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The Changing Politics of Tax Policy Reform in Developing Countries

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Management***Mick Moore*

Who shapes tax policy reform in developing countries? A wider range of political actors are beginning to exercise influence. A brief history will explain who they are and how they operate.

Recent History: The Pessimistic View

One of the most thorough tax reforms in recent history began in Peru in 1991.¹ The government simultaneously fired most of the tax collectors employed by the Ministry of Finance, established a new semi-autonomous revenue agency (SUNAT) staffed mostly by new recruits from the private sector, and radically simplified the tax code. Among other changes, it abolished most of the dozens of taxes on the books to leave only a handful of significant revenue sources. This reform has become almost iconic in the eyes international tax specialists. Most Peruvians were aware of it and affected by it. But they played no role in bringing it about. Neither tax policy nor tax administration issues had been significant in Peru's turbulent politics. They remain minor issues today. In that respect, Peru is typical of most developing countries, and very unlike the United States, where furious debates about taxes are a staple of electoral politics.

Why the difference? Why are tax issues so prominent on the public political agenda in most high-income countries, and so low profile in most developing countries? It is because the average citizen of a rich country is more likely to perceive herself as the source of the money that the government spends. To some extent, this perception is correct. While the governments of

rich countries are funded almost entirely from broad general taxation, governments of developing countries often depend substantially on non-tax revenue, especially income from development aid and from the control of oil, gas and mineral extraction. To some extent it is just a matter of perception, stemming from differences in the balance among types of taxes. The governments of rich countries depend heavily on two kinds of taxes that are highly visible to the average citizen: personal income taxes, which are paid by half or more of households through direct deductions from salaries through PAYE (Pay As You Earn) schemes; and excise taxes on products like alcohol, fuel and tobacco. By contrast, the governments of developing countries depend more on import duties and taxes paid by companies, especially corporate income tax. These taxes are highly visible to the small number of companies that pay them, but near-invisible to the average citizen. The public at large have little interest in tax policy. When politicians seek public support, they seldom talk of tax. Political parties typically take few positions on tax policy. Think-tanks produce few tax policy analyses. Legislative debates on government revenue are often cursory and badly informed.

The scarcity of public debate in developing countries does not mean that tax policy is static. To the contrary, it typically suffers from over-activity. Many governments revise their tax codes every

year. Policy change seems continuous. But it often lacks direction. Frequent small and apparently random changes in tax codes may cancel each other out.

Why are these changes made so frequently? It is partly because governments feel the need to appear to be in control. Annually or more frequently, ministers of finance present packages of small changes in tax regimes as part of a strategy to revive, dynamise or re-shape national economies. It is partly the outcome of continuous lobbying by politicians and lobbyists representing individual big companies, small industry groups, or the wealthy classes: the dominant brewing company; producers of solar panels or cycle helmets; exporters of reconditioned truck tires or processed cashew nuts; providers of low-cost mortgages or IT services to the financial sector; sellers of land in designated urban development zones; or investors in 'strategic' enterprises. For example, the 2012 Sri Lankan budget provided tax concessions to both new and existing investments in 'strategic import replacement enterprises', generously defined to include the cement, steel, pharmaceuticals, fabric and milk powder industries.

In developing countries, tax politics reflect the fact that the average citizen does not perceive herself as being taxed to any significant degree, and that most tax revenues are collected from a small number of larger companies. The tax activists are companies, wealthy individuals, national politicians and the revenue policy specialists in ministries of finance. The arenas in which policy is made are closed and exclusive. The bargaining often revolves around the exchange of tax concessions and exemptions for political support and contributions to politicians' funds.

Policies and practices that are continually re-shaped out of the limelight and under the direct influence of the wealthy and powerful tend to benefit no one as much as the wealthy and powerful. For example, in its 2011 budget, the Government of Sri Lanka offered tax holidays of up to 6 years to companies making new investments of up to 300 million rupees in selected export or import substitution sectors, but extended those tax holidays to up to 12 years for companies investing larger sums.

Recent History: The Optimistic View

Yet the story of tax reform in low income countries over the past two to three decades is far more positive than the paragraphs above lead us to expect. There has been a great deal of real, directed and purposeful tax reform. Although the content of reform has varied from country to country, two themes recur. The first

is the replacement of old sales taxes and high rates of duty on imports and exports with new value-added taxes. The second is continuous attempts to improve tax administration, especially by simplifying the tax code: reducing the number of taxes, the number of rates at which each tax is levied, and the number of tax exemptions.

Why has reform experience surpassed expectations? It is not because larger numbers of citizens have become involved, tax policy debate more intense, or policy-making more transparent. It is principally because another small group of people have brought their influence to bear in the closed circles in which tax policy is made: a network of transnational tax experts rooted largely in higher income countries and international organizations: the European Union (in relation to the former centrally planned economies of central, east and southeast Europe); the IMF; the World Bank; the OECD; the IDB; a range of aid donors; international consultancy companies; advisory staff from rich country tax authorities; and applied academics. This 'epistemic community' of knowledge-based experts who think along similar lines has been the dominant source of tax reform in most of Africa and the former Soviet bloc in particular. Some of their policy positions remain controversial, but they were undoubtedly designed principally with public good in mind. And they have been widely implemented. It is true that this is yet another small and rather elite group. However, it is better that tax policy should be shaped by such people than by the lobbyists who might otherwise rule the roost. And this international community of tax experts is becoming more global in composition. Latin Americans and Africans are fast joining the ranks.

The Future

Closed policymaking by lobbyists or closed policymaking by transnational experts. Is this the only choice? Fortunately not. Tax policy debate is opening up to a wider range of political actors. They vary from country to country and issue to issue. In general, the following four sets of political actors are increasingly prominent in developing countries, especially in sub-Saharan Africa:

- *Business associations.* Business associations typically are the most visible contributors to national tax policy discussions. If governments receive only a handful of written submissions about tax policy before the annual budget, these are likely to come

from chambers of commerce, employers' associations, or other organizations representing the private sector. Business associations are of course self-interested. But they generally pursue those self-interests in a more transparent way than do individual companies. It is better for the quality of policy debate that the National Association of Garment Exporters should openly make the case for a tax holiday for new investors than that the less scrupulous companies should be able to 'persuade' the Board of Investment to give them favorable individual treatment. The organizations that collectively represent the private sector are generally expanding in low-income countries. The effect on tax policy debate should be positive.

- *Professional associations.* Another type of association—the professional associations representing tax collectors—are having an even more visible impact on tax policymaking. The most impressive is the Inter American Center of Tax Administrations (CIAT). CIAT was founded in 1967. It is now expanding beyond the Americas. Its members include five national tax administrations from Europe, two from Africa, and one from Asia. The continent-wide African Tax Administration Forum (ATAF) has grown fast since its creation in 2008. These associations provide their effective members – the senior staff of national tax administrations – with ideas, inspiration and often quiet collegial support. Membership tends to strengthen the hand of national tax administrations in domestic policymaking, and is one of an increasing number of channels through which senior African tax administrators in particular can join the ranks of the international 'epistemic community' of tax experts mentioned above. Asia lacks effective regional tax administrators' associations. This may be one reason why tax policy and administration in most South Asian countries have experienced little reform in recent decades.
- *The Big Four.* The big international accounting and professional services firms—Deloitte, Ernst and Young, KPMG and PwC—are fast expanding their branch networks and staff numbers in many poorer countries, especially in sub-Saharan Africa. They recruit experienced tax administrators and appear on all sides of taxation processes and debates: as promoters of improved accounting and auditing standards in the private sector; as advisers to companies on how to minimize tax obligations; as interlocutors for tax administrations on the interpretation or reform of tax law; and as

producers of benchmark data on the performance of national tax systems. The *Paying Taxes* report produced annually by PwC and the World Bank currently has a global coverage and makes the best of very scarce hard data on tax system performance. Regional reports based on improved data, and collected according to common standards, seem likely to follow.

- The most vocal and effective new entrants to policy debates on tax and development are civil society organizations (CSOs) like Action Aid, Christian Aid, Global Financial Integrity, Oxfam and the Tax Justice Network. They focus mainly on international taxation issues such as transfer mispricing, tax havens, capital flight, information exchange among tax agencies, international tax treaties and the ways in which transnational corporations are required to report their activities and profits—all with a focus on reducing tax avoidance and evasion. These CSOs often form organizational coalitions, combining grant-funded policy analysis and policy advocacy capabilities in Europe and the United States with relatively small membership activities in Latin America and sub-Saharan Africa. They have generally been very effective in producing material for radio, TV, internet and print media; in gaining access to tax policy forums nationally and in international organizations like the European Commission and the OECD; and in organizing street-level activities to draw public attention to selected transnational companies believed to be avoiding or evading their tax responsibilities. Taking advantage of the recent drive by most OECD governments to close gaps in their tax-nets, these CSOs have played a major role in putting onto international policy agendas issues like tax havens and transfer mis-pricing by transnational companies. The scandal of the gross under-taxation of mining companies in countries like Zambia is likely to continue to help them mobilize grassroots memberships in resource rich nations. Their activities may change, especially as global business mobilizes in response, and perhaps tries to stimulate more civil society activism supportive of business interests. But the radical CSOs are likely to continue to be major international tax policy actors.

Conclusions

In the short term, tax policy debates in low-income countries will remain complex and inaccessible to many citizens and local CSOs. Accordingly, organized

special interests will remain influential. As the international aspects of business taxation come increasingly under the spotlight, the details of tax policy may become even less comprehensible to the ordinary person in the street. But the longer-term picture looks positive. Tax policy will be debated more openly. A wider range of people will participate. If they are to help bring about policy reform, organizations like the World Bank will rely less on their close connections

with the fiscal decision-makers, and put more effort into 'feeding' those policy debates. Because their tax specialists will increasingly be nationals of developing countries, they will be better placed to exercise influence without generating resistance.

Note

World Bank (2001) 'Strengthening Peru's Tax Agency'. PREM Notes, No.60.



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