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## Tax Policy Analysis and Capacity Building in Low and Middle Income Countries

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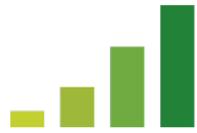
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# Outline of the talk

- Evidence-based tax policy and administration in developing countries
- IFS approach to tax and benefit analysis – examples from the UK
- IFS work on taxation in developing countries
  - TAXDEV @ IFS: recently established Centre for Tax Analysis and Capacity Building in Developing Countries (TAXDEV)



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## Evidence-based tax policy in developing countries

# Taxation and development (I)

- Taxation is receiving more attention from policy makers and administrators in developing countries and from donors and academics worldwide
- Many developing countries need to raise revenues
  - Ensure fiscal sustainability
  - Increase spending on health, education or infrastructure
  - Reduce reliance on donor funding
- Design and operation of tax system is important part of ‘state capacity’ agenda & key to government-citizen relations
- Important to take into account the crucial interaction between tax policy and administration
  - How a policy is administered affects its effectiveness and impact
  - Administrative feasibility of a policy

# Taxation and development (II)

- As countries develop they often begin to build systems of benefits (cash transfers)
  - To help tackle high levels of inequality and poverty
  - To create space to reduce wasteful subsidies, and raise taxes that would otherwise hit the poor
- Such systems need to be well targeted to make efficient use of limited resources, and considered jointly with the tax system
  - The effects of tax and benefit systems on behaviour and efficiency need to be analysed and understood
- Applied empirical research is key to this understanding

# Evidence-based tax policy and administration

- The cost of taxation is inevitably higher than the sums that are raised to fund public spending
  - Administrative costs
  - Compliance costs
  - Efficiency costs from induced changes in behaviour
- Tax system structure and its practical administration affect:
  - Size of these costs – which should aimed to be minimised
  - Ability of governments' to raise revenues
- Empirical research is key to inform tax policy and administration design, and context matter
  - To understand revenue potential and the nature and magnitude of these responses and costs



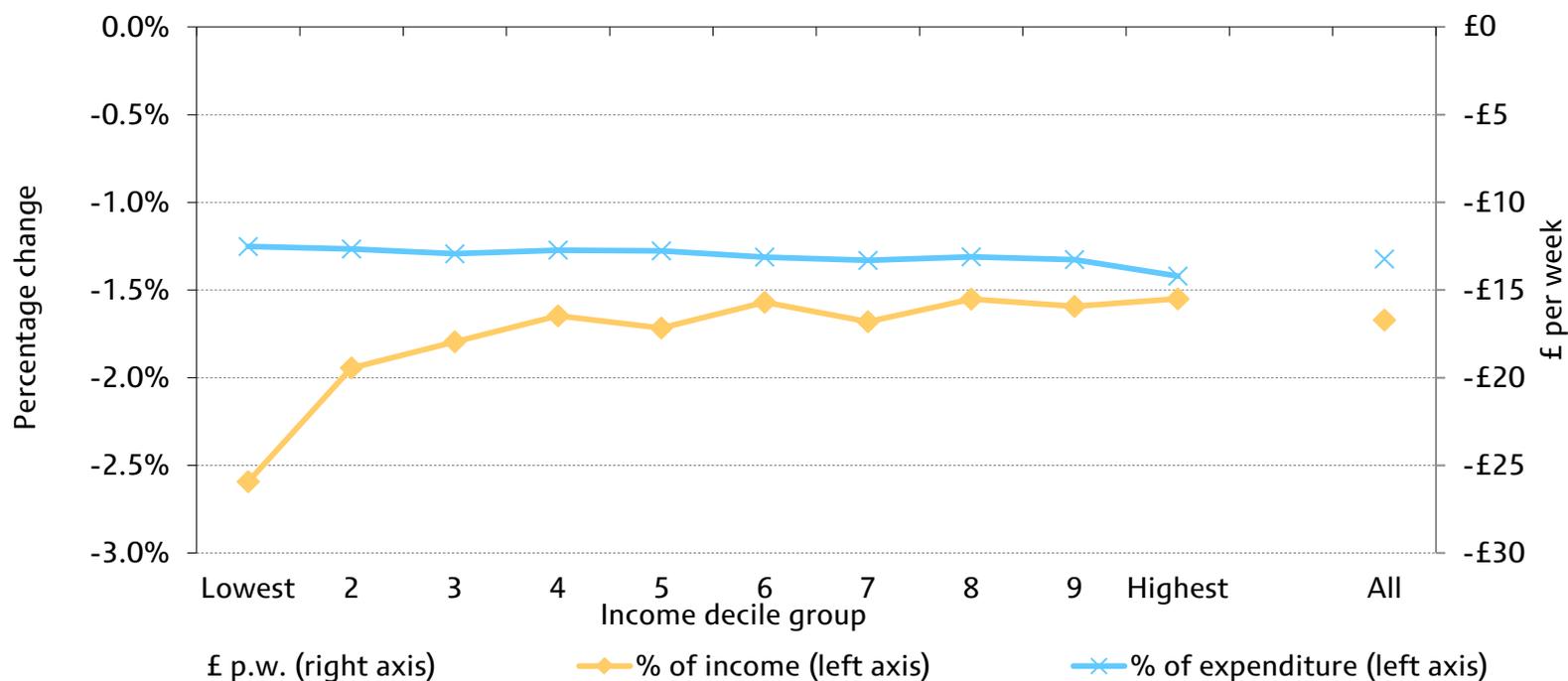
## The IFS approach – analysing tax and benefit policies

# Analysing tax at the IFS

- IFS set up in late 1960s in response to shortcomings in UK tax policy making process - Independent research think-tank
- Since then, we've shone a flashlight on the good, the bad, and the ugly of UK tax policy
  - Major reviews of the tax system (Meade, Mirrlees)
  - Economic analysis of specific policies covering all areas of tax – VAT, corporation, income tax, NI, property tax, etc.
  - Our micro-simulation model, TAXBEN
  - Post-budget briefing: analysis of policies contained in the budget
  - Green Budget: Flagship annual publication; economic impact of policy decisions and key issues in fiscal policy
- (We hope) the independent assessment of policy helps improve policy-making, and inform public debate

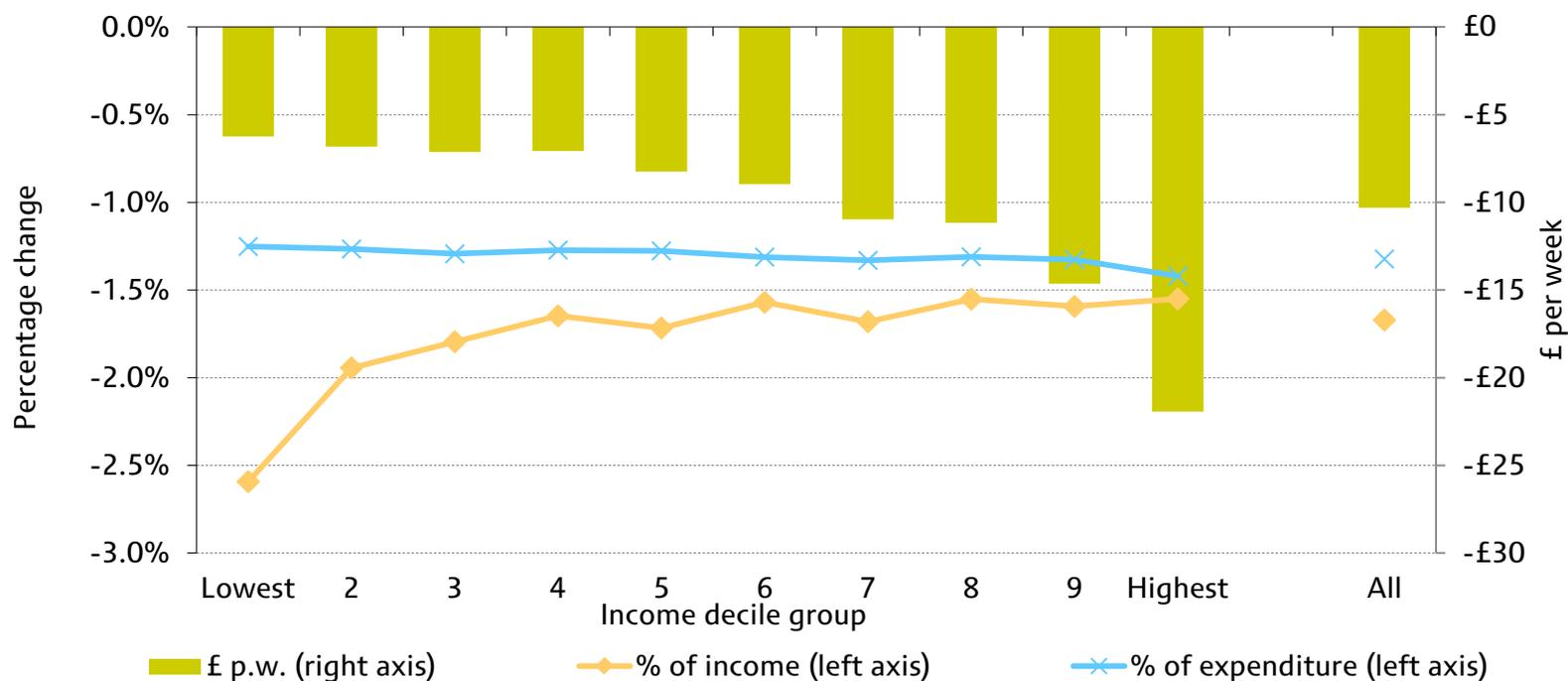
# Understanding the distributional effects of policy (I)

- We use TAXBEN to simulate the distributional (and other) effects of policy: results often challenging pre-conceived notions
- Example 1: “VAT is regressive”



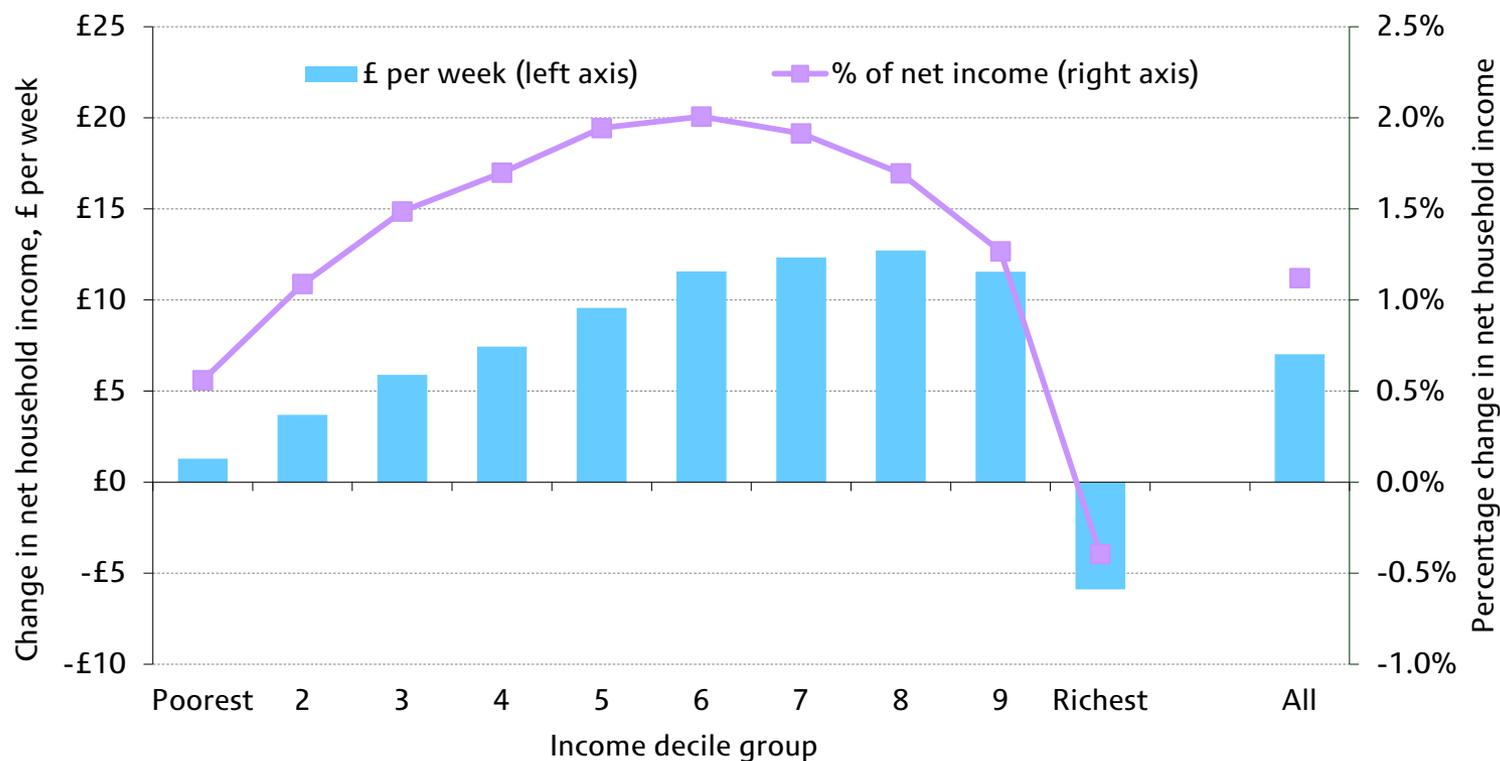
# Understanding the distributional effects of policy (I)

- We use TAXBEN to simulate the distributional (and other) effects of policy: results often challenging pre-conceived notions
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# Understanding the distributional effects of policy (II)

- Example 2: “Increasing the income tax personal allowance is progressive”



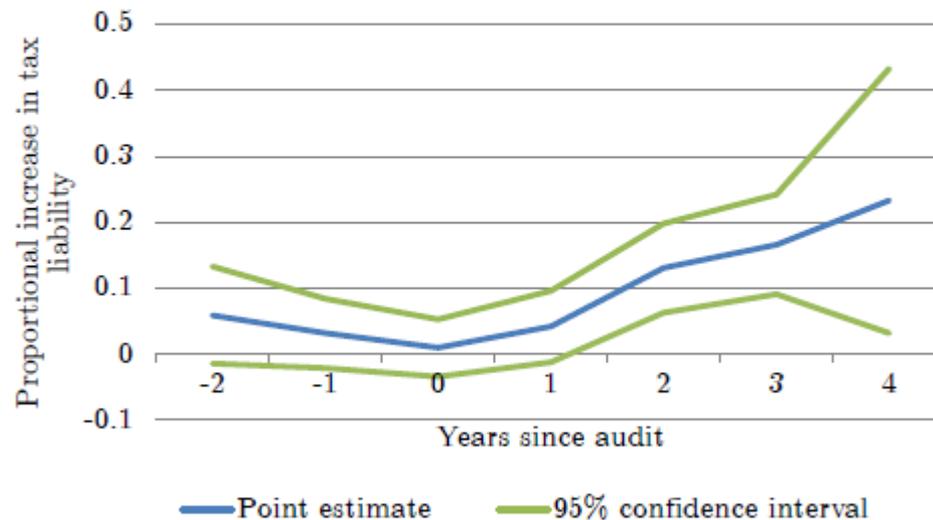
# Analysing impacts of policy on behaviour

- Tax and benefit policies can have desirable or undesirable behavioural effects – and sometimes both
- Example: the Working Families Tax Credit
- Evaluation of reform suggests it boosted employment rate of lone mothers by 3-5 percentage points
  - Small +ve effects on fathers, -ve effects on mothers in couples
  - In line with the change in financial work incentives
- But recent simulations suggest by boosting net income of low-earners, may reduce incentive for education

# Tax administration and enforcement

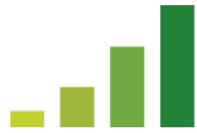
- Can also evaluate administration and enforcement using tax admin data provided by tax administrators - in this case HMRC
- What effects do random audits have on subsequent reported income

Figure 3: Impact of audit on reported tax liability: audit in any year



# IFS work with HMRC

- IFS uses admin data facilitated by HMRC for researchers to analyse a range of taxpayers responses to taxes and enforcement
  - Tax compliance responses to random audits
  - How owner managers respond to taxes by shifting income over time
  - Use tax data to look at the incomes of the rich (which aren't well measured in surveys)
  - Estimating responses to top tax rates using data derived from tax data
- IFS benefit from working with HMRC because of data and their knowledge / HMRC benefit from working with IFS because
  - expertise (e.g. econometrics, linking data, evaluation of policies)
  - extra resources to do the larger pieces of analysis
  - IFS tend to look at policies in a bigger picture way



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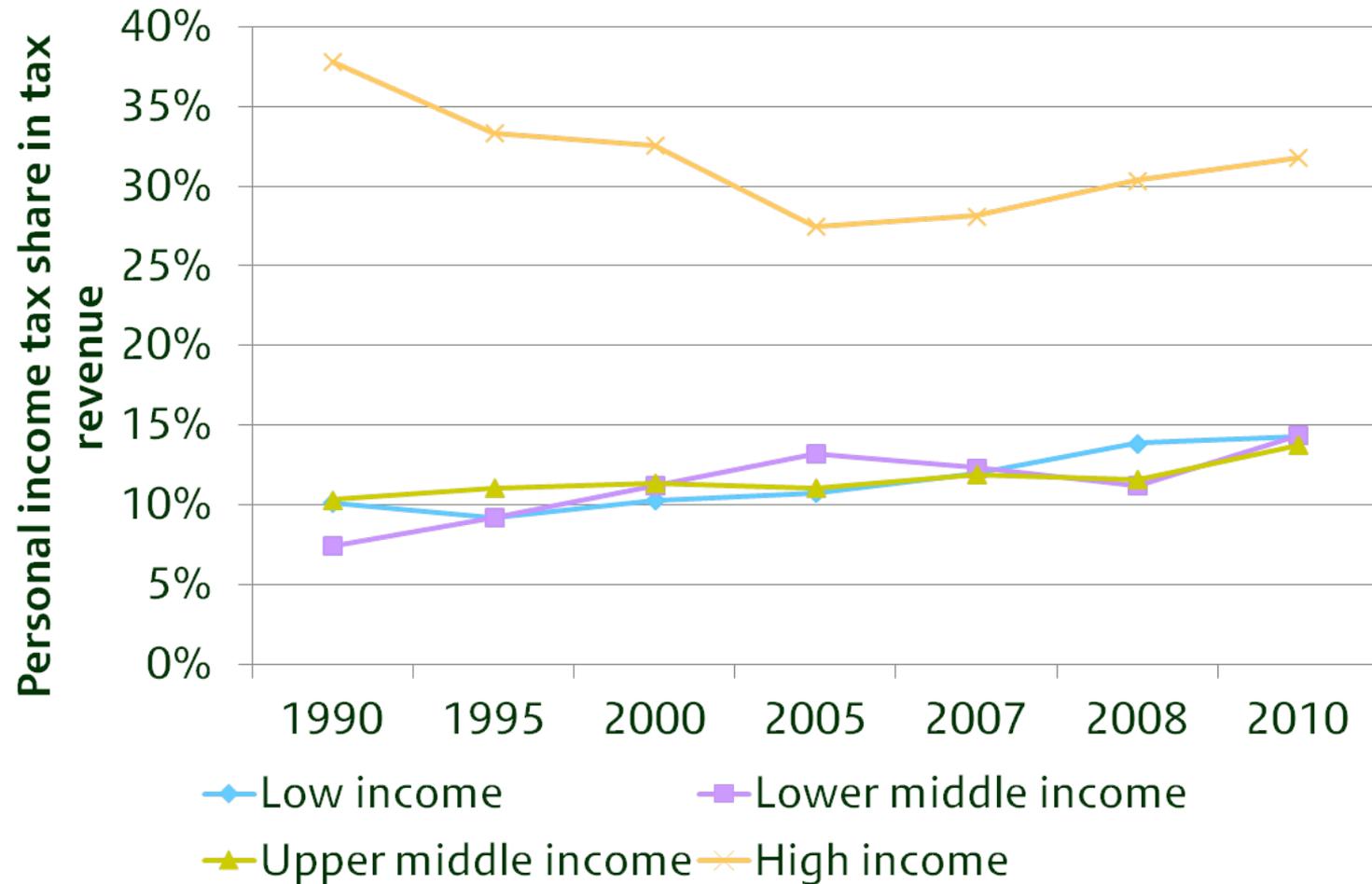


IFS work on tax analysis  
and capacity building  
in low and middle income countries

# The importance of evidence and context

- Ability to design better tax policy relies on understanding effects of existing, and proposed, policies
- Evidence from high income countries and optimal taxation literature might not be as relevant in low and middle income countries
  - Institutions, economic structures and political economies differ
- Choices about tax policy are shaped and constrained by a country's:
  - Economic structure
  - Level of state/administrative capacity
- Poorly designed tax and spending policies can exacerbate rather than alleviate poverty

# How does economic structure affect tax policy?



# Tax policy challenges

- Low and middle income countries face many challenges in the design of tax policy to achieve sustainable domestic revenue mobilisation:
  - 1. Lack of theoretical and empirical evidence about the impacts of individual tax policies, as well as how tax and benefit policies work together in fiscal system**
  - 2. Limited capacity within governments to undertake rigorous analysis of tax policy – reliance on external actors, who may not understand system or context**
  3. Data constraints that limits empirical research on tax policy and administration
  4. Tax administration systems and taxpayers with limited skills
  5. Tax policy design processes
  6. Sometimes limited cooperation between tax administrators and tax policymakers (data, analysis, policy formulation)

# TAXDEV @ IFS (I)

- Currently work on tax policy analysis in developing countries at IFS revolves around the Centre for Tax Analysis in Developing Countries (TAXDEV)

- TAXDEV has a number of key components:

## (A) Country Partnerships

- Generate high quality, rigorous, demand-led evidence and analysis of tax and benefit policies with partners in Ethiopia and Ghana
- Build skills and capacity for further policy analysis in partner countries through providing
  - tools and models
  - co-production of analysis and tools & “learning by doing”, training and feedback

# TAXDEV @ IFS (II)

- TAXDEV has a number of key components:
  - (B) Broader Research
    - Research on tax issues facing low and middle income countries more broadly – contribute to body of evidence for countries which share similar characteristics
      - Indirect taxes, redistribution and efficiency
      - VAT and simplified tax schemes
      - The taxation of businesses
      - What we know about the nature, rationale and effects of special corporate tax regimes

# Country partnerships: (i) quality, demand-led research and policy analysis

- Partnership with Finance Ministries and Revenue Authorities to identify, refine and answer key tax policy questions:
  - Develop preliminary ideas
  - Refine priority areas – is it possible to conduct rigorous analysis?:
    - Mapping the availability of survey and administrative data
    - Mapping legislative framework and policy reforms
    - Assessing appropriate tools and methodologies
    - Fit to researchers' comparative advantages
  - Consider political and institutional priorities, timelines and sensitivities
  - Consider impact: Short-term political interest or contribution to understanding broader distribution, growth, efficiency issues?

# What types of analysis are we working on in countries? Ethiopia

- MoFEC interested in major review and potential reform of VAT/ToT - equity/poverty, tax revenue, efficiency (economic and administration) and business-friendliness
- VAT study: partnership between MoFEC and IFS, in cooperation with Revenue Authority
  1. Overview of current VAT & ToT system
  2. Distributional, poverty and revenue analysis of VAT - household level tax & benefits microsimulation model
  3. Compliance, revenue & administrative issues – quantitative analysis of VAT/ToT Taxpayers
  4. Develop options for policy reform given government's objective based on final findings (expected 2018)
    - » Areas: policy (exemptions/rate level & structure) & administration

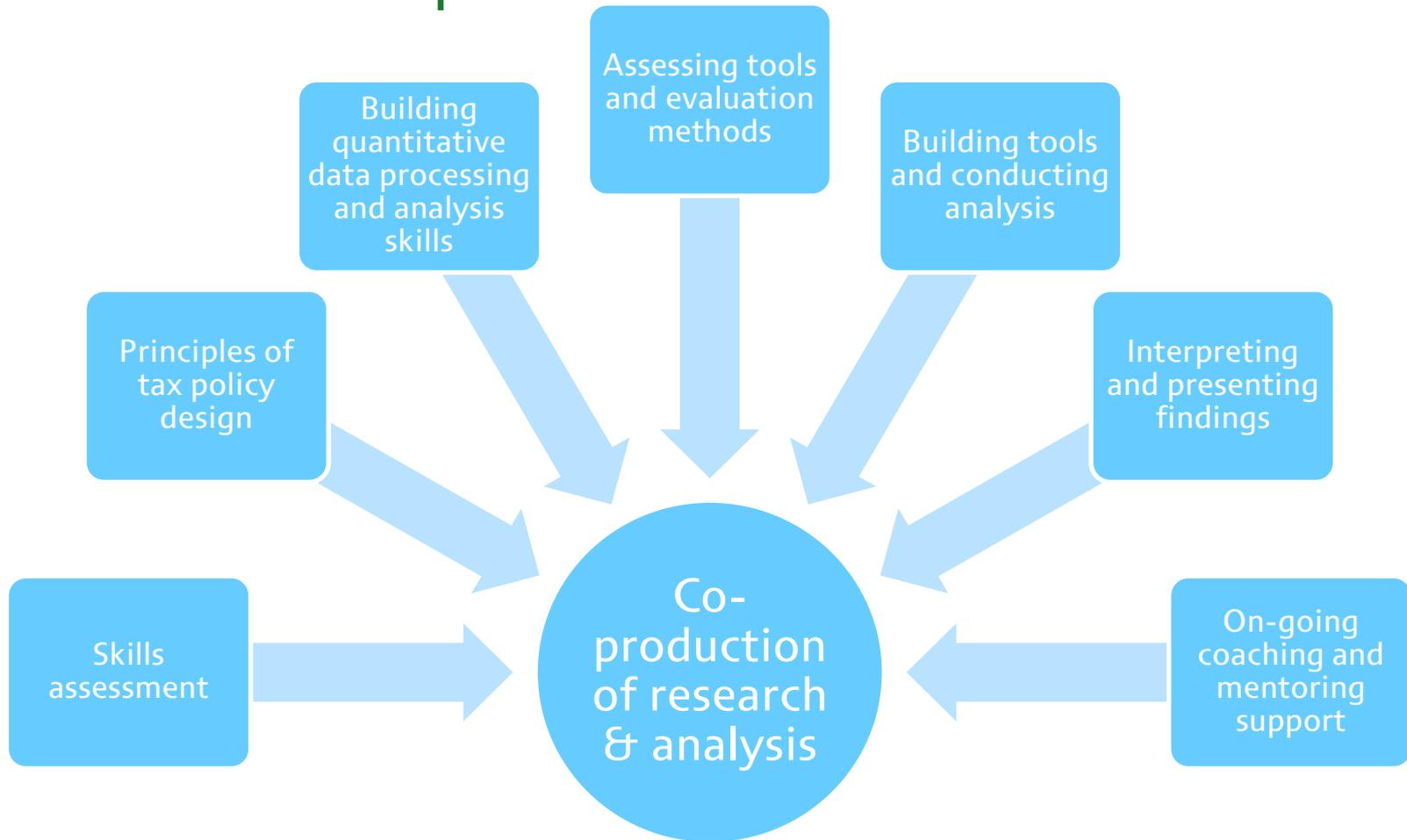
# What types of analysis are we working on in countries? Ghana

1. Tax policy costings
2. 'Microsimulation' model to estimate impacts of tax on households
3. Data capture
  - Support team to extract existing administrative data and enter data from tax returns
  - Obtain data to improve (1) and (2) and for broader use in policymaking, forecasting and compliance monitoring

# 1. Systematic approach to tax policy costing

- MoF requested support on policy costings
  - Better understand and critique Ghana Revenue Authority's (GRA's) costings
  - Incorporate, where possible, behavioural responses in costings
  - Apply to tax cuts announced in March 2017 budget
- TAXDEV developed a methodology and series of 'templates' to use
  - Based on the approach HMT / OBR use in UK
  - Step-by-step from...
    - Initial statement of policy and policy objectives, to...
    - Final policy costing
  - Clear statement of costs and calculations could aid decision making and transparency
- Will make available this template for other countries to use this tool – check our website <https://www.ifs.org.uk/centres/taxdev>

# Country partnerships: (ii) Co-production and skills development



# Lessons Learned 1: Research and policy analysis

- Access to, and quality of, data is a key barrier:
  - Challenges with tracking tax payers across bases, coherence of data on tax forms, unique identifiers
  - Even when data exists, extracting and sharing it is tricky
- In-depth understanding of administrative issues is a pre-requisite to undertaking policy analysis:
  - Partial, opaque implementation of law – again close collaboration between revenue authorities and tax policymakers is crucial
- Revenue effects dominate analysis and accountability mechanisms:
  - Compromises efforts to focus on equally crucial issues of equity and efficiency
- Plan strategies to turn demand-led research into impactful research, think about bigger picture and the system as a whole

# Lessons learned 2: Co-production & skills development

- Analytical work is technical, but the potential barriers to embedding new skills are often organisational and institutional
  - How do we ensure that our training supports delivery of normal workload, and not just viewed as a “special project”?
  - A flexible approach is vital
- IFS is a research institution – our partner organisations are not!
  - Working on discrete tasks, with consolidation, is important
  - Eg. dividing the microsimulation model into modules
  - Sequencing of training, relevance, sustainability are key issues

# TAXDEV outcomes and impact

- Medium-term outcomes:
  - Improvements in knowledge of national and international policy makers on optimal tax design for specific contexts
  - Improved technical capacity of policymakers to assess impacts on redistribution, revenues, work incentives and investment incentives and decisions
- Impact:
  - ➔ Stronger, inclusive economic growth, funded by more efficient taxes, with less reliance on donors

# Discussion

- What are the opportunities & challenges for implementing more evidence-based tax policy and administration policies in your countries?
- How could you benefit from specific capacity building in this area?

## Consider

- Policy objective definition
- Political interests, will and stability – short/long term agenda
- Policy processes and transparency
- Time to make more in-depth analysis
- Skills
- Data
- Personnel turnover



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## Thank you!

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