



Reforming tax systems: lessons from the 1990s

How can World Bank projects aimed at reforming tax administrations better integrate institutional analysis?

Bank-supported efforts to reform public institutions—including tax and customs administration—increasingly rely on institutional analysis. But there are no formal, generally accepted guidelines for analyzing tax systems. As a result the Bank's task managers and team leaders conduct these analyses in very different ways.

The paper on which this note is based reviewed 83 Bank-financed tax and customs reform operations in the 1990s to assess whether current approaches fall within the bounds of institutional analysis and add up to a consistent methodology (see Barbone and others 1999). The review compiled Bank projects that supported tax administration reform, compared their diagnostic work to an emerging diagnostic model, and assessed their focus and their results.

Project commitments

In the 1990s, 120 World Bank credits and loans had components involving tax system reform. (Here *tax system* includes the tax structure, the tax administration—including the customs administration—the institutional framework of tax policy, and the environmental and institutional framework of tax administration.) These operations occurred in 67 countries and cost \$14 billion. Tax system reform was a major component in 83 of these operations (55 countries and \$8.5 billion); 43 (with outlays of \$4.7 billion) focused on modernizing tax or customs administrations. Of the 83 projects, 51 were structural or sectoral adjustment

loans, accounting for 90 percent of the funds (averaging \$150 million each). The other 32 were technical assistance projects, very focused and smaller (averaging \$25 million).

Revenue enhancement—a precondition for macroeconomic stability and poverty alleviation—was a major objective in two-thirds of the projects. More than one-third aimed at strengthening administrative institutions. Other frequently cited objectives included strengthening administrative capacity and enhancing taxpayer compliance.

How did diagnostic work influence project design?

The Operations Evaluation Department's *1997 Annual Review of Development Effectiveness* identified quality at entry—a product of pre-project preparation and diagnostic work—as the most important ingredient of project success. Table 1 shows some key elements of the diagnostic framework used to assess the design of the Bank's tax reform projects. This framework suggests that a tax system should be analyzed by focusing on tax policy, accountability, and the efficiency and effectiveness of service delivery. For each, performance can be assessed as a function of the capacity to perform the task, the institutional framework of the taxation department, and the constraints exogenous to the taxation work.

Measured against this diagnostic framework, the average project reviewed scored rather low, covering less than 40 percent of the categories suggested. Projects analyzed tax policy institutions and structures

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TABLE 1 A BASIC FRAMEWORK FOR DIAGNOSING TAX SYSTEMS

<i>Area</i>	<i>Performance indicators</i>	<i>Capacity</i>	<i>Institutions</i>	<i>Exogenous and environmental constraints</i>
Tax policy	<ul style="list-style-type: none"> • Are tax policy, administrative law, and taxpayer-related procedures simple and equitable? • Are management decisions made efficiently? 	<ul style="list-style-type: none"> • Is there capacity for policy formulation and research? • Is there capacity for training? 	<ul style="list-style-type: none"> • Division of powers • Legal provisions governing administration • Administrative autonomy and political interference • Adequacy of organizational structure • Appropriateness of tax structure 	<ul style="list-style-type: none"> • Level of economic development • Openness • Level of commercial development • Extent of transition to market • Accounting profession and standards • Financial and banking development
Accountability	<ul style="list-style-type: none"> • Corruption • Revenue loss due to administrative lapses • Taxpayer survey 	<ul style="list-style-type: none"> • Evaluation of resources devoted to management supervision, audit, and anticorruption efforts (including training) • Civil society involvement 	<ul style="list-style-type: none"> • Status of audits • Ombudsman and taxpayer survey process • Penalties and rewards in taxation departments tied to performance evaluations 	<ul style="list-style-type: none"> • Literacy • Legal conventions, constitutional law • Law and order • Compliance attitudes of taxpayers • Government credibility • Government stability • Civil service conditions
Service delivery—efficiency and effectiveness	<ul style="list-style-type: none"> • Ratios of revenue to potential revenue • Indicators of activity effectiveness • Ratios of revenue to costs • Time indicators • Taxpayer survey 	<ul style="list-style-type: none"> • Evaluation of available resources (human and budget) • Career management and salary policy for staff • Training facilities • Automation • Feasibility and extent of outsourcing and privatization 	<ul style="list-style-type: none"> • Adequacy of administrative procedures—compliance, taxpayer identification, tax audit, taxpayer education, taxpayer services, sanctions and appeals, customs clearance procedures, preshipment inspection, information sharing 	

Source: Nick Manning and Brian Levy use this framework in unpublished work. Further disaggregation of the categories can be found in the diagnostic and project formulation framework of Gill (forthcoming), though diagnostic categories are formulated differently there.

summarily, rarely using quantitative indicators beyond tax ratios, rate differentiation and multiplicity, and the absence of a value added tax. Scant effort was made to compare current systems with best practices.

The effectiveness of the tax system (compliance, client services, revenue relative to the tax base) was largely discussed in a qualitative manner, while analysis of efficiency (the cost of achieving results) was largely based on how much technology and automation were used in various activities. Analysis of the institutional framework and of the institutional determinants of performance was often inadequate; only a few structural or sectoral adjustment loans paid it much attention (perhaps because these operations included loan components covering a broader area).

Admittedly, some diagnostic work—such as background material from the International Monetary Fund or economic and sector work

by the country or the Bank—was not always fully documented but influenced project design. The average score also hides several projects that relied on excellent diagnostic work: projects in Colombia, Jamaica, and Latvia provided sufficient diagnostic information that was incorporated into their design.

What did the projects try to accomplish?

Structural and sectoral adjustment loans with tax components tended to focus on broad objectives, such as introducing a value added tax, lowering import taxes, or eliminating import quotas in the context of exchange rate changes or in support of market reforms. These policies helped raise additional revenue by broadening the tax base in a nondiscriminatory manner.

Although they reflected the policy commitment of governments, these operations

did not provide the hands-on support needed for effective implementation. To the extent that rate and tariff changes did not require enhanced implementation capacity, this was reasonable. But other reforms often required stronger tax and customs administrations or new operational procedures.

The technical assistance projects, on the other hand, aimed at helping the authorities implement their policy decisions. The projects concentrated on improving basic tax administration functions such as taxpayer identification, taxpayer self-assessment, audits and tax collection, and customs cargo clearance. Tax procedures were computerized in all the technical assistance projects, but a lack of significant organizational, procedural, and staffing reforms proved to be a shortcoming in many. At times too much was expected from a reform driven by computerization without other institutional reforms. One task manager noted that the purchase of computers was expected to solve all the problems in his project. But that did not turn out to be the case, and the project was stalled for two years after acquiring the computers. This also points to the importance of properly sequencing project components.

Reflecting inadequate diagnostic work, most projects paid little attention to strengthening accountability and monitoring, improving client services and administrative autonomy, or enhancing incentives for civil servants to reduce the risk of corruption.

A number of operations focused on facilitating trade—creating a more favorable business environment for the private sector while also raising additional revenue. The Philippines Tax Computerization Project (1993) helped brokers, importers, and tax authorities accelerate the processing of goods through customs. A Bank project, it implemented technical advice from the International Monetary Fund and refined a computerization system supported by the United Nations Conference on Trade and Development to accommodate country requirements. Private service providers were hired to make the change and to oversee computerization. The result? A technical assistance project that drew on different

development partners to deliver a product that raised revenue and streamlined the import activities of the private sector.

Few projects, however, addressed the need for better customer service or tested promising new approaches in taxation, such as presumptive taxes, privatized collection or inspection services, or performance-linked bonuses or administrative budgets. An exception to this was the support for independent revenue authorities with discretion in allocating resources and managing personnel. A better understanding of the contributions these innovative approaches can make to achieving project objectives—including transparency, effectiveness, and efficiency—could add significant value to Bank assistance.

Were objectives achieved?

Without performance indicators, it is impossible to judge whether a project has achieved its objectives. Thus pre-project assessments and post-project targets are essential. Such performance indicators require good diagnostic work and follow-up. An earlier study of technical assistance projects noted the absence of performance indicators as a major weakness in the design of tax administration components of structural and sectoral adjustment loans (Datta-Mitra 1997). In technical assistance projects the design problem is somewhat less serious—most such projects included performance indicators, though there was a preference for qualitative over quantitative indicators.

The customs administration component of the Turkey Public Financial Management Project (1995) provides an example of well-defined performance indicators. The component set many pre-project benchmarks for a large number of qualitative and quantitative performance indicators and identified ways to measure results. Indicators for the tax administration component are less revealing—they simply list project components and their launch dates.

Few projects had closed at the time of the review, precluding generalizations. An unscientific review of progress to date suggests that some projects have achieved most of their objectives, while others have failed. The Operations

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Evaluation Department reviewed Chile's Second Public Sector Management Project (1991) and rated it highly. Even though it was unabashedly a computer project, it included training, organizational reform, and evaluation. The focus on managing information rather than simply introducing computers was essential. Since all the tax administration technical assistance projects had a computerization component, future projects may want to examine the design of the Chile project.

What have we learned?

Improving the design and process of tax and customs administration projects requires a better understanding of the theoretical underpinnings for efficient and effective tax and customs administration. While recent theories stress the importance of institutions that harness voice and lead to contestability and transparency, evidence on the efficacy of these and other reforms is lacking in the specific context of tax administration. Although we have more to learn about what determines successful tax administration, some conclusions and recommendations are already apparent:

- Pre-project diagnosis can improve project design. Diagnosis should generally be guided by a framework that covers institutional concerns—accountability, client services, cost-effective administration, anticorruption efforts—as well as the traditional concerns of tax administrators (see table 1).
- Project design should be based on a strategic vision of the administration, should pay attention to good governance, and should be matched to a country's implementation capacity. Alternative designs and sequencing should be analyzed and their benefits assessed.
- A standard set of performance indicators

should be clearly specified, including pre-project base values and post-project objectives measured against best practices. Cost permitting, client surveys should provide input for these indicators.

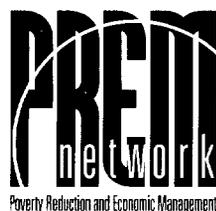
- Appraisal and post-project evaluation should be based on the same performance indicators.
- Finally, to improve our understanding of the institutional framework of tax administration reform, work hypotheses could be specified and tested. Academic consultants could help with proper diagnosis, design, and evaluation.

Further reading

- Barbone, Luca, Arindam Das-Gupta, Luc De Wulf, and Anna Hansson. 1999. "Reforming Tax Systems: The World Bank Record in the 1990s." Policy Research Working Paper 2237. World Bank, Washington, D.C.
- Datta-Mitra, Jayanti. 1997. "Fiscal Management in Adjustment Lending." World Bank, Operations Evaluation Department, Washington, D.C.
- Gill, Jit. Forthcoming. "A Diagnostic Framework for Revenue Administration." World Bank, Washington, D.C.

This note was written by Luc De Wulf (Principal Country Economist, Middle East and North Africa Region) and is based on Policy Research Working Paper 2237, "Reforming Tax Systems: The World Bank Record in the 1990s," by Luca Barbone (Country Director, Europe and Central Asia Region), Arindam Das-Gupta (former Coordinator, Tax Policy and Administration Thematic Group, PREM Network), Luc De Wulf, and Anna Hansson (Research Analyst, PREM Network).

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