ACROPOLIS-BeFinD Dissemination Seminar

Domestic Resource Mobilization in the Partner Countries of the Belgian Governmental Cooperation: the role of institutions and the Value-Added Tax*

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Extended Abstract

Over the past two years we conducted various (but interlinked) studies that essentially evaluate the Domestic Revenue Mobilization (DRM) capacities of partner countries of the Belgian Governmental Cooperation (BGC) and other developing countries. This research can be structured in two categories. On the one hand, we examine the role of the Value-Added Tax (VAT) in contributing to DRM. Moreover, we compare how much VAT revenue countries could 'potentially' collect to what they 'actually' mobilize. On the other hand, we examine the role of institutional quality in enhancing tax-revenue collection. Institutional factors (such as the capacity of the tax administration, government effectiveness in providing public goods, trust in the government etc…) are expected to matter for the design as well as the effectiveness of tax policies and tax compliance.

The overall picture: VAT, DRM and developing countries

First, analysis of data from 149 countries over the 1970 - 2013 period indicates that VAT adoption has improved tax-revenue collection not only in developed countries - but also in developing countries, both in Sub-Saharan Africa (SSA) and elsewhere. Moreover, the marginal effect of VAT adoption (i.e. relative contribution of VAT to tax revenue) is estimated to be strong for SSA and other developing countries as compared to their developed counterparts. The positive effect of VAT on tax collection in SSA is reassuring because some earlier studies were not able to identify an overall positive effect for the region. We show that analysis of data over the recent period (where VAT has become more contributive) is important to highlight its positive role in SSA's DRM efforts.

The role of VAT for DRM in partner countries of the Belgian Governmental Cooperation (BGC)

Second, we focus on the performance of VAT (and DRM) in 18 partner countries of the BGC (i.e. past and present partners; namely, Morocco, Algeria, Burkina Faso, Mali, Niger, Senegal, Benin, DRC, Rwanda, Burundi, Uganda, Tanzania, Mozambique, South Africa, Ecuador, Peru, Bolivia, and Vietnam) over the 1990-2012 period. Our study shows that, although the performance of VAT has improved in recent years, significant revenue gaps are still observed in most of them. Among the best performers (e.g. Bolivia, Ecuador, South Africa, Vietnam) Bolivia and Vietnam stand out. On the contrary, governments of many DGD-partner countries could mobilize more resources by improving the efficiency of their VAT system. For instance, VAT gaps in countries like Benin, Burkina Faso, Burundi, DRC, Niger, Mali, Rwanda, and Uganda still stand in excess of 60% in recent years.

Third, we present an in-depth analysis on Bolivia to illustrate how such reforms could be designed and implemented. Bolivia is an interesting case since the country was one of the first developing countries to adopt VAT in a context characterized by socio-economic and political challenges. We argue that the credibility of the Bolivian government as well as the institutional design of its tax system were very important for the success of their tax reforms. Moreover, we show that the improvements of both the policy gap (which emanates from the fact that the standard-VAT rate is not applied to all items as well as well as various exemptions and deductions that are defined in the legal-tax code) and compliance gaps (capturing the amount of VAT liabilities that were not collected due to the imperfect implementation of the VAT system) have contributed to the reduction of Bolivia's VAT gap in recent years. But we show that improvements in the compliance gap are the main deriver of the reduction in VAT gap in Bolivia.

We are now extending the analyses to Benin and Burkina Faso where VAT gap our still relatively high. Our preliminary results show that both the compliance gap and the policy gap are responsible for poor performance of the VAT system in the two countries. We also document the economic sectors where the gaps lie in. These findings are the good basis to design policy reforms as well as overhaul of national tax administrative capacities to improve the VAT system of Benin and Burkina Faso.

The role of institutions for DRM in DGD-partner countries

Fifth, in a related analysis data from 149 countries over the 1970 - 2013 period show that, on average, tax-revenue collection is higher in countries with a better-institutional quality - even before the introduction of VAT. Interestingly, we also demonstrate that the gain from adopting VAT is maximized in countries with better institutions. Given VAT is by now adopted in almost all countries across the world, our findings suggest the need to promote institutional reforms to facilitate tax collection in developing countries.

Sixth and finally, we analyze how weak institutions affect individual taxpayer’s behavior in Sub-Saharan Africa (SSA), where many DGD-partner countries are located. Analysis of Afrobarometer’s (2011/2013) survey data in 29 SSA countries shows that tax payers’ attitudes towards paying taxes are significantly dependent on the quality of institutions in their countries. When the quality of institutions is perceived as ‘good’, individuals are more likely to pay taxes. This reinforces the need for partner countries to work on improving broader institutional qualities - rather than simply focusing on passing new tax laws. Better institutions (e.g. sound legal system, less corruption, less discrimination, ease of doing business, etc.) enhance the overall potential for rapid economic growth and stability - thereby creating sustained tax revenue streams to governments.

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