3

Taxation and Developing Countries

3.1 Taxation and Tax Policy Analysis

In both developed and developing countries, governments collect taxes to fund public services. Although many developing countries are highly dependent on foreign aid, taxes are the principal own-revenue source. Other own-revenue sources are non-tax revenue, which includes fees, licences, mineral rights, etc., and capital revenue, which includes income from sales of government assets, including privatisations.[8]

Since taxes are the principal source of recurring revenue under government control, in all countries tax policy is at the heart of the political debate on the level of public services that should be provided and who should pay for them. The resolution of the debate varies by country and within countries over time. In democratic countries, the resolution depends on the ability of political parties, factions and interest groups to influence policy decisions and to influence voters to support these decisions. Groups without political or economic power, such as the poor and women, are often excluded from this debate and from tax policy decisions.

The goal of tax analysis is to identify the potential macro and micro impacts of tax policy options on individuals, businesses and economic growth, so that policymakers and the public have full knowledge of the impact of tax policy decisions. On the macro side, a gender analysis of tax policy would include analysis of the overall fiscal position of the budget, since deficits and options to close these can have explicit and implicit gender implications. Questions to be considered from a gender perspective might include: Are the estimates of revenue and expenditure, and of the projected budget surplus/deficit, reasonable?; What are the proposed policies for addressing government deficits and national debt?; What are the budget's expected effects on economic growth, inflation and employment? On the micro side, a gender analysis of tax policy would explore the implications for individual and household behaviour – in terms of labour supply, household production and time use, and marriage and fertility. Within both the macro and micro gender analysis, it is particularly important to address differential impacts by income, geography, ethnicity and race.

Tax analysis should also provide cost-benefit estimates of tax policy options, and ensure that the design of tax incentives (discussed in Section 3.4.5) is constructed to include provisions for proper implementation and periodic evaluation. Tax analysis, therefore, is essential to ensuring that the political debate regarding tax policy is fully informed of the social as well as fiscal impact of tax policy options, including the impact on income and gender equity.

3.2 Tax Systems in Developing Countries: Background

The tax system of each country reflects its specific history, legal tradition, political structure and economic base. Developing country tax systems originated from the traditions of their colonial powers, with little relationship to the actual conditions or interests of the country. Initially these systems were designed to extract wealth from the colony for the benefit of the coloniser.[9]

At the time of independence, most ex-colonies inherited tax systems based on early twentieth-century European conditions and a fiscal system in collapse – with few or no revenue sources, a weak civil service, and low levels of human and physical capital. In some developing countries, for example Guinea and Mozambique, the colonising power had consciously destroyed economic assets as it withdrew. In others, for example Angola and Guatemala, economic destruction had resulted from civil conflict sponsored by major economic powers or, as in Mozambique and Namibia, by apartheid South Africa.

Developing countries that adopted a market economy were encouraged by major commercial banks to borrow freely at low interest rates, and these liabilities turned into unsustainable deficits when interest rates turned high. Countries that followed a socialist path often suffered economic sanctions as well as political disruption by major powers, and/or stagnated economically because of misguided economic policies. Countries in transition from socialism, as well as post-apartheid South Africa, were faced with re-orienting their entire societies and economies to deliver to the majority rather than a minority, drafting new constitutions and constructing new government structures. Overcoming these historical conditions continues to be a major challenge for developing and transition country tax systems in attempting to produce sufficient revenues for needed services.

3.3 Tax Systems in Developing Countries: Current Issues

The tax systems of developing countries include the same basic tax categories used in developed countries: direct taxes on income and wealth; indirect taxes on consumption; property taxes; and trade taxes. The most common direct taxes are personal income tax, corporate income tax and wealth or inheritance taxes. The most common indirect taxes are value-added tax (VAT), and selected sales and excise taxes. Property taxes may be imposed on real property, such as land and housing, or on personal property, such as cars and boats. Trade taxes may take the form of import or export duties. For each type of tax, gender bias may exist explicitly in the tax laws and/or implicitly through the differential impact of the tax on women and men (Stotsky, 1997a). These biases will be discussed further in Section 5.

Table 3.1 describes the principal components of total government revenue: tax revenue, non-tax revenue and capital revenue.[10]

Table 3.1: Components of Government Revenue

Tax Revenue
Income taxes (individual and corporate)
Payroll/social security taxes
Taxes on goods and services (VAT, sales, excise)
Property taxes
Trade taxes (import duties, export duties)
Other taxes
Non-tax Revenue
Income from public enterprises and property
Administrative fees and charges
Interest receipts
Other non-tax revenue
Capital Revenue
Sale of fixed capital assets

Source: IMF, 2002

The distribution of tax authority between national, provincial and local government differs in each country. There are at least two aspects of how taxation is distributed across the levels. The first is who has authority to impose and collect it. The second is to which levels the money collected is distributed. Usually, broad-based taxes such as income tax and VAT are assigned to the central government, while geographically-specific taxes such as the property tax are local revenue tools. By spreading tax revenues across different tax instruments, ideally the fiscal system can better withstand economic fluctuations and can minimise the tax burden on any particular group of taxpayers or sectors of the economy.

A frequently used measure of the effectiveness of a country's tax system, and/or its tax competitiveness relative to other countries, is the ratio of total tax revenue to GDP. This ratio varies widely among both developed and developing countries. Sweden, for example, had a tax/GDP ratio of 51 per cent in 2002, whereas Australia and the US had ratios of 30 and 29 per cent, respectively, in 2001.[11] Among developing countries, there is also a wide range: 7.8 per cent in Bangladesh; 8.3 per cent in India; 10 per cent in Nigeria; 23.2 per cent in South Africa; 26.6 per cent in Jamaica; 31 per cent in Barbados; and 32.2 per cent in Botswana.[12] A low tax/GDP ratio may reflect an inadequate tax system and/or weak tax administration, or there may be other substantial non-tax sources of income, such as petroleum in Nigeria. Or it may be the result of conscious policy, as in South Africa where a national tax/GDP target was set in 1996 at no more than 25 per cent.

The following box provides a summary of the tax system in one country, Argentina, and its tax/GDP ratio.

Box 3.1: Tax System Example – Argentina

The Argentinian tax system includes an income tax and various social security contributions, a value-added tax and a series of excise taxes, and trade taxes. These resources average 17–18 per cent of GDP. Provincial governments collect an additional 3 per cent of GDP in their own sales tax (a gross receipts tax (GRT)) and property and stamp taxes. There is a high degree of expenditure decentralisation, financed through a complex system of revenue sharing and transfers.

Source: Cuevas, 1990

Khattry and Rao (2002) study the use of different kinds of taxes according to the level of development. From a sample of 205 countries, they consider three main tax categories – income taxes, domestic taxes on goods and services and trade taxes – according to their relative shares of total tax revenue and of GDP at four levels of development ranked from low to high income. Their results are shown in Table 3.2.

As would be expected, poor countries derive a proportionally lower share of tax revenue from income taxes than high-income countries do, and they rely significantly more on trade taxes to fund essential public spending. For low-income countries, from 1970 to 1998 the share of trade taxes to total revenue fell from 40 per cent to 35 per cent, and the share of consumption taxes increased from 26 per cent to 33 per cent. The share of income taxes in low-income countries remained approximately the same over the period studied, constituting 27 per cent of total revenue in 1995–98.

Table 3.2 also shows the difference in shares of tax revenue at different levels of development. In 1995–98, trade taxes were 35 per cent of total revenue in low-income countries, 20 per cent in lower-middle-income countries, and less than 1 per cent in high-income countries. Domestic taxes on goods and services were about one-third of total tax revenue at all levels of development, with the share slightly higher in the middle-income countries.

Data for specific countries suggest that each country's distribution of tax revenues across types of taxes depends not only on its level of development, but also on its particular economic structure, the relative availability of alternative revenue sources and its unique social and political factors. Table 3.3 shows the relative shares of total revenue derived from income taxes, taxes on goods and services, property taxes and trade taxes for 22 selected Commonwealth developing countries. The income tax (personal and corporate) share of total revenue, for example, varies widely: from a low of 14–15 per cent in Bangladesh, Mauritius and Sri Lanka to a high of 48–60 per cent of total revenues in Malaysia, South Africa and Zimbabwe.

Table 3.2: Structure of Taxation and Level of Development

Income Group	Time Period	Income Tax (% of GDP)	Income Tax (% of Tax Revenue)	Domestic Taxes on Goods and Services (% of GDP)	Domestic Taxes on Goods and Services (% of Tax Revenue)	Trade Taxes (% of GDP)	Trade Taxes (% of Tax Revenue)	Indirect Taxes (% of GDP)	Indirect Taxes (% of Tax) Revenue
Low-income									
	1970–74	3.47	28.58	3.18	26.19	4.88	40.20	8.06	66.39
	1975–79	3.53	27.24	3.82	29.48	4.90	37.81	8.72	67.28
	1980–84	4.16	28.65	4.50	30.99	5.02	34.57	9.52	65.56
	1985–89	3.60	25.94	4.59	33.07	4.98	35.88	9.57	68.95
	1990–94	3.53	25.52	5.00	36.15	4.86	35.14	9.86	71.29
	1995–98	3.83	27.16	4.66	33.05	4.90	34.75	9.56	67.80
Lower middle-income									
	1970–74	3.57	24.37	4.06	29.09	5.05	34.99	9.11	64.08
	1975–79	4.64	27.32	4.15	26.06	6.05	34.70	10.20	60.76
	1980–84	5.20	29.82	4.55	27.80	5.27	30.03	9.82	57.83
	1985–89	5.27	29.64	5.28	31.76	4.59	26.33	9.87	58.09
	1990–94	5.27	29.79	5.77	34.07	4.81	25.16	10.58	59.23
	1995–98	4.79	27.30	7.40	41.85	3.80	20.18	11.20	62.03
Upper middle-income									
	1970–74	5.57	32.06	4.27	25.81	4.67	26.39	8.94	52.20
	1975–79	6.06	31.26	4.73	24.63	4.30	21.96	9.03	46.59
	1980–84	6.16	29.46	5.91	32.39	4.11	19.97	10.02	52.36
	1985–89	6.41	30.43	5.90	31.69	3.73	18.25	9.63	49.94
	1990–94	6.18	30.19	5.84	31.26	3.56	16.92	9.40	48.18
	1995–98	5.98	31.10	7.56	39.37	2.29	13.04	9.85	52.41

Table 3.2 (continued)

Income Group	Time Period	Income Tax (% of GDP)	Income Tax (% of Tax Revenue)	Domestic Taxes on Goods and Services (% of GDP)	Domestic Taxes on Goods and Services (% of Tax Revenue)	Trade Taxes (% of GDP)	Trade Taxes (% of Tax Revenue)	Indirect Taxes (% of GDP)	Indirect Taxes (% of Tax) Revenue
High-income									
	1970–74	8.81	35.94	7.73	31.54	1.66	6.77	9.39	38.31
	1975–79	9.52	35.97	7.94	30.00	1.32	4.99	9.26	34.98
	1980–84	10.36	36.41	8.67	30.47	1.07	3.76	9.74	34.24
	1985–89	10.74	36.54	9.69	32.97	0.75	2.55	10.44	35.52
	1990–94	10.37	35.40	9.62	32.84	0.46	1.57	10.08	34.41
	1995–98	10.80	35.36	10.20	33.40	0.25	0.82	10.45	34.22

Source: Khattry and Rao, 2002
Note: Income tax includes taxes on income, profits and capital gains; indirect taxes are the sum of domestic taxes on goods and services and trade taxes. Income group definitions: Low-income = GNP per capita of less than $775, N = 62; Lower middle-income = $756–2995, N = 55; Upper middle-income = $2996–9265, N=38; High-income = $9266 or above, N=50.

Table 3.3: Tax Structure of 22 Selected Commonwealth Countries

	Bangladesh	Barbados	Botswana	Ghana	Grenada	India	Jamaica	Kenya	Malawi	Malaysia	Mauritius
	1999/2000	2000/2001	1997/1998	1998	1995	2000/2001	1999/2000	2001/2002	2000/2001	1999	2001
Total revenue*	203.70	1,703.00	8,169.00	3,551.60	205.00	2,039.00	90,373.00	196,613.00	20,880.00	59,157.00	25,374.00
Tax revenue*	158.40	1,613.10	6,767.00	2,728.50	172.20	1,886.00	75,965.00	160,394.00	19,285.00	47,917.00	21,642.00
Tax revenue (% of total revenue)	77.76	94.72	82.84	76.82	84.00	92.50	84.06	81.58	92.36	81.00	85.29
PIT + Corporate (%)**	14.71	36.67		22.94	25.01	35.79	38.69	34.83		52.51	14.04
PIT (%) **				11.24		16.86			19.79		
Corporate (%)**				11.70		18.93			16.28		
Property (%)**		5.81			2.65					0.61	6.12
International trade taxes (%)**	26.26	8.39	17.53	31.84	19.96	25.19	30.90	13.46	12.37	11.28	29.34
Goods and services (%)**	51.52	46.50	4.85	26.21	49.52	36.32	30.42	51.72	42.36	30.43	43.77
Sales (%)**			4.85	20.38							
Excise taxes (%)**				5.83		36.32					

Source: Authors' calculations from IMF, 2002

Notes: The sub-components of tax revenue are not exhaustive; some taxes have been excluded such as levies, taxes on minerals and petroleum. Thus the columns do not sum to 100 per cent. Total revenue includes tax revenue and non-tax revenue but excludes grants.

*Total revenue and tax revenue are in local currency. Bangladesh: billions of taka; Barbados: millions of dollars; Botswana: millions of pula; Ghana: billions of cedis; Grenada: millions of dollars; India: billions of rupees; Jamaica: millions of dollars; Kenya: millions of shillings; Malawi: millions of kwacha; Malaysia: millions of ringgit; Mauritius: millions of rupees; Nigeria: millions of naira; Pakistan: millions of rupees; Papua New Guinea: millions of kina; Singapore: millions of dollars; South Africa: billions of rand; Sri Lanka: millions of rupees; Tanzania: billions of shillings; Trinidad and Tobago: millions of dollars; Uganda: billions of shillings; Zambia: millions of Kwacha; Zimbabwe: millions of dollars.

**Stated as percentage of tax revenue.

Table 3.3: Tax Structure of 22 Selected Commonwealth Countries (continued)

	Nigeria	Pakistan	Papua New Guinea	Singapore	South Africa	Sri Lanka	Tanzania & Tobago	Trinidad	Uganda	Zambia	Zimbabwe
	2001	**2001**	**2002**	**2001**	**1998/1999**	**2000**	**2001/2002**	**1999/2000**	**1997/1998**	**1998**	**1997**
Total revenue*	2,227,236.00	535,091.00	3,222.00	42,661.00	184.00	211,282.00	1,042.90	12,144.00	1,254.00	1,131,405.00	30,669.50
Tax revenue*	470,402.00	422,781.00	2,370.00	23,466.00	180.20	182,392.00	938.50	7,706.00	1,156.00	1,093,819.00	26,913.90
Tax revenue (% of total revenue)	21.12	79.01	73.56	55.01	97.93	86.33	89.99	63.46	92.19	96.68	87.75
PIT + Corporate (%)**	32.71	28.96		52.71	60.16	15.05	24.34	46.85	24.57	34.83	48.24
PIT (%) **										26.60	
Corporate (%)**										8.23	
Property (%)**		0.50		6.47		4.48		0.83			2.42
International trade taxes (%)**	41.40	15.39		2.60	0.22	13.14	9.47	10.15	10.12	26.04	22.85
Goods and services (%)**	25.89	47.93		30.74	36.57	67.33	56.46	41.29	65.23	37.57	26.49
Excise taxes (%)**							18.92		31.23	19.29	
VAT (%)**							37.54		34.00	18.28	

Source: Authors' calculations from IMF, 2002

Notes: The sub-components of tax revenue are not exhaustive; some taxes have been excluded such as levies, taxes on minerals and petroleum. Thus the columns do not sum to 100 per cent. Total revenue includes tax revenue and non-tax revenue but excludes grants.

*Total revenue and tax revenue are in local currency. Bangladesh: billions of taka; Barbados: millions of dollars; Botswana: millions of pula; Ghana: billions of cedis; Grenada: millions of dollars; India: billions of rupees; Jamaica: millions of dollars; Kenya: millions of shillings; Malawi: millions of kwacha; Malaysia: millions of ringgit; Mauritius: millions of rupees; Nigeria: millions of naira; Pakistan: millions of rupees; Papua New Guinea: millions of kina; Singapore: millions of dollars; South Africa: billions of rand; Sri Lanka: millions of rupees; Tanzania: billions of shillings; Trinidad and Tobago: millions of dollars; Uganda: billions of shillings; Zambia: millions of Kwacha; Zimbabwe: millions of dollars.

**Stated as percentage of tax revenue.

3.4 Tax Terminology and Concepts

3.4.1 Tax Base

A country's overall economic base, to which its various taxes can be applied, is its land, labour, capital, mineral resources, and level of production and consumption. Some countries have unique resources such as oil and/or diversified economies, while others have a very narrow tax base, with only minimal economic resources or activities on which to draw for own-source revenues. For any specific tax, the tax base is the resources to which the tax rate is applied. To obtain a desired amount of revenue, the rate can be lower if the tax base is broad than if the tax base is narrow. A tax on a base of economic activities or assets that is more common to one sex than the other may result in gender bias.

3.4.2 Tax Administration

The tax system must be consistent with each country's level of administrative capacity. Developing countries, especially, suffer from inadequate tax administration resources, weak public sector infrastructure, the lack of both quantity and quality of civil service workers, low public sector salaries and high levels of corruption. Thus, tax administration considerations are an especially critical issue for the design of tax systems in developing countries. There may be gender bias in tax administration if women, in their taxable activities, are more vulnerable to sexual harassment, bribes or other behaviours.

3.4.3 Tax Burden

The tax burden is defined as the ratio of the tax payment to disposable income. Tax burden analysis is a critical tool for tax policy in order to evaluate the fairness, as well as the social and economic impact, of taxation alternatives. The tax burden can be calculated from data from tax returns by various categories such as income class, sector of the economy, individual vs. business, etc. Since the sex of the filer is not captured on tax forms,[13] gender tax burden analysis can be done by using assumptions based on demographic censuses and household surveys, or by matching sample tax information to other data captured by sex, such as social security information

3.4.4 Tax Incidence

Tax burden measures tax payments according to who is remitting the tax payment by law. This is defined as the statutory incidence of the tax. However, the statutory taxpayer can, depending on market conditions, sometimes recover her/his tax payment by 'passing on' the cost of the tax to others. In the case of a business taxpayer, the business may recover taxes paid by passing on the cost of the tax in lower wages to workers or by charging consumers higher prices for its products. In this way, the true incidence of the

tax may fall on others. True tax incidence is difficult to calculate, so estimates are generally not part of formal tax analysis. However, consideration of tax incidence is an important consideration.

3.4.5 Tax Incentives/Tax Expenditures

Many developing countries which are seeking to encourage business development and capital investment encounter pressure to provide tax incentives or exemptions, especially when they are competing for foreign direct investment. Evidence from years of local and national development efforts in both developed and developing countries show limited, if any, gain from such incentives. Socio-economic and political factors such as basic infrastructure, stable government, sound fiscal condition, available labour force and low social conflict are generally more decisive in influencing business investment decisions. In practice, however, decisions around tax incentives are often driven by political pressure.

3.4.6 Tax Reform

Both developing and developed countries have engaged in periodic tax reform efforts over the last several decades. In developing and transition economies, tax reform has often been driven by international agencies such as the World Bank and the IMF, seeking to address countries' budget deficits and to open markets to globalisation. Their recommendations have resulted in the following reforms in most countries:

- Simplification – eliminating minor taxes and consolidating others so as to reduce the number and complexity of taxes;
- Base-broadening – bringing various forms of in-kind income into the base of the income tax and reducing special credits and exemptions;
- Rate reduction and harmonisation – reducing top marginal tax rates and making these consistent across personal and corporate income taxes, and reducing the number of applicable tax rates and/or tax brackets;
- The creation of a VAT, often in a single-stage form, in order to provide a broad-based consumption tax with relatively simple administration;
- The reduction or elimination of import duties and export tariffs.

In the US, Western Europe and Australia, the emphasis of tax reform has been on reducing tax rates, and especially on providing tax relief to the rich and to businesses on the argument that this will stimulate investment and production ('supply side economics'). Developed countries rely heavily on income taxes, so tax reform has emphasised simplifying personal income tax rate structures, lowering top marginal rates, and bringing personal and corporate top marginal rates in line.

In both developing and developed countries there is concern that tax reform has adversely affected the poor both on the tax and the expenditure side. In developing countries, the increased reliance on indirect taxation, such as VAT, has raised concerns about regressivity. In developed countries there is evidence of an increase in the tax burden of the lower and lower-middle income groups and a reduction in the tax burden of the highest income groups. In both developing and developed countries there is also concern that there has been an increase in the relative tax shares paid by individuals through the personal income tax compared to those paid by businesses through corporate income taxes. Finally, in both developing and developed countries reductions in overall tax revenues have resulted in a 'fiscal squeeze' which can mean the reduction of needed public services with adverse effects in the short term on the poor and low-income groups and in the long term on overall social and economic development.

Tax reform has also posed two specific issues with explicit gender implications. First, the emphasis on tax simplification in both income and consumption taxes has led to policy recommendations to limit deductions and exemptions. Such limits have equity implications from both a class and a gender perspective. In the personal income tax, the restriction of certain deductions and exemptions which provide tax relief to women – for example childcare deductions, exemptions for dependents or deductions for insurance and pension contributions – may create gender inequity. In consumption taxes, the elimination of exemptions on products which are primarily consumed by women or are of primary importance to women could create gender bias. And in both types of taxes, base broadening which imposes a higher burden on the poor will also create higher burdens for women who are disproportionately poor in developed countries, and primarily poor in developing countries.

3.4.7 Fiscal Decentralisation

An emphasis on fiscal decentralisation has been part of tax policy reform in developing and former socialist countries in the last few decades. The theory of fiscal federalism allocates expenditure responsibilities and tax authority between the various levels of government – national, provincial/state and local/municipal. The national government has expenditure responsibility for services that cannot be provided locally, such as defence; basic public institutions, infrastructure and services that address redistributional goals, such as equalising a basic level of development across regions; and 'merit goods' which the society deems should be provided to all citizens. Lower levels of government have responsibility for locally-provided services. The theory of fiscal decentralisation argues that citizens in a particular region or location can decide their own specific preferences for government services as indicated by their willingness to pay for those services through local taxes and fees.

Decentralisation can have serious equity implications if expenditure responsibilities

are devolved to lower levels of government which lack revenue instruments to support these responsibilities and if no money from national government or elsewhere follows. In many local areas of developing countries there is practically no tax base at all. In others, taxation of local bases such as property or agriculture has no relation to the taxpayer's ability to pay, creating an unfair tax burden on the poor and especially on poor women. In addition, a range of charges can occur at local level, which are often inequitable between and within localities.

In most systems of intergovernmental fiscal relations, there is sharing across levels of government for some services, such as health and education, but other services are a distinctly local responsibility, for example sanitation, and parks and playgrounds. Where there is sharing of expenditure responsibility with the national government, mid-level and local level governments receive grants or transfers from tax revenues collected nationally, and/or they may be authorised to apply a separate local tax rate to a tax base also used by the national government. Sub-national levels of government are also expected to rely on own-source revenues. Property taxes and user fees are the most common local source of revenue. But to cover costs, user fees are often set so high that they create a burden on the poor or limit access to basic necessities such as water.

The following section discusses key tax concepts that are used in tax analysis as a basis for the review of tax and gender in Section 5.