondents strongly favoured a detailed assessment tool like PEFA to guide diagnostic analyses on the revenue side of the budget. But the endorsement was not unanimous. A few officials regard the PEFA approach as too generic and donor-driven. Second, most respondents oppose the creation of yet another multilateral entity to manage a diagnostic tool of this sort.

The interviews ended with a question on priorities for further research on links between taxation and governance. There was a consensus that more systematic study is needed to test the hypotheses about tax effects on governance and state building. Another frequent suggestion was the need for more research on the effectiveness of various tax measures, including administrative reforms, to determine what works and what doesn't, and under what conditions. A third priority is further research on the politics of taxation, including drivers of reform. Finally, several respondents noted the lack of systematic compiling and sharing of information on revenue performance indicators used in aid programmes and the results observed.

Annex D

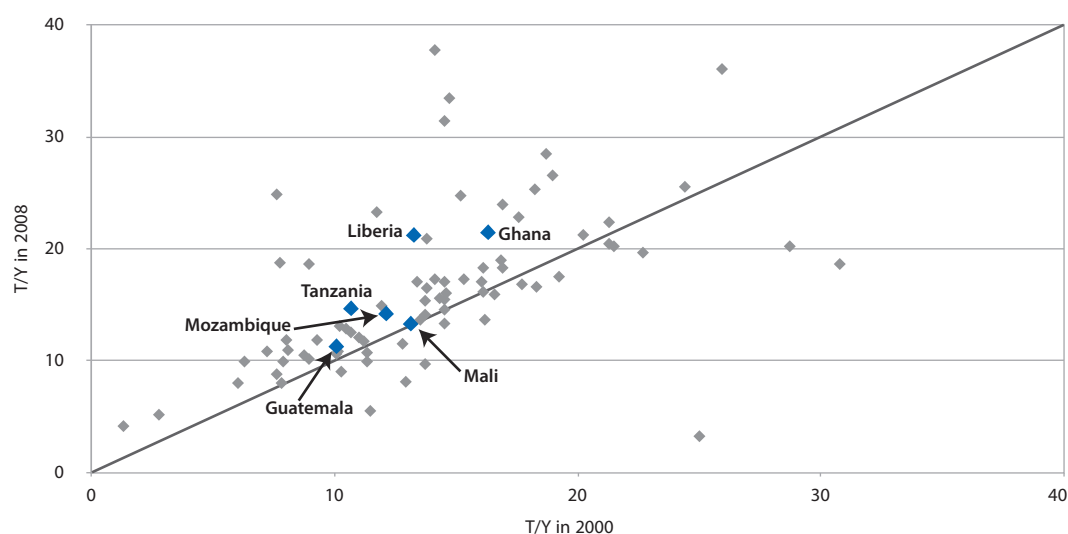
Empirical Perspectives

This annex provides a brief overview of the data on tax collection performance in low- and lower-middle income countries, and some “stylised facts” on the relationship between taxation and two prominent indicators of governance.¹

Tax collection performance is most readily (and most often) judged using the ratio of tax revenues to GDP or national income. In its *2010 African Economic Outlook*, the African Development Bank assessed levels and trends in tax ratios in Africa (AfDB and OECD, 2010). The report found that, on average, the tax ratio increased significantly from the early 1990s to 2007 in each income group. In addition, the average tax ratio in Africa for each income group reached levels comparable to the respective norms on other continents. However, the largest improvements were achieved by the upper-middle income countries in Africa, and much of the gain overall was driven by revenue from energy and mineral production. For the average African country, improvements relative to GDP in the yield from trade taxes, indirect taxes, and direct taxes were very slight.

For a broader group of 83 low- and lower-middle income countries, the average tax ratio increased from 14.2% of GDP in 2000 to 16.7% in 2008.² For oil producers, these statistics include only non-oil tax revenues relative to non-oil GDP.³ Figure D.1 shows how tax ratios in this group changed from 2000 to 2008; in the graph, points above the 45-degree line indicate that the tax ratio has increased.⁴ This figure shows that a majority of the countries achieved an increase in the tax ratio over this period.

Figure D.1. Tax ratios (T/Y) in 2000 and 2008



Source: Calculations by Nathan Associates based on World Bank and IMF data.

Table D.1 lists the countries with the largest absolute increase or decrease in collection performance. The tax ratio rose by 10 percentage points or more in several transition countries of the former USSR and two members of the South Africa Customs Union, Lesotho, and Swaziland. The largest declines were in Zimbabwe, Kiribati, and Guyana. In 2008, the five countries with the highest ratios were Lesotho, Ukraine, Swaziland, Moldova and Mongolia, while the five countries with the lowest ratios were Sudan, Guinea-Bissau, Afghanistan, Iraq, and Zimbabwe.

Table D.1. **Tax ratios (excluding oil-related taxes)**

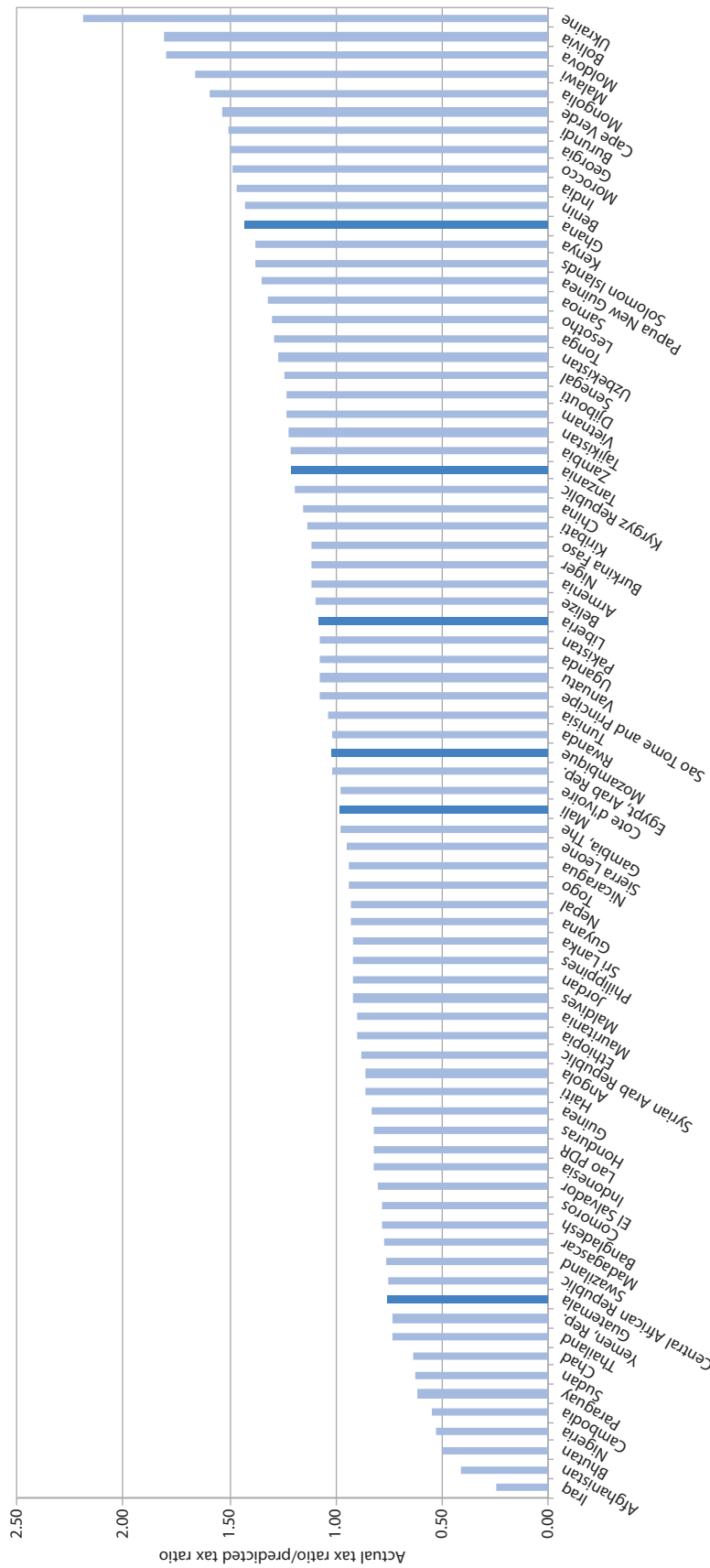
Largest Increases				Largest Decreases			
Country	2000	2008	Change	Country	2000	2008	Change
Ukraine	14.1	37.7	+23.6	Zimbabwe	25.0	3.3	-21.7
Lesotho	35.6	57.7	+22.1	Kiribati	30.8	18.6	-12.2
Moldova	14.7	33.4	+18.7	Guyana	28.7	20.2	-8.5
Georgia	7.7	24.9	+17.2	Guinea-Bissau	11.4	5.5	-5.9
Mongolia	14.5	31.4	+16.9	Nigeria	12.9	8.1	-4.8
Kyrgyz Republic	11.7	23.3	+11.6	Ethiopia	13.7	9.7	-4.0
Tajikistan	7.7	18.7	+11.0	Uzbekistan	22.7	19.6	-3.1
Swaziland	25.9	36.0	+10.1	Gambia, The	16.2	13.7	-2.5
Bolivia	18.7	28.5	+9.8	Burundi	18.3	16.6	-1.7
India	9.0	18.6	+9.6	Zambia	19.2	17.5	-1.7
Vietnam	15.2	24.8	+9.6	Yemen, Rep.	11.3	9.9	-1.4
Liberia	13.2	21.2	+8.0	Djibouti	21.5	20.2	-1.3
Papua New Guinea	19.0	26.6	+7.6	Micronesia	12.8	11.5	-1.3
Maldives	13.8	20.9	+7.1	Bhutan	10.3	9.0	-1.3
Cape Verde	18.2	25.3	+7.1	Sri Lanka	14.5	13.3	-1.2

Source: Calculations by Nathan Associates based on World Bank and IMF data.

Tax ratios, though, are not a very telling indicator of performance because they are heavily affected by structural conditions that the government cannot control. A more sophisticated way to assess tax performance is to control statistically for major structural characteristics that affect the capacity to mobilise revenue, in order to establish a “norm” for the tax ratio. Comparing the actual tax ratio against this norm gives a “tax effort index”, which exceeds unity if the tax ratio exceeds the level that would be expected given the country’s structural characteristics.

Many tax effort studies have been carried out for developing countries.⁵ The statistical analysis typically controls for per capita income, the share of agriculture in GDP, the level of international trade relative to GDP and, often, the size of the oil sector. In countries with low per capita income, the scope for revenue mobilisation is limited by poverty and low capacity for tax administration. The share of agriculture is often included because this sector is especially hard to tax due to subsistence activities and non-market transactions. International trade is generally regarded as an accessible “tax handle.” And developing countries can raise revenues more easily when they have a large oil sector.

Figure D.2. Tax effort in 2008 for 79 low- and lower-income countries



Source: Estimated by Nathan Associates using World Bank and IMF data.

The present study generated tax effort estimates for 2008 for 79 low- and lower-income countries by regressing the observed tax ratios against per capita income, the share of agriculture in GDP, the ratio of trade to GDP, and a variable for members of the South African Customs Union (SACU).⁶ The oil variable was not used, because the data set only included non-oil revenue. (See “Technical Notes” below for details.)

Figure D.2 shows the range of (non-oil) tax effort indices for this sample of countries, while Table D.2 shows the five highest and five lowest tax effort countries, as well as the six countries examined as case-studies for this report. Four of the countries with the highest tax effort (Ukraine, Bolivia, Moldova, and Mongolia) also delivered large absolute increases in the tax ratio from 2000 to 2008. Among the six case-study countries, tax effort was well above one in Ghana and Tanzania, and well below one in Guatemala.⁷

Table D.2. **Tax effort in 2008**

Lowest		Highest	
Iraq	0.25	Ukraine	4
Afghanistan	0.41	Bolivia	1.81
Bhutan	0.50	Moldova	1.80
Nigeria	0.52	Malawi	1.66
Cambodia	0.55	Mongolia	1.60
Case study countries			
Ghana	4	Liberia	4
Mozambique	1.02	Tanzania	1.21
Mali	0.98	Guatemala	0.76

Source: Estimated by Nathan Associates using World Bank and IMF data.

It is important to point out that the tax ratio for Ghana is greatly overstated in the data because of problems with the denominator, GDP. The government recently rebased the national accounts statistics and increased GDP by nearly half. Adjusting for these changes, Ghana’s tax ratio is actually below par. This vividly illustrates one of the major problems with using the tax ratio, or indeed tax effort analysis, to judge revenue performance – namely, weak data. Another issue with the tax effort is imprecision in the estimated “norm” for each country. When the tax effort is not much different from one, or exhibits moderate changes, the methodology does not justify clear conclusions about collection performance.

Tax effort analysis can also shed some empirical light on the relationship between taxation and governance. As explained in Chapter 2, the development literature suggests that the quality of governance is likely to influence tax collection through its effect on government legitimacy and the culture of tax compliance. And that reliance on taxation is likely to affect the quality of governance by creating incentives for government to be responsive and accountable, and creating incentives for citizens to demand better governance. In short, there is a two-way relationship between taxation and governance.

It is difficult, if not technically impossible, to distinguish the relative strength of these two causal links. But it is still of interest to see whether the data confirm the hypotheses that tax effort and governance are positively related. Several governance measures can be

used for this purpose, including Transparency International's Corruption Perceptions Index and the six components that enter the World Bank's World Governance Indicators (WGI): control of corruption, government effectiveness, political stability, regulatory quality, rule of law, and voice and accountability.

For the present sample of 79 countries in 2008, all seven governance indicators have a positive and significant correlation with tax effort. Table D.3 summarises the extent to which variability in the tax effort is associated with each of the indicators. Clearly, the correlations are not especially large. The strongest relationships, though, appear for political stability, and for voice and accountability, with the rule of law not far behind. The other correlations are markedly weaker.

Table D.3. **Percent of variance in tax effort**

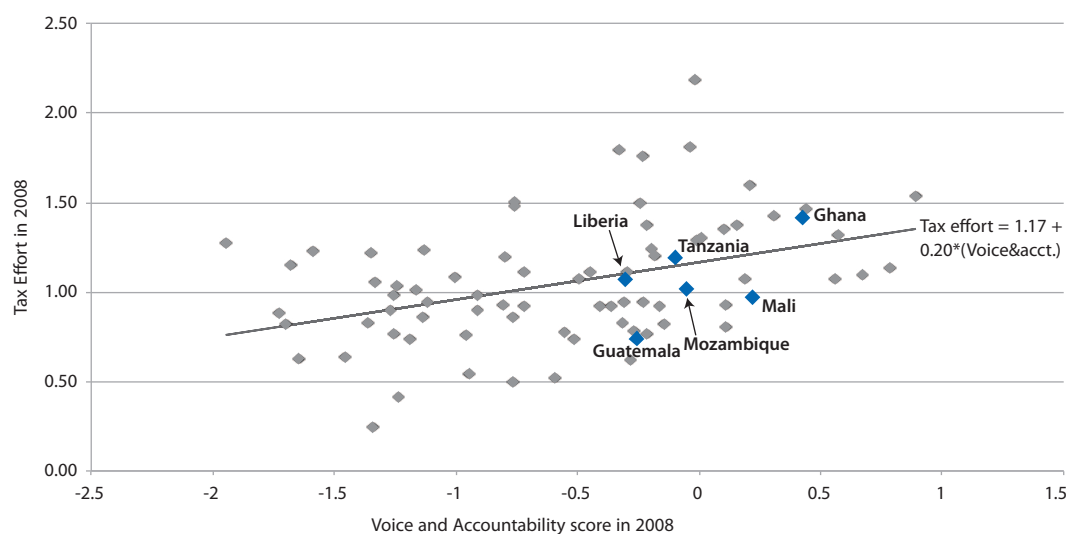
Associated with *	Variance %
Corruption perceptions index	5
Control of corruption	7
Government effectiveness	7
Political stability	15
Regulatory quality	5
Rule of law	12
Voice and accountability	16

* *Adjusted R² from regression of tax effort on indicator.*

Source: Estimated by Nathan Associates using IMF, World Bank, and Transparency International data.

When tax effort is regressed against all six WGI indicators simultaneously, the only one that turns out to be statistically significant is voice and accountability. Figure D.3 plots the relationship between tax effort and the voice and accountability rating for 2008 and

Figure D.3. **Tax effort and voice and accountability**



Source: Estimates by Nathan Associates and World Bank data.

the regression line shows the underlying relationship. This analysis does not say anything about whether voice and accountability contribute to tax collection or vice versa. But it does confirm that there is a positive and significant relationship between taxation and governance. It should be recalled, too, that by using the tax effort index, this result emerges after controlling for the effect of key structural characteristics on the capacity to collect taxes.

Technical notes

For the empirical analysis, data on the ratio of non-oil tax revenue to non-oil GDP were collected for the years 2000 and 2008 (or the closest years with available data) for the following countries (which are included in Figure D.2):

Afghanistan (2003 and 2008), Angola, Armenia, Bangladesh, Belize, Benin, Bhutan, Bolivia, Burkina Faso, Burundi, Cambodia, Cameroon, Cape Verde, Central African Republic, Chad, China, Cote d'Ivoire, Djibouti, Egypt (2001 and 2008), El Salvador, Ethiopia, the Gambia, Georgia, Ghana, Guatemala, Guinea, Guinea Bissau, Guyana (2001 and 2008), Haiti, Honduras, India, Indonesia (2001 and 2008), Iraq (2004 and 2008), Jordan, Kenya, Kiribati, Kyrgyz Republic, Lao PDR, Lesotho, Liberia, Madagascar (2000 and 2006), Malawi, Maldives, Mali, Marshall Islands, Mauritania, Micronesia (Fed. States), Moldova, Mongolia, Morocco, Mozambique, Nepal, Nicaragua (2000 and 2009), Niger, Nigeria, Papua New Guinea, Pakistan, Paraguay, Philippines, Rwanda, Samoa, Sao Tome and Principe, Senegal, Sierra Leone, Solomon Islands, Sri Lanka, Sudan (2001 and 2008), Swaziland, Syria, Tajikistan, Tanzania, Thailand, Togo, Tonga, Tunisia, Uganda, Ukraine, Uzbekistan (2003 and 2008), Vietnam, Yemen, Zambia, and Zimbabwe.

The regression analysis (Table D.4) excludes Cameroon, Guinea-Bissau, Marshall Islands, Micronesia, Vietnam, and Zimbabwe, and adds Vanuatu. Data on per capita national income and the ratios of tax revenues, agriculture, and trade-to-GDP were obtained from the World Bank's World Development Indicators database, with missing values added from IMF reports wherever possible.

Table D.4. Regression results

Dependent variable: log of tax ratio in 2008				
Number of countries included: 79				
Estimation method: ordinary least squares				
	Coefficient	Std. error	t-statistic	Probability*
Constant	-0.07	0.86	-0.08	0.94
SACU indicator	0.89	0.27	3.25	0.00
Log (per capita income)	0.12	0.07	1.68	0.10
Log (agriculture share in GDP)	0.08	0.10	0.80	0.43
Log(trade turnover share in GDP)	0.39	0.10	3.72	0.00
R ²	0.37		Adj. R ²	0.33

*Probability that the estimated coefficient is not significantly different from zero.

Notes

1. The empirical analysis summarised in this annex was produced by Peter Miller and Bryan Roberts of Nathan Associates.
2. Nathan Associates calculation based on data from the World Development Indicators data base and IMF country reports. The countries are listed below.
3. Countries with a significant oil sector include Angola, Cameroon, Chad, Iraq, Nigeria, Sudan, Syria, and Yemen.
4. One outlier whose tax ratio increased from 36% to 58% (Lesotho) is excluded from Figure D.1.
5. Sengupta (2007) reviews the tax effort literature and presents a sophisticated analysis covering 105 developing countries over 1980-2004 relating the tax ratio to structural features, foreign aid dependence, tax policy measures, and indicators related to governance quality and political stability. More recent studies in this genre expand on the links between governance and tax effort; see Bird, Martinez-Vasquez and Torgler (2008), and von Haldenwang and Ivanyina (2011).
6. The two SACU members in the sample (Lesotho and Swaziland) report atypically high tax ratios reflecting a revenue sharing agreement with South Africa.
7. The 2010 African Economic Outlook analysis shows tax effort indices for Ghana, Mozambique and Mali that are close to those estimated here, but its estimate for Liberia is significantly higher than unity, and for Tanzania slightly below unity. The differences here arise because the present study uses a broader sample of countries, and the estimate of tax effort uses data that excludes the influence of oil.

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